BETWEEN:

FURNESS, WITHY & COMPANY LIMITED ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

Montreal 1966

May 16-20, 24-27, 30-31 & June 1-2

Ottawa Aug. 24

Income tax—Income Tax Act, R.S.C. 1952, c. 148, sections 2(2), 4, 10(1)(c), 31(1)—Canada-U.K. tax agreement (1946)—Articles II(1)(i), III, IV, V—Income from business carried on in Canada by non-resident—Operation of ships or aircraft by non-resident persons—Whether income exempt under either section 10(1)(c) of the Act or Article V of the Agreement—French text of the Act—Industrial and commercial profits—Permanent establishment.

The appellant was incorporated in the United Kingdom in 1891 and during the years in question in the appeal had its head office and ten branch offices there and also had six branch offices in Canada. Its business and that of some of its many subsidiaries included the operation of cargo vessels owned or chartered by them. The appellant's own business also included the providing of general agency and stevedoring services for ships owned or chartered by subsidiary and affiliated companies, (all referred to as "inside business") and also general agency services for ships owned or chartered by strangers (referred to as "outside business"). Whenever any such ships were in Canadian waters, such services were arranged for by Canadian branch offices of the appellant. For all these services the appellant was remunerated at agreed rates.

Until the year 1956, the Minister had accepted the appellant's apportionment of its Canadian profits as between "inside business" and "outside business" and had treated only the latter as taxable. However for the years 1957 to 1963 inclusive the Minister took the position that there was no distinction in law between the two classes of business and that the entire profit of the Canadian branches was taxable.

On appeal the appellant took the position that the whole of its Canadian profits was exempt from tax in Canada either under section 10(1)(*c*) of the *Income Tax Act* or under Article V of the Canada-United Kingdom Tax Agreement both of which exempt from taxation the profits derived by non-resident persons from operating ships.

A secondary issue concerned the deductibility, in computing Canadian profits, of a proportion of the appellant's head office administration expenses, for which no deduction had been made.

Held,

1. That neither the Act nor the Agreement exempted from tax the earnings of the appellant from its managing, agency or stevedoring services rendered in Canada to others, whether such others were affiliates or subsidiaries, or strangers and that the profit attributable to Canadian branches in respect thereof was taxable under sections 2(2) and 31(1) of the Act and Articles III and IV of the Agreement, as being attributable to a permanent establishment in Canada.

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2. That since the expression "operated by him" in section 10(1)(*c*) of the *Income Tax Act* and the expression "from operating" in Article V of the Agreement are used in each case in an income tax context they implied an operation that was productive of the subject matter of the tax, rather than an operation in any other sense and as referred to both in the *Income Tax Act* and in the Agreement, especially in the light of the official French versions thereof, the term implies operation by the owner or charterer rather than by a mere manager, agent or stevedore who carried out duties for the owner or charterer.

3 That any profits imputable to such managing, agency or stevedoring activities in respect of ships owned or chartered by the appellant itself were part of the profits from the operation of such ships and were exempt from tax under the Act or the Agreement and that the re-assessments should be referred back to the Minister to be revised accordingly.

4. That in computing its income from its operations in Canada subject to taxation, the appellant was entitled to deduct that portion of the general head office expenses of its business chargeable to its Canadian operations other than that portion thereof concerned in the operation of ships owned or chartered by the appellant and operated in its own service.

APPEAL from assessments of the Minister of National Revenue.

H. Heward Stikeman, Q.C. and *W. David Angus* for appellant.

M. A. Mogan and *R. A. Wedge* for respondent.

THURLOW J.:—This is an appeal from re-assessments of income tax for each of the years 1957 to 1963 inclusive. The main issue, which is the same in respect of each of the years in question, is whether, or to what extent, amounts which the Minister treated as profits earned by the appellant in Canada are subject to tax having regard to section 10(1)(*c*)[1] of the *Income Tax Act*[2] and to Article V[3] of

[1] 10(1) There shall not be included in computing the income of a taxpayer for a taxation year

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(*c*) the income for the year of a non-resident person earned in Canada from the operation of a ship or aircraft owned or operated by him, if the country where that person resided grants substantially similar relief for the year to a person resident in Canada.

[2] R.S.C. 1952, c. 148.

[3] Article V

Notwithstanding the provisions of Articles III and IV, profits which a resident of one of the territories derives from operating ships or aircraft shall be exempt from tax in the other territory.

the agreement of June 5, 1946 between Canada and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. The appellant's position is that the amounts in question are exempt from Canadian tax either as *income...earned in Canada from the operation of a ship...owned or operated by the* appellant within the meaning of section 10(1)(*c*) of the Act or as profits which it *derives from operating ships* within the meaning of Article V of the agreement, or both. An issue also arises as to certain deductions to which the appellant claims to be entitled in computing its profits from its operation in Canada.

The appellant was incorporated in the United Kingdom in 1891 and has its head office and ten branch offices there. It also has six branch offices in Canada, twelve in the United States and one in Trinidad. For the purposes of this appeal it is admitted that the appellant in the years in question was resident in the United Kingdom and was not resident in Canada. The appellant has either complete or majority control of some thirty-eight subsidiary companies, which are engaged in a variety of business operations, and substantial investments not amounting to majority control in several others which may be conveniently referred to as affiliated companies. During the years in question the appellant and some of the subsidiary and affiliated companies owned and chartered ships which were engaged in carrying goods in various parts of the world including the North and South Atlantic Oceans, the Great Lakes, the Mediterranean Sea and the North and South Pacific Oceans.

In the North Atlantic these ships plied on regularly scheduled voyages between particular ports in the United Kingdom and ports of Eastern Canada and the United States and while in Canadian waters the ships, whether belonging to or chartered by the appellant or subsidiary or affiliated companies, were serviced and their activities were regulated by personnel of the branch offices of the appellant in Canada. The same applied to ships of the appellant and its subsidiary and affiliated companies in Canadian waters on the Pacific coast. The principal branch office of the appellant in Canada was in Montreal where at all material times one of the directors of the appellant, who

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was also a director of several of the subsidiary and affiliated companies engaged in North Atlantic shipping, was resident.

The functions carried out by the appellant's Canadian branch offices for these ships covered a range which included everything both of an administrative and of a trading nature that would otherwise require the attention of the owner or charterer himself while the ship was in these waters, including in some ports the provision of stevedoring services, and in addition included the finding and booking of cargo for the ships and attending and participating in the rate setting and other activities of the Canada-United Kingdom eastbound freight conference of which the companies concerned were members. Most, if not all, of these functions were carried out by the Canadian branch offices without reference either to the appellant's head office or to the subsidiary or affiliated companies.

Besides the appellant itself there were three subsidiary and two affiliated companies whose ships traded in Canadian ports during the years in question. All of these companies were closely related to the appellant either through shareholding by the appellant or by its other subsidiaries or by long standing arrangements between them. The insurance, and in some if not in all cases the fuel requirements of these companies were arranged for on a group or bulk basis by the appellant in the United Kingdom. The appellant also acted as agent for them in United Kingdom ports in which the companies had no branch offices, provided inspection services for all of them and as broker arranged for chartering of ships by them when required. In the case of two of the subsidiary companies the appellant also acted as manager of the companies' affairs and business under management contracts. The picture as developed by the evidence was one of a group of companies of which the appellant, working in concert with each of the other companies, carried out the functions of a branch office in Canada for each of them as well as for itself.

The enterprises of these other companies, however, were entirely their own. In rendering services to ships of these

companies in Canada the appellant did so as their local agent. In each case the bills of lading for the carriage of goods by them were signed by the appellant as agent for the company concerned. Nor were these companies mere shams or alter egos of the appellant or agents or partners of the appellant. On the contrary each was a substantial shipping company with its own board of directors and business undertaking and the situation as I view it was one in which the appellant and the subsidiary or affiliated companies each conducted its own separate enterprise but in so doing cooperated with the other to secure the maximum advantage to both.

In respect of all services (other than stevedoring services) rendered by the appellant's Canadian branch offices to ships of subsidiary or affiliated companies the appellant was remunerated by a commission on the inward and outward freights of the voyage. For stevedoring services the appellant was remunerated in accordance with the terms of a contract between the appellant and the company to whose ship the services were rendered. These charges would be realized from the freights collected by the branch offices for the principals concerned but the balances of the funds representing freights so collected were not forwarded to the principals by the branch offices. Instead an accounting would be made from time to time and the appellant's head office in the United Kingdom would pay the balance due to the subsidiary or affiliated company. Funds would be transferred between the Canadian branches and the head office of the appellant only once or twice a year as occasion or circumstances of the appellant's business might require.

For purposes of administration and accounting the appellant's branch offices were conducted as if they were separate entities. Whether a ship belonged to the appellant itself or to one of the subsidiary or affiliated companies charges against the ship's account would be made for the commissions and stevedoring fees accruing for the services rendered by the Canadian branches to the ship according to prearranged scales and would be included as part of the receipts of the branch offices. The cost to the appellant of

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providing such services, so far as paid for by the branch office, appeared as disbursements in the branch office accounts. On the basis of such receipts less such disbursements and any other applicable expenses of running it the branch office might or might not show a surplus which, if shown, might be wholly or partly profit from its activities. These activities, consisting of the servicing of ships of the appellant and of its subsidiary and affiliated companies were referred to by counsel for the appellant as "inside business".

The Canadian branches of the appellant company also rendered agency services in Canadian ports on a commission basis to ships of other shipping enterprises during the years in question and both earned revenue therefrom and incurred expenses in connection therewith. In these cases accounting for freights collected and payment of balances to principals was effected by the Canadian branches. This was referred to by counsel as "outside business". The terms on which such services were made available were not materially different from those applicable in the case of "inside business".

For the taxation years 1957 to 1963 inclusive, and indeed for many years prior to 1957, the appellant reported as the taxable portion of its income from its business in Canada the total of the profits earned by its six Canadian branches from "outside business", and treated the remainder of its income as exempt from Canadian income tax. For the years prior to 1957, this basis for Canadian taxation was accepted by the Minister but for 1957 and subsequent years the Minister took the position that there was no distinction to be made between "inside business" and "outside business" and that the appellant was liable for tax on the total of the profits shown by the accounts of the Canadian branches as arising from both. He therefore added the amounts shown as profits from all "inside business" by the accounts of the six Canadian branches and assessed tax accordingly. In so doing he included the amounts credited to the branches as commissions for services and fees for stevedoring performed by the branches in servicing ships belonging to or chartered

by the appellant itself and he made no deduction in respect of any portion of the head office expenses of the appellant company. On the appeal to this Court the appellant took the position that the whole of its income was exempt and its counsel in opening claimed judgment to that effect, though he indicated at the same time that the appellant would be content to be assessed on the basis followed by it and by the Minister prior to the 1957 taxation year.

The first and, as I see it, the principal question to be determined in the appeal is that of the extent of the exemptions provided for in section 10(1)(*c*) of the Act and in Article V of the agreement. The section, it may be noted, is not dependent upon any treaty or other arrangement with any particular country but applies to the income of any non-resident provided the country of his residence, whatever country that may be, grants substantially similar relief to a person resident in Canada. It is admitted in the present case that the United Kingdom fell within the proviso in the years in question. The section, moreover, while first enacted in its present form in the 1948 *Income Tax Act*[1] had a forerunner in somewhat similar form as section 4(*m*)[2] of the *Income War Tax Act*. In section 4(*m*) the exemption was granted in respect of earnings of a non-resident "*derived from the operation of a ship or ships registered under the laws of a foreign country*" which granted equivalent exemption to residents of Canada. This had been in effect for some twenty years before the agreement came into force. In the present section 10(1)(*c*) the exemption applies to income *earned in Canada from the operation of a ship or aircraft owned or operated by* the non-resident. Since in the case of a non-resident person it is only income earned in Canada that is subjected to tax under the *Income Tax Act*[3] the effect of the exemption provided by section 10(1)(*c*) is that none of the income of the non-resident from the operation of ships owned or operated by him, wherever earned, is subject to Canadian income tax.

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[1] S of C, 1948, c. 52.

[2] Enacted by S. of C., 1926, c. 10, s. 10.

[3] *Vide* sections 2 and 31(1).

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Article V of the agreement, which has the force of law by virtue of chapter 38 of the Statutes of Canada, 1946,[1] has a somewhat different field of operation. It is part of an agreement between two governments and applies only to the taxation of residents of those two countries. In Article III[2] provision is made both for the exemption of the industrial or commercial profits of enterprises of one country from taxation by the other except when the enterprise has a

[1] Sections 2 and 3 read as follows:

2. The Agreement entered into between Canada and the United Kingdom, set out in the Schedule to this Act, is approved and declared to have the force of law in Canada.

3. In the event of any inconsistency between the provisions of this Act or of the said Agreement and the operation of any other law, the provisions of this Act and the Agreement shall, to the extent of such inconsistency, prevail.

[2] . . .

Article III

(1) The industrial or commercial profits of a United Kingdom enterprise shall not be subject to Canadian tax unless the enterprise is engaged in trade or business in Canada through a permanent establishment situated therein. If it is so engaged, tax may be imposed on those profits by Canada but only on so much of them as is attributable to that permanent establishment.

(2) The industrial or commercial profits of a Canadian enterprise shall not be subject to United Kingdom tax unless the enterprise is engaged in trade or business in the United Kingdom through a permanent establishment situated therein. If it is so engaged, tax may be imposed on these profits by the United Kingdom, but only on so much of them as is attributable to that permanent establishment: Provided that nothing in this paragraph shall affect any provisions of the law of the United Kingdom regarding the imposition of excess profits tax and national defence contribution in the case of inter-connected companies.

(3) Where an enterprise of one of the territories is engaged in trade or business in the other territory through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment.

(4) No portion of any profit arising from the sale of goods or merchandise by an enterprise of one of the territories shall be deemed to arise in the other territory by reason of the mere purchase of the goods or merchandise within that other territory.

(5) Where a company which is a resident of one of the territories derives profits or income from sources within the other territory, the Government of that other territory shall not impose any form of taxation on dividends paid by the company to persons not resident in that other territory, or any tax in the nature of an undistributed profits tax on undistributed profits of the company, by reason of the fact that those dividends or undistributed profits represent, in whole or in part, profits or income so derived.

permanent establishment in the other and for the extent of the subject matter to be taxed when the exception applies. Article IV[1] prescribes the extent of the subject matter of permissible taxation where there are related but separate enterprises in both countries. In both articles the test of what may be taxed is the extent of earnings in the particular country. Article V then provides for an exemption which is to apply regardless of where profits are made and which is also to apply notwithstanding the provisions of Articles III and IV which would otherwise permit one of the countries to impose tax on a resident of the other within the limits therein mentioned. The exemption is provided for *profits which a resident of one of the territories derives from operating ships or aircraft.*

It was not suggested by either party to the appeal that there is any difference between the meaning of the expression *from the operation of a ship or aircraft owned or operated by him* in section 10(1)(*c*) and the expression *derives from operating ships or aircraft* in Article V of the agreement. For the purposes of this case the key words are *operated by him* in section 10(1)(*c*) and *from operating ships* in Article V and the principal question at issue appears to me to turn on the meaning to be given to them. Despite the differences in the fields of operation of the two provisions and despite the rule of strict construction[2] of the exemption provided by section 10(1)(*c*) and the principle[3] of broad interpretation applicable to the agree-

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[1] Article IV

Where

(*a*) An enterprise of one of the territories participates directly or indirectly in the management, control or capital of an enterprise of the other territory, or

(*b*) The same persons participate directly or indirectly in the management, control or capital of an enterprise of one of the territories and an enterprise of the other territory, and

(*c*) In either case conditions are made or imposed between the two enterprises, in their commercial or financial relations, which differ from those which would be made between independent enterprises,

then any profits which would but for those conditions have accrued to one of the enterprises but by reason of those conditions have not so accrued may be included in the profits of that enterprise and taxed accordingly.

[2] *Lumbers v. M.N.R.* [1943] Ex C.R. 202 at 211. *M.N.R. v. Sunbeam Corp. (Can.) Ltd* [1961] Ex C.R. 234 at 241

[3] *Vide* Lord Macmillan in *Stag Line Ltd. v. Foscolo, Mango & Co.* [1932] A.C. 328 at 350

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ment the meaning of these particular expressions may therefore be considered together.

The first observation on the construction of these words is that the use of the expression *owned or operated by him* in section 10(1)(*c*) makes it clear that except in the case of an owner the operation contemplated is operation by the taxpayer himself and that, as a matter of the ordinary meaning of the words used, the expression *profits which a resident...derives from operating ships or aircraft* appears to refer only to the operating of ships or aircraft by the resident. In this respect the meaning of the expressions used both in section 10(1)(*c*) and in Article V are thus narrower than that of the statutory provision considered in *Minister of National Revenue v. Hollinger North Shore Exploration Company Limited*[1] and that case is accordingly different from the present case and in my opinion is of no assistance to the appellant.

The second observation is that while the sense or meaning of the verb *operate* and its derivatives may vary with the context and expression in which the words are used neither in section 10(1)(*c*) nor in Article V do they bear two different senses or meanings. Thus if the words are used in the sense of physically directing the working of a ship they might at times refer to direction by an owner or charterer who actively carries out the functions and at other times to direction by a manager or agent for him depending on the extent of his authority and the range of the functions carried out by him. But they could not refer to the owner and to the manager or agent at the same time for *ex hypothesi* in this sense the words refer only to the person physically directing the working of the ship. On the other hand if the references are to operation in the sense of employment by an owner or charterer for the purpose of earning profit therefrom the sort of direction carried out by a manager or agent, regardless of the extent of his authority or the scope of the services which he performs, is not within the meaning since the operation of the ship is not his at all but that of his principal.

The problem then is to determine in which sense the words are used. In the course of argument references were made to a number of dictionaries but I have not been able

[1] [1963] S.C.R. 131.

to find in the meanings there assigned anything that appears to advance the solution of the problem and it appears to me that it is the context and the particular expression in which the words are used rather than the words themselves which determine the particular sense in which they are used. Here the general context in the one case is that of an exempting section in a taxation system and in the other is that of a provision in an international agreement by which the contracting governments agree to grant an exemption from taxation to the extent therein mentioned. Both are thus concerned with income taxation and may be taken to use the words in what, for lack of some better way of expressing it, I shall call an income tax sense, that is to say a sense in which the *operating* referred to can be regarded as productive of the subject matter of the tax rather than in some sense which might fit other contexts.

Briefly, the position taken by the Minister was that neither section 10(1)(*c*) of the Act nor Article V of the agreement exempts the income of a mere agent or stevedore and that it is the carrier and no one else who is exempted by these provisions.

The appellant's position on the other hand, as I understand it, was that regardless of who else might be entitled to exemption under section 10(1)(*c*) and Article V the expressions used therein are apt ones to refer to the profits earned by a person who on behalf of the owner carries out anywhere in the world, all or substantially all, of the functions involved in administering the ship and its trading activities or to one who carries out such functions while in a particular geographical area when the ship is in that area in the course of a voyage. This submission is not unattractive since in ordinary parlance the verb, *operate* would not I think be inept to characterize in a particular sense the activities as a whole of such a manager or agent with respect to the ship and the noun, *operator* would not be inept to characterize the manager or agent in the same sense. The submission moreover appears to me to draw support from the reflection that the revenues earned by employing ships in carrying cargo are their freights and that the revenues of such a manager or agent, (who, at least in cases such as this, has an interest as a member of a team consisting of himself and the owner in the earning of the freights) in a sense represent a portion of the freights

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earned by the efforts of both which would be exempt in the hands of the shipowner if he performed all the functions himself.

I have come to the conclusion, however, that the appellant's submission cannot succeed. In the absence of any expression of judicial opinion on these or similar provisions in effect in other countries, I am of opinion that neither the expression *operated by him* in section 10(1)(*c*) of the Act nor the expression *from operating ships* in Article V of the agreement refers to one whose functions with respect to the ship are merely those of a manager or agent for another or others whether generally or in a particular geographical area, or of a manager or agent and stevedore combined, and that this is the legal position no matter how extensive the authority exercised by him as such manager or agent or the services rendered by him may be.

There are several reasons which lead me to this conclusion. First the situation which leads to taxation in more than one country of the profits of a shipowner or charterer from operating ships or aircraft engaging in international trade,[1] and which both section 10(1)(*c*) and Article V

[1] The problem is described as follows in a note by Arnold D. McNair in the *American Journal of International Law* (1925) Vol 19, page 569:

> Although the operation of the British Income Tax Acts is primarily territorial, tax is leviable upon non-residents who derive income "from any trade profession employment or vocation exercised within" Great Britain and Northern Ireland. During recent years the zeal of the officials of the British Inland Revenue Department induced them to levy tax upon foreign shipowners who both had vessels trading to the United Kingdom and had offices or subsidiary companies or other regular agents in the United Kingdom who booked freight for them in the United Kingdom. The profits (or a portion of them,) deemed to accrue from freights booked in this manner were assessed to income tax, and it was paid. The precise kind of trading to a British port, which exposed a foreign shipowner to British taxation, need not be considered here. Thereupon the United States of America by the Income Tax Law of 1916 followed suit or retaliated by taxing a portion of the profits earned by foreign shipowners on freights booked in the United States, and there was every prospect of the maritime countries of the world drifting into a tax war.
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> . . .
>
> A shipowner earns profit in respect of the service rendered by him of transporting passengers and cargo from the territory of State A to the territory of State B (We may eliminate for our present purpose the incidental services of feeding passengers and of assisting in the loading and unloading of cargo.) The space in which the services are rendered is divisible as follows: (i) in the port of A and its adjacent maritime belt, (ii) on the high seas, and (iii) in the

appear to me to have been intended to remedy does not appear to me to apply or to call for a remedy so far as such a manager or agent is concerned. Nothing in the nature of the business of such a manager or agent or stevedore requires that it be carried on in more than one country so as to attract tax in both as in the case of the owner or charterer of the ship or aircraft who is engaged in the carriage of goods or passengers in international trade and I regard it as unlikely that either of these provisions was intended to exempt any portion of the earnings of a person as such a manager or agent or stevedore. In short since the nature of the services from which the profits as such of a person so engaged arise is such that the services are rendered or can be rendered in a single country there was never any occasion to provide exemption for such profits and I regard it as unlikely that any such exemption was ever intended.

Next I think it likely that the exemption was meant to apply to the whole of the profit earned by the owner or charterer of a ship who has it engaged in international trading and not merely to such profit as might, when he conducts his own operation in the country of his residence and has an agent abroad, by some difficult method of apportionment, be attributed to the part of a voyage in which he has the ship under his personal direction. This latter might leave the rest of the exemption to apply in favour of an agent who during the rest of the voyage would be regarded as operating the ship but would raise the problem of taxation in two countries all over again with respect to the owner's or charterer's profit from that portion of the voyage. It seems to me that to construe the words *operated by him* in section 10(1)(*c*) or the words *operating ships* in Article V as referring to the person physically directing the activities of the ship as agent for another or others would thus lead to an absurd division of the exemption between the agent and the owner or charterer unless the exemption

port of B and its adjacent maritime belt. Thus a state which adopts the practice of taxation under discussion taxes a foreigner upon the profits earned in respect of services rendered partly in a foreign country and partly on the high seas, and it taxes him either because he has an office or agent in its territory or because his ship comes into one of its ports and so becomes *pro hac vice* amenable to its jurisdiction. The factor of space is relevant upon a consideration of the equity of the double taxation to which profits so earned may be subjected, but it does not, it is submitted, cast any doubt upon the legality of the practice.

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could be said to apply to both agent and owner or charterer at the same time. To hold that the exemption applies to both agent and owner or charterer at the same time, however, as already indicated, appears to me to involve construing the words of the statute and of the agreement in more than one sense, depending on whose taxation is being considered, and I do not think that that could have been intended.

Finally, the French language text, which also states the law in this country, in section 10(1)(*c*) expresses the meaning of *operated by him* by the words "qu'elle met en service" and the corresponding expression "de la mise en service" is used in Article V to represent the meaning of *from operating* in the English language text of Article V. The French expressions so used appear to me to be apt ones to refer to operation by an owner or charterer who puts a ship into service in the trading in which he is engaged and to be quite inept to embrace or refer to one who simply carries out tasks, however extensive, for such an owner or charterer whether generally or in a particular geographical area into which the ship is sent in the course of a voyage.

Accordingly I shall hold that neither section 10(1)(*c*) nor Article V exempts earnings of the appellant from managing or agency or stevedoring services which it renders in Canada to other corporations and since for tax purposes each other corporation must in my opinion be treated as a separate entity[1] there is, as I see it, no distinction to be made for this purpose between such other corporations whether they are subsidiaries or affiliates of the appellant or mere strangers.

The appellant is, however, in my opinion, entitled to exemption under these provisions in respect of the portion of the amounts treated as income by the Minister which arose from entries of charges made by the branches for "agency" and stevedoring services to ships which were owned or chartered by the appellant itself and were operated in its own service. Such amounts, in my opinion, are mere bookkeeping entries but if and to the extent that they represent profits they are in my view profits from the operation of ships owned or operated by the appellant and from operating ships within the meaning of both section

[1] Compare *The Gramaphone and Typewriter Limited v. Stanley* [1908] 2 K.B. 89.

10(1)(*c*) and Article V. Both the "agency" and stevedoring services in respect of which the entries arose were part of the process of operating the ships and the amounts entered in the books in respect of such services do not become any the less exempt by reason of the manner in which the appellant organized the activities of its branches or arranged their bookkeeping and accounting.[1] In this respect and to this extent therefore the appeal succeeds.

The amounts representing receipts from all other companies, however, less the expenditures incurred, appear to me to represent profits earned by or through the appellant's branches in Canada and to be subject to tax under sections 2(2) and 31(1) of the Act as income from a business carried on by the appellant in Canada. The branches through which these profits were earned moreover appear to have been permanent establishments as defined in Article II (1)(i)[2] of the agreement and the profits properly "attributable" to them were thus within the exception to the exemption provided by Article III. With respect to what profits were properly "attributable" to these branches it has not been established either that the appellant did not

[1] Compare *M.N.R. v. Imperial Oil Limited* [1960] S.C.R. 735 at 748.

[2] Article II

(1) In the present Agreement, unless the context otherwise requires—

. . .

(i) the term "permanent establishment", when used with respect to an enterprise of one of the territories, means a branch or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf.

An enterprise of one of the territories shall not be deemed to have a permanent establishment in the other territory merely because it carries on business dealings in that other territory through a *bona fide* broker or general commission agent acting in the ordinary course of his business as such.

The fact that an enterprise of one of the territories maintains in the other territory a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute that fixed place of business a permanent establishment of the enterprise.

The fact that a company which is a resident of one of the territories has a subsidiary company which is a resident of the other territory or which is engaged in trade or business in that other territory (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary company a permanent establishment of its parent company.

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have "industrial or commercial profits" within the meaning of Article III (1) for the years in question from its enterprise or (subject to what follow with respect to deductions) that the amounts added in the Minister's computation and thus subjected to tax by the assessments were not the portions of such profits "attributable" to the appellant's permanent establishments in Canada within the meaning of Article III (3). The appeal in respect of the inclusion of such amounts in the computation of the taxable income of the appellant therefore fails.

There remains the issue whether the appellant is entitled to a deduction in each of the years in question in respect of a portion of what were referred to as head office administration expenses. On this issue the evidence is not such that one can determine whether the appellant is entitled to any further deduction under Article III (3) of the agreement since the amounts of the "industrial or commercial profits" for the years in question of the appellant's "enterprise" were not established and evidences lacking as to what industrial or commercial profits the appellant's permanent establishments in Canada could have been expected to derive if they had been an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the appellant's enterprise. It is thus not established that the portion of the appellant's profits properly attributable to its branches in Canada was less than the amount subjected to tax by the assessments. If, therefore, the issue turned solely on the provisions of the agreement the appellant would fail. But the matter is also governed by section 4 of the Act which defines income for a taxation year from a business as being, subject to the other provisions of Part I of the Act, "*the profit therefrom for the year*" and by section 31(1). For the 1957, 1958 and 1959 taxation years this section provided:

> 31. (1) For the purposes of this Act, a non-resident person's taxable income earned in Canada for a taxation year is
>
> (*a*) the part of his income for the year that may reasonably be attributed to the duties performed by him in Canada or the business carried on by him in Canada,
>
> minus
>
> (*b*) the aggregate of such of the deductions from income permitted for determining taxable income as may reasonably be considered wholly applicable and of such part of any other of the said deductions as may reasonably be considered applicable.

For the remaining years under appeal section 31(1) was worded somewhat differently but as applied to the present problem appears to have meant the same. It read:

> 31. (1) For the purposes of this Act, a non-resident person's taxable income earned in Canada for a taxation year is
>
> (*a*) his income for the year from all duties performed by him in Canada and all businesses carried on by him in Canada,
>
> minus
>
> (*b*) the aggregate of such of the deductions from income permitted for determining taxable income as may reasonably be considered wholly applicable and of such part of any other of the said deductions as may reasonably be considered applicable.

Under this provision the limit of the amount upon which tax is imposed is (subject to the rules for computing income prescribed by the Act) the "profit" from the agency and stevedoring and other business activities carried on by the appellant in Canada. In computing this profit the head office administration expenses that would be deductible in the case of a resident company carrying on its business only in Canada in computing its profit would also appear to me to be deductible on ordinary principles by a non-resident company and where the business of the non-resident company is carried on both in Canada and elsewhere some proportionate part of the general expenses incurred in carrying on the business in more than one country including Canada would ordinarily be attributable to the portion of the business carried on in Canada and be deductible on ordinary principles in computing profit from the business carried on in Canada.

In the present case the appellant in its returns made no claim for any such deductions. This may have been due to the fact that its returns followed a pattern which appears to have been accepted in earlier years by which only income from *outside business* was reported as taxable, but whether or not this is the reason why no claim was made the appellant on this appeal, was I think, entitled to raise and show its right to such deductions. On the evidence I am satisfied that the appellant was entitled to some deduction in each year, particularly since the completion of accounting to subsidiary and affiliated companies and payment over to them of balances of freight collected for them in Canada, which was part of the process of earning the Canadian revenue, was done through the appellant's head office in London, but as I view it the evidence of the

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witness, Harry C. S. Croft, and the information contained in Exhibit A-4 respecting the total of such expenses and the total gross revenues of the appellant for each of the years in question do not afford a sufficient basis for me to reach a conclusion as to the amount of the deductions to which the appellant was entitled. In this situation all that has been established is that the Minister's computation was incorrect in not allowing any deductions and the proper course is I think to refer the matter back to the Minister for reconsideration and re-assessment on the basis that the appellant is entitled to a deduction in each year in respect of that portion of the general head office administration expenses of the appellant's business which is properly chargeable to the appellant's operations in Canada other than that portion thereof which is concerned with the servicing in Canada of ships owned or chartered by the appellant and operated in its own service.

My conclusion is therefore that the appeal should be allowed and that the re-assessments should be referred back to the Minister for reconsideration and re-assessment in accordance with these reasons.

I will hear the parties on the question of costs, as well as on any question on which there may be disagreement as to the form of the judgment, when an application for judgment is made.