Toronto
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BETWEEN:

QUALITY CHEKD DAIRY PRODUCTS ASSOCIATION (COOPERATIVE) ..... APPELLANT;

AND

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

Income tax—Withholding tax—Fees paid for use of trade marks and "know-how"—Income Tax Act, s. 106(1)(d)(iii)—"Property or other thing"—Onus of proof.

Appellant, an American company, provided services to its members in the dairy industry, *viz* production advice, production seminars, laboratory

1967

QUALITY CHEKD DAIRY PRODUCTS ASS'N. (CO-OP.) v. MINISTER OF NATIONAL REVENUE

analysis of products, preparation of advertising programs and materials, marketing and sales advice, sales workshops, and permitted them to use its certification marks. Appellant was remunerated *inter alia* by fees on a sliding scale based on sales and for 1964 was assessed to 15% withholding tax under s. 106(1)(*d*) of the *Income Tax Act* in respect of $397.83 fees received by it from one of its Canadian members.

Held, the payment in fees by appellant was in part for "a royalty or similar payment" for use in Canada of marks within the meaning of those words in s. 106(1)(*d*) of the *Income Tax Act*, which part was less than $397.83, but which was part of the payment for a so-called "package deal" which included services referred to in the evidence and the use of the marks and that in respect to the part of the fees that represented services such was not a payment within the ambit of s. 106 (1)(*d*) of the Act so as to be subject to withholding tax.

INCOME TAX APPEAL.

S. E. Edwards, Q.C. for appellant.

D. G. H. Bowman and *J. R. London* for respondent.

GIBSON J.:—In this appeal under the *Income Tax Act* the issue is whether or not certain payments made in 1964 to the appellant by a corporation known as Kellough Brothers Dairy Limited are subject to a withholding income tax of 15 per cent under section 106(1)(*d*).

The appellant is a State of Wisconsin corporation without share capital, having no offices or place of business in Canada, which at the material time had on its staff certain itinerant personnel experienced and trained in the dairy industry especially in the fluid milk, ice cream and cottage cheese, sour cream, dips and other related products business. In 1964 there were 97 members of the appellant all of whom were independently in business dealing in the said products. Nine of these members were from Canada, and one of them was the said Kellough Brothers Dairy Limited, a corporation with share capital incorporated under the *Ontario Corporations Act* carrying on business in the Port Arthur-Fort William, Ontario area.

At the material time the appellant allowed Kellough Brothers Dairy Limited in common with other members, in consideration of certain "dues", "fees", "mechanical charges" and "assessments" to use its certification mark "Quality Chekd" and its mark including the symbol "Q" with a check mark, application for certification of which has been filed with the Trade Marks Office in Ottawa; and in addition provided services which in brief were: (1)

1967

QUALITY CHEKD DAIRY PRODUCTS ASS'N. (CO-OP.) v. MINISTER OF NATIONAL REVENUE

Gibson J.

production advice on an ad hoc basis to individual members according to their needs; (2) the holding of production seminars on an annual basis in each district at which sometimes experts outside the staff of the appellant were included in such things as panel discussions; (3) laboratory analysis of products; (4) preparation of advertising programmes and materials; (5) marketing and sales advice, also on an ad hoc basis; and (6) the holding of sales workshops at which sales people from various member companies attended to exchange ideas and also to share other ideas and suggestions from the staff of the appellant and sometimes outside consultants.

The "dues", "fees", "mechanical charges" and "assessments" respectively are adequately described in the by-laws of the appellant Exhibit A-2, the membership agreement Exhibit A-6 and the financial statements of the appellant for the years 1963 and 1964 Exhibit A-14.

I make only one comment as to these, namely, that the difference between "dues" and "fees" was that the latter were charged according to size of the business of the member and were on a sliding scale based on sales. This, it was said, enabled there to be a more equitable distribution of the costs of the appellant in providing the services to the members of it.

The respondent in its pleading relies, among other things, on the following assumption, (which was amended at trial) as follows, at paragraph 6(*a*) namely:

> 6. In making the assessment for the Appellant's taxation year 1964 the Respondent acted on the following assumptions, *inter alia*:
>
> (*a*) that during the 1964 taxation year Kellough Bros. Dairy Limited paid or credited to the Appellant an amount not less than $397.83 for the use in Canada of the certification mark "Quality Chekd" and the mark applied which included the symbol "Q" with a check mark, of which the Appellant was at all material times the owner;

In addition, the respondent pleaded at paragraph 6A as follows, which paragraph also was amended at trial, namely:

> 6A. The Respondent says in the alternative that if the said sum of $397 83 was not, in its entirety, paid or credited to the Appellant in satisfaction of rent, royalty or similar payment for the use in Canada of the certification marks, it was, to the extent that it was not so paid or credited for the use in Canada of the certification marks, paid or credited on account of or in satisfaction of rent, royalty or similar

payment for the use in Canada of know-how and that the said know-how is "property or . . . other thing" within the meaning of s. 106 (1)(*d*) of the *Income Tax Act*.

Fees are the only item of payment involved in this appeal.

The respondent submits these pleadings are supported by the evidence adduced.

The appellant, on the other hand, submits that the fees paid in 1964 by Kellough Brothers Dairy Limited to the appellant were not paid for use of the said marks and not for "know-how" in so far as it might be categorized as "property or . . . other thing" within the meaning of section 106(1)(*d*) of the *Income Tax Act*, but instead were membership fees paid to reimburse the appellant for expenses it incurred for providing (1) the services referred to above, and (2) the use of the marks; and that the excess of monies so collected by the appellant from its members, as the evidence indicated, which were over and above expenses, were returned to them by way of patronage dividends. (As to this see Schedule B-1 of Exhibit A-14).

The appellant also submits that the principle of mutuality applies to the monies paid in the matter by Kellough Brothers Dairy Limited to the appellant.

Dealing first with this latter submission, I am of opinion that the principle of mutuality has no application in the circumstance disclosed in the evidence of this case, to a payment under section 106(1)(*d*) of the Act.

As to the other issue raised in this case, it is my view that the Minister's assumption in paragraph 6(*a*) of the Reply is not supported by the evidence, but instead the appellant has shown this to be wrong. Specifically, I find as a fact that during the 1964 taxation year Kellough Brothers Dairy Limited paid or credited to the appellant an amount less than $397.83 for the use in Canada of the certification mark Quality Chekd and the mark including the symbol "Q" with a check mark for which certification had been applied for.

In my view, what was paid for by Kellough Brothers Dairy Limited was for a so-called "package deal". This is a colloquial phrase used so often now in business transactions, and in reference to its meaning, I note there is a definition of it in *Webster's Third New International Dictionary* which reads in part as follows:

> PACKAGE DEAL—1a: an agreement to accept or pay a lump sum for a correlated group of goods or services (a *package deal* with

1967

QUALITY CHEKD DAIRY PRODUCTS ASS'N. (CO-OP.) v. MINISTER OF NATIONAL REVENUE

Gibson J.

all 30 to be leased for four years at a total fee reported somewhat in excess of $1,250,000—*Wall Street Jour.*) . . . *specif*: a contract involving such an agreement achieved through collective bargaining (union-management committees have reportedly worked out a *package deal,* with increased fringe benefits . . . but no flat wage increase—*Time*) b: the goods or services supplied through such an agreement (offers the franchise operator a complete *package deal,* including ground development, building construction—R. B. Andrews) . . .

The so-called package deal in this matter for which payment was made was in my view (1) a "royalty or similar payment" for use in Canada of the certification mark and the mark including the symbol "Q" with a check mark for which certification has been applied for; and (2) the "know-how" of the appellant with respect to the services rendered as described above.

The only question left for decision therefore is whether or not these services provided by the appellant as disclosed in the evidence constituted "know-how" as pleaded in paragraph 6(*a*) of the respondent's Reply, and if so, whether "know-how" is "property or . . . other thing" within the meaning of section 106(1)(*d*) of the *Income Tax Act*.

"Know-how" is not a word of art but instead of the vernacular. Again *Webster's Third New International Dictionary* describes know-how as:

> KNOW-HOW: practical knowledge of how to do or accomplish something with smoothness and efficiency: ability to get something done with a minimum of wasted effort: accumulated practical skill or expertness (business *know-how*) (needed the *know-how* of a good carpenter) (salesmanship *know-how*) (the *know-how* involved in producing a play) (developed his bowling *know-how*); esp: technical knowledge, ability, skill, or expertness of this sort (the company needed to use all its ingenuity and *know-how* to succeed in laying the oil lines).

In argument certain English and other cases were cited in which a distinction is made between "know-how" as a capital asset payment for which is a capital receipt and "know-how" as a service, payment for which is income; and also some cases in which the Court did not find it necessary to decide whether or not the particular know-how was a capital asset to enable it to adjudicate on whether a particular receipt was income or capital. These cases were: *Handley Page v. Butterworth (H.M. Inspector of Taxes)*[1]; *Evans Medical Supplies, Ltd. v. Moriarty (H.M. Inspector of Taxes)*[2]; *Jeffrey (H.M. Inspector of Taxes) v. Rolls-*

[1] 19 T.C. 328.

[2] 37 T.C. 540.

Royce, Ltd.[3]; *English Electric Company Limited v. Musker*[4]; *Technical Tape Corporation v. M.N.R.*[5]; and *The Federal Commissioner of Taxation v. United Aircraft Corporation*[6].

For the purpose of this case, these cases show that the line between asset "know-how" and service "know-how" is illusory. However, in this case, it is sufficient to find upon a consideration of the whole of the evidence, and I do find, that the "know-how" provided by the appellant to Kellough Brothers Dairy Limited should be categorized as services rendered, or at least and in any event not "property" within the meaning of the word as it is employed in section 106(1)(*d*)(iii) of the Act and also not "other thing" as those words are also so employed there, applying as I do the *ejusdem generis* rule of construction to it and not the extremely wide dictionary definition of "thing" as may be found, for example, in the *Shorter Oxford Dictionary* and other dictionaries.

In the result, therefore, I find that the payment of fees in 1964 in this matter to the appellant by Kellough Brothers Dairy Limited were in part for "a royalty or similar payment" for the use in Canada of the said certification mark and other mark referred to in the evidence and in the pleadings within the meaning of those words in section 106(1)(*d*) of the *Income Tax Act* which part of such payment of fees was less than $397.83 but which was part of the payment for a so-called "packaged deal" which included the services referred to above and the use of the marks and that the part of the fees paid in 1964 which represented payment for the services was not a payment within the ambit of section 106(1)(*d*) of the Act so as to be subject to a withholding income tax of 15 per cent.

As the onus was on the respondent under paragraph 6A of the Reply in the pleadings quoted above to adduce evidence of the proper apportionment to be made of this payment between these two matters and he has failed to do so, the appeal is allowed with costs to the appellant and the assessments is vacated.

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[3] 40 T.C. 443.
[4] (1964) 25 T.R. 129.
[5] 64 D.T.C. 428.
[6] (1943) 68 C.L.R. 525.