
APPENDIX 24 (THE SURROGATUM – IN LIEU OF RULE FOR PART XIII)

Material:

Selected extracts from *Transocean Offshore Ltd. v. Her Majesty The Queen*, 2005 DTC 5201

Federal Court of Appeal
Toronto, Ontario
Rothstein, Sharlow and Malone JJ.A.
Heard: February 28, 2005.
Judgment: March 21, 2005.
(66 paras.)
Taxation -- Income tax -- Assessments and reassessments -- Appeals -- To courts --Income from business or property -- Income Tax Act -- Application -- Payment of tax -- Withholding of tax -- Statutory interpretation -
Statutes -- Construction -- Legislative intent -- Ordinary meaning.
Appeal by the taxpayer, Transocean Offshore Ltd, a United States corporation not resident in Canada, from
a judgment of the Tax Court of Canada dismissing its appeal from an assessment made under the Income Tax Act. The tax was assessed on a payment of over $40 million made as consideration for the voluntary termination of a lease agreement under which rent would have been payable for the use in Canada of an offshore drilling rig by a consortium of oil companies. Due to escalating costs associated with various up grades that were required before the rig could become operational, the consortium ultimately decided not to
lease it and entered into negotiations with the appellant to quantify the payment at issue. However, the Minister
of Revenue denied the appellant's application for a refund of the 25 percent of the settlement price withheld
by the consortium and remitted to the Minister. The appellant conceded that any rent received under the lease agreement would have been taxable, and the Minister conceded that the settlement payment was not rent, because no rent became due under the lease agreement.
HELD: Appeal dismissed. As the damages paid to the appellant were so paid to compensate it for the rent that would have been paid under the lease agreement if it had not been repudiated, the compensatory monetary
amount in question was paid as, on account of or in lieu of payment or in satisfaction of rent or a similar payment for the use of or right to the use of a property in Canada. Parliament, in using the words "in lieu of"
in s. 212(1)(d) of the Income Tax Act, must have intended to expand the scope of the provision to include payments other than payments that had the legal character of rent.
Statutes, Regulations and Rules Cited:
Income Tax Act, RS.C. 1952, c.148, s. 6(1)(b).
Income Tax Act, RS.1970-71-72, c. 63, ss. 6(1)(a), 56(1)(n).
Income Tax Act, RS.C. 1985, c. 1 (5th Supp.), Part I, Part XIII, s. 212, 212(1)(d).
Counsel:
Richard Thomas and Michael Friedman, for the appellant.
Kathryn Philpott, for the respondent.
[...]

43 I turn now to the only legal issue raised in appeal, which is whether paragraph 212(1)(d) of the Income
Tax Act is broad enough to cover an amount paid to compensate for the rent that would have been paid for
the use of the Explorer in Canada if the Bareboat Charter had not been repudiated before the commencement
of the rental term. It is argued for Transocean that paragraph 212(1)(d) does not apply because if an

agreement to rent certain property for a specified term is terminated before the commencement of the term,
the property is never "used" and therefore no rent is payable. For ease of reference, I reproduce the relevant
portions of paragraph 212(1)(d) of the Income Tax Act:
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212. (1) Every non-resident person shall pay an income tax of 25% on every amount)
that a person resident in Canada pays [...] to the non-resident person as, on account
or in lieu of payment of, or in satisfaction of,
[...]
(d) rent, royalty or similar payment, including, but not so as to restrict the generality
of the foregoing, any payment
(i) for the use of or for the right to use in Canada any property [...]
but not including [...]
(ix) a rental payment for the use of or the right to use outside Canada any corporeal
property [...] .
.. .. ..
212. (1) Toute personne non-residente doit payer un imp6t sur Ie revenu de 25% sur
toute somme qu'une personne residant au Canada lui paie [...] au titre ou en
paiement integral ou partiel :
[...]
d) du loyer, de la redevance ou d'un paiement semblable, y compris, sans
prejudice de la portee generale de ce qui precede, un paiement fait:
(i) en vue d'utiliser, ou d'obtenir Ie droit d'utiliser, au Canada, des biens [...]
mais aI'exclusion : [...]
(ix) d'un loyer en vue d'utiliser ou d'obtenir Ie droit d'utiliser aI'etranger tout
bien corporeI [...].

44 Broadly speaking, section 212 of the Income Tax Act is part of a statutory scheme that imposes tax on certain payments made to persons who are not resident in Canada, if the payments have a specified link to a
business carried on in Canada, or income earning property in Canada. Paragraph 212(1)(d), for example, imposes tax on any payment of rent, if it is paid to a non-resident for the use of property in Canada, or for the
right to use property in Canada.

45 Rent is defined as an amount paid as compensation for the use or occupation of property, or for the right to use or occupy property: Extendicare International Inc. v. Ontario (Minister of Revenue) **(2000),47** O.R. (3d) 1 (Ont. C.A.), Buonincontri v. Canada, 85 D.T.C. 5277, [1985] 1 C.T.C. 370 (F.C.TD.), C.1. Burland
Properties Limited v. Minister of National Revenue, 67 D.T.C. 5289, [1967] CTC. 5289 (E.C.), reversed without discussion of this point, 68 D.T.C. 5229 (S.C.C.). Thus, a payment made as compensation for the use of property in Canada or for the right to use property in Canada is within the scope of paragraph 212(1)(d) of the Income Tax Act (if it is paid to a non-resident).

46 By virtue of the additional words in paragraph 212(1)(d), that provision also applies to any payment made on account of such compensation, or in satisfaction of such compensation. That would appear to cover
virtually all situations in which a payment is made to discharge, in full or in part, an obligation to pay compensation
to a non-resident for the past or current use, in Canada, of property.

47 However, paragraph 212(1)(d) of the Income Tax Act also includes a payment made in lieu of compensation
for the use, in Canada, of property. The ordinary meaning of the phrase "in lieu of', according to a

number of dictionaries, is "instead of' or "in place of': Black's Law Dictionary (7th ed., 1999), The Canadian
Oxford Dictionary (2001, Oxford University Press), Gage Canadian Dictionary (1983, Gage Publishing Limited),
The Canadian Dictionary of English Law (2nd ed 1995 Thomson Canada Limited). It seems axiomatic that an amount that is paid instead of a payment of a particular legal character, or in the place of such a payment, does not hav~ that same legal character. Parliament, in using the words "in lieu of' in paragraph ()
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212(1)(d), must have intended to expand the scope of paragraph 212(1)(d) to include payments other than
payments that have the legal character of rent.

48 If the phrase "in lieu of rent" is interpreted to include only payments made as com pensation for the past
. or current use of property, which is essentially the position of counsel for Transocean, it would add nothing to
paragraph 212(1)(d), and thus would have no meaning. However, it would have meaning if it is interpreted,
as the Crown contends, to include an amount paid as compensation for the anticipatory breach of a rental agreement. In my view, that is a consideration that would favour adopting the Crown's interpretation in preference
to the interpretation proposed by counsel for Transocean.

49 The Crown cites, in support of its interpretation, two cases in which an amount paid to a landlord as compensation for early termination of a lease was held to be taxable as income if the payment if found to be
a replacement or substitute for future rent: Grader v. Minister of National Revenue, 62 DTC. 1070, [1962] CTC. 128 (E.C.), Monart Corporation v. Minister of National Revenue, 67 D.T.C. 5181, [1967] C.T.C. 263
(E.C.). A recent case illustrating the same principle is R. Reusse Construction Co. v. Canada, [1999]2 C.T.C. 2928, 99 D.T.C. 823 (T.C.C.).

50 These cases do not deal with the meaning of "in lieu of'. They do not involve the application of paragraph
212(1)(d) of the Income Tax Act at all. Rather, they involve the application of Part I of the Income Tax Act, which taxes every resident of Canada on all profits earned from a business or property anywhere in the
world. The concept of "profit" is very broad, but it is not broad enough to include capital receipts. Thus, the
question addressed in these cases was whether a payment made to a landlord as damages or settlement of the termination of a lease is income or a capital receipt. For the purposes of Part I of the Income Tax Act, the
answer to that question requires the application of a judge-made rule, sometimes called the "surrogatum principle", by which the tax treatment of a payment of damages or a settlement payment is considered to be
the same as the tax treatment of whatever the payment is intended to replace. Thus, an amount paid as a settlement or as damages is income if it is paid as compensation for lost future rent (Grader, Monart, Reusse
Construction, cited above). It is a capital receipt if it is compensation for a diminution of capital of the recipient:
Westfair Foods Ltd v. Minister of National Revenue, [1991]1 CTC. 146,91 D.T.C. 5073 (F.C.T.D.), affirmed
[1991]2 C.T.C. 343, 91 D.T.C. 5625 (F.C.A.).

51 The surrogatum principle need not be considered in this case because the words "in lieu of' in paragraph
212(1)(d) of the Income Tax Act express a similar idea. The fact finding process that precedes the application
of the surrogatum principle is similar to the fact finding process that must be undertaken to determine whether a payment has been made "in lieu of' a specified thing. Here, the fact finding exercise was completed when the Judge determined that the US $40 million payment was made as compensation for lost
future rent.

52 Counsel for Transocean does not dispute the ordinary meaning of the phrase "in lieu of'. However, he makes two arguments for limiting that meaning in the context of paragraph 212(1)(d) of the Income Tax Act,
one based on the French version of paragraph 212(1)(d), and the other based on the cases dealing with the
interpretation of other provisions of the Income Tax Act that use the same or similar language.

53 Counsel for Transocean argues that the French version of paragraph 212(1)(d) of the Income Tax Act
. is narrower than the English version, because the French phrase "au titre" means "as", and does not mean
"instead of'. Counsel for the Crown answers this argument by explaining, with numerous references to the
legislative history of the French version of the Income Tax Act, that the French phrase "au titre" is used in the
French version of the Income Tax Act to mean "in respect of'. The phrase "in respect of' has been described
as "the widest of any expression intended to convey some connection between related subject matters": Nowegijick v. The Queen, [1983]1 S.C.R. 29, per Dickson J., writing for the Court at page 39.

54 The French version of the statutory provision considered in Nowegijick was not "au titre", it was "quant
a". However, the Nowegijick definition of the phrase "in respect of' was applied in The Queen v. Savage, [1983]2 S.C.R. 428, in which the statutory provision in issue used the phrase "in respect of' in the English version and "au titre" in the French version. The case involved an employee of a life insurance company who
received from her employer $300 as a result of passing certain examinations she had taken, voluntarily and
on her own time, to improve her understanding of the life insurance business. There was a dispute as to whether the $300 was taxable as income from employment on the basis that it was, in the words of what was
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then paragraph 6(1)(a) of the Income Tax Act, R.S. 1970-71-72, c. 63, a benefit or advantage (emphasis added):

[...] in respect of, in the course of, or by virtue of an office or employment.

* * *

[...] au titre, dans I'occupation ou en vertue de la charge ou de I'emploi.

55 Dickson J., writing for the majority, held that the payment fell within this provision. (He went on to conclude
that the payment was exempt from tax because it also came within the scope of a more specific provision, paragraph 56(1)(n) of the Income Tax Act, which taxed certain awards, but only over $500.)

56 Given the manner in which the French phrase "au titre"is typically used in the French version of the Income Tax Act, the Crown has the better side of this debate. I conclude that the French version of paragraph
212(1)(d) of the Income Tax Act is at least as broad as the English version.

57 The second argument advanced on behalf of Transocean for limiting the scope of paragraph 212(1)(d) of the Income Tax Act is based on cases dealing with similarly worded provisions. Counsel for Transocean
cited Puder v. Minister of National Revenue, 63 D.T.C. 1282, [1963] CTC. 445 (E.C.), as the case that most
strongly supports that argument. Puder involved the interpretation of paragraph 6(1)(b) of the Income Tax
Act, R.S.C. 1952, c. 148, which reads as follows:
6(1) Without restricting the generality of section 3, there shall be included in computing
the income of a taxpayer for a taxation year [...]
(b) amounts received in the year or receivable in the year (depending upon
the method regularly followed by the taxpayer in computing his profit) as interest
or on account or in lieu of payment of, or in satisfaction of interest
[...].
* * *
6(1) Sans restreindre la gemeralite de I'article 3, doivent etre inclus dans Ie calcul du revenu
d'un contribuable pour une annee d'imposition [...]
b) les montants re9us ou arecevoir dans I'annee (selon la methode que suit
regulierement Ie contribuable dans Ie calcul de ses benefices) atitre d'interets,
ou acompte ou au lieu de paiement, ou en acquittement d'interets
[...].
58 The issue in Puder was whether an amount paid to a lender for the early repayment of a mortgage debt was within paragraph 6(1)(b). The term of the mortgage was 7 1/2 years, but the mortgage gave the borrower
the right to discharge the mortgage after three years upon payment of the principal plus an amount
equal to three months' interest. The borrower wished to discharge the mortgage after only 15 months. The lender agreed, provided the borrower paid a "bonus" of $4,678, representing $4,161 of interest that would have become payable for the remainder of the initial three year term (21 months) plus $517 of interest that would have become payable for an additional three months. The payment was held not to be interest, or an
amount paid in lieu of interest, because it did not represent consideration for the use of borrowed money (the
principal amount of the mortgage debt having been repaid at the same time as the "bonus").
59 The broad proposition in Puder seems to be that the phrase "in lieu of interest" means an amount that serves the same function as interest, which is compensation for the use of borrowed money. The case recognizes,
for example, that damages for breach of a contractual obligation to pay accrued interest would be
an amount paid "in lieu of interest". However, according to Puder, when a debt is repaid before its term, an
amount paid to compensate for the loss of potential future interest cannot be an amount paid in lieu of interest,
because once the debt is repaid, the borrower is no longer using the lender's money. If the same reasoning is applied to this case, no amount can be paid "in lieu of' rent (which is compensation for the use of property),
if the property is never used because the rental agreement is terminated before the rental term.
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() **60** In my view, Puder should not be accepted as the governing authority in this case because it imposes an unjustifiably narrow meaning on the phrase "in lieu of'. As mentioned above, the ordinary meaning of that
phrase connotes something that takes the place of something else or is a substitute for something else.

Theoretically, a thing may take the place of another thing if it performs exactly the same function as that other thing, or if it performs a function that is not exactly the same but is a reasonable substitute. Puder recognizes
the first possibility but rejects the second, without suggesting any justification for doing so.

61 It may be that Puder was decided as it was because, at the time, the prevailing view was that taxing statutes were to be strictly construed. That is no longer the correct approach to statutory interpretation. Now,
the interpretation of a statute requires a search for the intent of Parliament by reading the words of the provision
in context and according to their grammatical and ordinary sense, harmoniously with the scheme and the object of the statute: R. v. Jarvis, [2002)3 S.C.R. 757 at paragraph 77. That must require, at least, favouring
an interpretation that gives meaning to the phrase "in lieu of' over an interpretation that renders it redundant.

62 Counsel for Transocean also cited The Queen v. Atkins, 76 D.T.C. 6258, [1976) CTC. 497 (F.C.A.), affirming 75 D.T.C. 5263 (F.C.T.D.), as another case that supports his proposed interpretation of paragraph
212(1)(d) of the Income Tax Act. That case deals with the application of a statutory provision that is sim ilar
but not identical to the provision in this case.

63 In Atkins, this Court held that an amount paid as damages for wrongful termination of a contract of employment
was not a benefit received by the recipient "in respect of, in the course of, or by virtue of the office or employment ("a I'agard, dans Ie cours ou en vertu de la charge ou de I'emploi"), and therefore it was not
taxable under a provision of the Income Tax Act that used those words. As I read that case, the result did not
turn on the interpretation of that provision, but on a finding of fact. The trial judge had rejected the Crown's
allegation that the payment was made as a replacement for future salary. He said this at page 5270:

> Counsel for the plaintiff [the Crown) contended there was evidence, certainly a strong inference, that the employer intended to compensate only in respect of loss of salary; that $18,000 represented approximately 42 weeks of salary in lieu of notice; that if notice of dismissal had in fact been given, 42 weeks was a reasonable period. No witness from the company was called to say what was in the corporate mind, what the company felt would have been reasonable notice, what matters, in economic values, added up to $18,000, whether that figure was "salary" only. For alii know, the company and its advisers may well have considered (in initially offering $18,000, and later making further concessions) that the total settlement package covered many more compensable items than mere salary. I note that clause 5(a) of Exhibit 1-A does not describe the $18,000 as "salary" but as a "severance allowance ... in satisfaction of all your claims against the company for the termination of your employment and under any other arrangements with the Company ...." In paragraph 6, the employee is to release "the Company from all claims which you may directly or indirectly have against the Company ... in respect of any matters ...." Did the company have in mind claims for loss of use of the leased car, for company contributions to the pension plan, in respect of the scholarship plan, loss of group life insurance coverage, loss of potential profit sharing, and other matters on which one might realistically speculate? The evidence is silent. No reasonable inference can be drawn that the company and the defendant considered loss of salary as the sole matter for compensation. Further, it is impossible to say what portion of the $18,000 one, or either, party attributed to that aspect of the defendant's loss.

64 Thus, even if it is assumed that the statutory language in Atkins is analogous to what is now paragraph 212(1)(d) of the Income Tax Act, the findings of fact in Atkins dictated a result favouring the taxpayer. In this
case, the findings of fact point in the opposite direction.

65 In summary, I conclude that the Crown's proposed interpretation of paragraph 212(1)(d) of the Income
Tax Act is more consistent with the ordinary meaning of the words used in paragraph 212(1)(d), and its purpose,
than the interpretation proposed by counsel for Transocean. I am not persuaded that any of the cases
cited by counsel for Transocean requires this Court to reject the Crown's proposed interpretation.