
APPENDIX 26

(HER MAJESTY THE QUEEN v. SAINT JOHN SHIPBUILDING & DRY DOCK CO. LTD.)

Material:

Her Majesty The Queen v. Saint John Shipbuilding & Dry Dock Co. Ltd., 76 DTC 1283

Her Majesty The Queen v. Saint John Shipbuilding & Dry Dock Co. Ltd., 79 DTC 5297

Her Majesty The Queen v. Saint John Shipbuilding & Dry Dock Co. Ltd., 80 DTC 6272

Saint John Ship Building & Dry Dock Co. Ltd. (Appellant) v. The Minister of National Revenue (Respondent).

Tax Review Board, October 22, 1976. (Received from the Board, November 8, 1976.)

Non-resident tax—Payments to non-resident corporations—Use of equipment—Licence fee for use of technical information—Rents and royalties—Income Tax Act, R.S.C., 1952, ss. 106(1)(d) and 109(1) and (5) [see ss. 212(1)(d) and 215(1) and (6) of the new Act].

The appellant taxpayer company, engaged in the business of repairing and constructing ships, made payments amounting to $10,925 to a non-resident corporation for the use of certain equipment in the 1971 taxation year. The company also made payments amounting to $182,250 in the 1971, 1972 and 1973 taxation years to another non-resident corporation as a licence fee for user rights in certain computer programs. The Minister treated the above mentioned payments as rents and royalties, within the meaning of paragraph 106(1)(d) of the former Act, from which the company had failed to withhold the appropriate amounts of non-resident tax and, consequently, assessed the company to 15% non-resident tax plus interest pursuant to subsections 109(1) and (5) of the former Act. The company appealed contending that the payments were capital in nature.

***Held:* The appeal was allowed in part. From the evidence it was clear that the sum of $10,925, paid for the use of the equipment, was in the nature of rent and, therefore, the Minister's assessment to non-resident tax plus interest was correct. However, in the case of the second transaction, the amount of $182,250 was paid as a licence fee for certain user rights and technical information which, when obtained, remained permanently in the possession of the company and, therefore, constituted an enduring benefit. Consequently, the sum of $182,250 was a capital payment and was not subject to non-resident tax.**

Counsel: I. Whitcomb and L. Burnham for the appellant; O. A. Pyrcz for the respondent.

Before: Delmer E. Taylor, C.A.

DELMER E. TAYLOR, C.A.: This is an appeal from income tax assessments for the years 1971, 1972 and 1973. There are two matters at issue.

[*First issue*]

The first is the taxability of payments totalling $10,925.00 made by the appellant in the year 1971 to a company called Kongsberg Systems Incorporated for the use of certain equipment. Kongsberg Systems Incorporated (hereinafter referred to as "Kongsberg") being a non-resident corporation, the Department of National Revenue has assessed against the appellant a 15% tax of $1,638.75, and has added $299.00 as interest, since the appellant failed to withhold the appropriate amounts from its remittances to Kongsberg. The appellant contends that the payments were made in conjunction with a capital expenditure for new equipment purchased from Kongsberg and therefore were not subject to the said tax. The respondent claims these were ordinary rental payments under a lease, and relies on sections 106(1)(*d*) and 109(1) of the *Income Tax Act*, R.S.C. 1952, c. 148, as amended.

[*Second issue*]

The second issue is the taxability of payments made by the appellant in amounts of $25,375.00, $75,000.00 and $81,875.00 in the years 1971, 1972 and 1973 respectively and totalling $182,250.00, to a non-resident corporation, Com/Code Corporation (hereinafter referred to as Com/Code), pursuant to an agreement signed between the appellant and Com/Code on April 8, 1971 involving the acquisition by the appellant of certain rights and the obtaining of certain technical information pertaining to a system known as Autokon-I. Since the appellant failed to deduct the appropriate amounts from its remittances to Com/Code under this agreement, the Department of National Revenue has assessed against the appellant a 15% tax for each year in the following amounts: 1971 — $3,806.25 plus interest of $762.46; 1972 — $11,250.00 plus interest of $1,500.00; 1973 — $12,281.25 plus interest of $987.60. The appellant contends these were not payments subject to Canadian income tax under any existing taxing provisions. The respondent relies on sections 106(1)(*d*) and 109(5) of the *Income Tax Act*, R.S.C. 1952, c. 148 as amended (the old Act), and paragraph 212(1)(*d*) and subsection 215(6) of the *Income Tax Act*, S.C. 1970-71-72, c. 63 as amended (the new Act). It should be noted that, due to the transitional provisions between the "old" Act and the "new" Act, the withholding tax continued at 15% rather than at the 25% rate called for under section 212 of the "new" Act.

[*Activities of the taxpayer*]

The appellant, (hereinafter referred to as the Company), is, and at all material times was, a company incorporated under the laws of the Province of New Brunswick and having its head office in Saint John, New Brunswick. It is engaged in the business of repairing and constructing ships, boats and other vessels. In addition to evidence introduced directly by the appellant through witnesses, there were two main documents provided at the hearing. One is the agreement between the Company and Com/Code, and the other the agreement between the Company and Kongsberg. These are, respectively, Exhibits A-1 and A-2, and shall be designated as such in this decision.

[*Appeal on first issue dismissed*]

Dealing first with the Kongsberg matter as evidenced through witnesses, and the document filed as Exhibit A-2, the Board notes the point brought forward by counsel for the appellant that Exhibit A-2 represents only an interim arrangement between the Company and Kongsberg, awaiting the availability of the equipment purchased by the Company and delivered at a later date by Kongsberg. The Board also accepts the fact that, if the purchased equipment had been available for delivery by Kongsberg, the Company might not have been required to enter into this interim arrangement. Nevertheless, the Company chose this method of maintaining operations when the equipment to be purchased was not available, presumably after weighing up the advantages and disadvantages of other alternatives, and there is nothing in the evidence which would detract from a conclusion that this arrangement was simply the result of a lease, subject to the tax imposed. The major document, Exhibit A-2, utilizes the understood terms, and has the accepted characteristics of a lease, including references to "rent", "initial six-month period", "may be renewed from month to month", etc. It is the view of the Board that this part of the appeal is not supported by the facts, and must be dismissed.

[*Second issue—taxpayer's contentions*]

Turning now to the second part of the appeal, counsel for the appellant and counsel for the respondent both presented considerable information in connection with the characteristics of these payments to Com/Code and the definitions which should be attached thereto, as well as outlining the meanings and interpretations which in their opinion should be placed on both the words and the context of the applicable provisions in both *Income Tax Acts*. Counsel for both parties agreed that the wording of section 106 of the "old" Act and of section 212 of the "new" Act were identical to the extent that they were relevant in this appeal. Counsel for the appellant made two main points: first, that the payments to Com/Code were "industrial and commercial profits" and not "rents or royalties" as described in the *Tax Convention and Protocol* between Canada and the United States and were not taxable because Com/Code did not have a permanent establishment in Canada; and second, that if the payments were "rents, royalties, etc.", these payments were for "information" under the applicable sections of the *Income Tax Acts*, and since none of the

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conditions therein for taxability of information appeared to have been met, the payments were exempt from such taxation.

[*The Agreement*]

Before proceeding to examine these points in detail, it would be of advantage to make some determination of just what type of asset was received from Com/Code. The following are quotations from Exhibit A-1:

AUTOKON LICENSE AGREEMENT

THIS AGREEMENT made this 8th day of April, 1971,

BY AND BETWEEN:

SAINT JOHN SHIPBUILDING & DRY DOCK CO., LTD., with head office in Saint John, New Brunswick, Canada, hereinafter called "the Subscriber", of the one part,

—and—

COM/CODE CORPORATION, with executive officies located at 1812 K Street, N.W., Washington, D.C., U.S.A., hereinafter called "the Company", of the other part.

WHEREAS the Company has valuable technical information known as the Autokon-I System:

AND WHEREAS the Subscriber is desirous of acquiring rights with respect to said Autokon-I System and of obtaining the technical information pertaining to the said Autokon-I System;

NOW, THEREFORE the parties agree as follows:

I. DEFINITION OF TERMS:

(A.) The Company refers to COM/CODE Corporation of Washington, D.C., who has exclusive rights to sell and service the said Autokon-I System in North America; these rights being granted by Shipping Research Services of Oslo, Norway, the owners of the said Autokon-I System.

(B.) The Autokon-I System (the System)—refers to all technical information as presently developed and/or controlled by the Company consisting of the following five integrated computer programs which are the up-to-date version of the System and which has been already adopted to some certain computer hardware system and is currently operational thereon (all as more specifically defined in Schedule "A" attached hereto):—

1. Hull Definition
2. Plane Plate Contour Generation
3. Plate Nesting
4. Shell Expansion
5. Longitudinal Fairing

(C.) Use—In return for the obligations assumed under this agreement, *the Subscriber is hereby granted a non-exclusive license* (italics mine) to use the System, as defined in Section B, above, in connection with the design and construction of the Subscriber's ships, the forming of sections of ships, and for other industrial applications for which the System may be suitable. Such use of the System is to be confined to the Subscriber and associated Irving companies. This license may be exercised by the Subscriber by having the Company install an operating version of the System on the Subscriber's own computer or on such other computer of suitable capacity as may be selected by the Subscriber provided a non-disclosure and confidence agreement is first entered into between the owner of such other computer and the Company similar to the terms set out in Section VII hereof.

. . .

II. TECHNICAL INFORMATION:

The technical information on the System consists of user's manuals, programmers' manuals and computer programs. In accordance with the terms of this agreement, the Company shall furnish and disclose technical information to the Subscriber as follows:

(A.) User's manuals, containing rules for the preparation of input data and recommended operating practices. Five (5) registered copies of said user's manuals will be provided in the English language.

(B.) Programmers' manuals, including flow charts of sub-routines contained therein. Two (2) registered copies of said programmers' manuals will be provided in the English language.

I.B.M. 360-40*

* (The words "I.B.M. 360-40" were inserted in writing and appropriately initialled, apparently at the time of signing the document.)

(C.) Computer programs of the System supplied in source code form on magnetic tape and/or card deck.

It becomes obvious that in some sections the agreement is, at the very least, unclear with regard to its purposes, and may indeed be contradictory. "Acquiring rights . . . . and obtaining the technical information . . . . " (preamble) must be viewed as referring to the same transaction as "the Subscriber is hereby granted a non-exclusive license" (I. (C)). The "rights" to the Autokon-I System, and obtaining the "technical information" pertaining thereto, are indicated in the preamble as separate and distinct, whereas the "Autokon-I System" mentioned in paragraph (A.) of Clause I is referred to as "the System", and in paragraph (B.) thereof is stated in rather specific terms to refer to five integrated computer programs. If there is any doubt left about the use of the word "refers" in this section, it is cleared up by the definition under section II — Technical Information. In the view of the Board, that which the Company received was an integgrated set of computer programs together with the attendant "User's and Programmers' Manuals". The "System" which the Company obtained is simply that, no more and no less.

[*Use of programs acquired*]

Turning to the question of the use of these programs by the Company, one is confronted with some additional lack of clarity. Com/Code under I. (A.) had "exclusive rights to sell and service the said Autokon-I System in North America". The Company was "desirous of obtaining rights with respect to the said Autokon-I System" (preamble). There is no indication that the desire of the Company with regard to such "rights" was ever specifically satisfied, or indeed that Com/Code had any authorization to grant rights of any description. However, the Company was "granted a non-exclusive licence to use the System". So, the Company obtained the technical information, described as "the System", which was further identified as five (5) integrated computer programs with supporting manuals, and the Company was granted a non-exclusive licence to use the computer programs. There is no indication of the penalties or liabilities which the Company would incur in the event of violation of the mutual agreement on use restriction of the System contained in other clauses of the Agreement. The very nature of computer programs is that, once made available, they can be readily copied, or the necessary data can be readily extracted and stored. The original computer program itself might become virtually worthless as a specific and individual item once it has been made available to a user.

[*Payments for rights acquired*]

The following clause from the Agreement deals with the payment, and the Board includes paragraph (A.) thereof in its original form and repeats it as it appears after the addition of clearly legible handwritten changes apparently inserted and initialled at the time of the signing of the agreement and indicated by asterisks:

V. COMPENSATION:

(Original)

(A.) For license to use the System, as defined in Section I, (C) hereof, a license fee of $175,000.00 (U.S. funds) is to be paid as follows: $90,000 upon the signing of this agreement and $85,000 upon acceptance of the System by the Subscriber.

(As altered and initialled)

(A.) For license to use the System, as defined in Section I, (C) hereof, a license fee of $175,000.00 (U.S. funds) is to be paid as follows: (*$25,000) upon the signing of this agreement, (*$20,000 upon the acceptance of each of the said five programs,) and (*$50,000) upon acceptance of the System by the Subscriber.

(B.) Labour cost of installation of the System is for the account of the Subscriber and will be covered by a separate purchase order.

(C.) Additional registered copies of the said user's manuals are available at a price of $70.00 (U.S. funds) per copy. Copies of the said programmers' manuals are available at $150.00 (U.S. funds) per copy. Such prices shall apply until 1 April, 1976.

(D.) All invoices will be paid by the Subscriber within fifteen (15) days after receipt.

At this stage it should be pointed out that, whereas the Agreement calls for payments of $175,000.00, the Company actually paid Com/Code a total of $182,250.00. No specific evidence was brought forward at the hearing regarding this difference in price but a reading of the Agreement in the context of the evidence supports the view that the difference of $7,250.00 was for labour, installation, and service.

As already stated, the parts above marked with asterisks (*) and shown in brackets are the changes made in handwriting and appropriately initialled. Therefore the Agreement was changed to call for the payment of $25,000.00 upon signing, $100,000 paid in instalments of $20,000.00 as each of the five programs was accepted, plus a final payment of $50,000.00, thus maintaining the total of $175,000.00. It is clear that the Company was to pay $175,000.00 for a *licence fee*, and there does not appear to be any term or period of time associated with the said fee. There is no mention made that any of this payment was to defray the cost of the computer programs themselves. It is this point which is significant to the Board. No matter whether the nature of that which was received by the Company was a *property* consisting of a series of computer programs, as held by the respondent, or merely *information* on the computer programs, as held by the appellant, the payments made to Com/Code related to a licence fee for the *use* of that which was received, and there was no payment made for the physical property which was acquired.

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[Meaning of rent and royalty]

The Board appreciates the efforts of both counsel to provide enlightenment on some of the words used both in the Agreement and in the *Income Tax Acts*, but it should prove helpful to set out here the definitions which the Board will use in dealing with this matter. These are taken from *"The Living Webster Encyclopedic Dictionary of the English Language"*, 1973-1974 Edition, published by North American Educational Guild, Ltd., Winnipeg, Manitoba.

license: formal permission or authorization to do or forbear some act;

fee: a sum paid for a privilege;

rent: compensation paid at intervals to the owner of a property;

royalty: a compensation or portion of proceeds paid to the owner of a right, as an oil right or a patent, for the use of it; . . . ; the payment made for such a right.

In reviewing whether or not the payment of $175,000.00 for this licence fee should be characterized as either a rent or a royalty, the Board has been particularly aware of the reasons for judgment of what was then the Exchequer Court of Canada in *United Geophysical Company of Canada v. Minister of National Revenue*, 61 DTC 1099, (1961) C.T.C. 134; and of this Board and the Trial Division of the Federal Court in *Vauban Productions v. Minister of National Revenue*, (TRB) 73 DTC 184, (1973) CTC 2230; (F.C.T.D.) 75 DTC 5371, (1975) CTC 511. In the first matter, the learned judge provides as a summary definition of rent " . . . there are but two characteristics of the sum, namely it is for the use of machinery, etc. and it is paid for that use for a certain time". When the second matter was before the Tax Review Board, Mr. Prociuk commented: "In my humble opinion the agreement is a lease of motion picture films and not a sale. It contains all the elements of a lease. The fact that consideration thereof is one lump-sum payment does not alter its character in any way". In the same matter, before Addy, J. in the Federal Court, Trial Division, the following explanation was provided by the learned judge at 75 DTC 5372 and (1975) CTC 513:

The term "royalties" normally refers to a share in the profits or a share or percentage of a profit based on user *(sic)* or on the number of units, copies or articles sold, rented or used. When referring to a right, the amount of the royalty is related in some way to the degree of use of that right. This is evident from the various dictionary definitions of the word "royalty" when used in connection with a sum payable. Royalties, which are akin to rental payments, have invariably been considered as income since they are either based on the degree of use of the right or on the duration of the use, while a lump sum payment for the absolute transfer of a right, without regard to the use to be made of it, is of its nature considered a capial payment, although it may of course be taxable as income in the hands of the recipient if it is part of that taxpayer's regular business. This concept of the basic difference between "royalties" and "lump sum payments" for the transfer of rights has been recognized in the following cases: *Commissioners of Inland Revenue v. Rustproof Metal Window Co., Ltd.*, 29 T.C. 243 at 254 and 255; *Commissioners of Inland Revenue v. British Salmson Aero Engines, Ltd.*, 22 T.C. 29 at 36; *Desoutter Bros. Limited v. J. E. Hanger & Co.; Limited et al.*, (1936) 1 All E.R. 535 at 536; *Strick (H.M. Inspector of Taxes) v. Regent Oil Co. Ltd.*, 43 T.C. 1 at 18, 44, 50 and 59; *Withers (H.M. Inspector of Taxes) v. Nethersole*, (H.L.) (1948) 1 All E.R. 400 at 403 and 405; and *Technical Tape Corporation v. Minister of National Revenue*, 18 DTC 428, (1964) 35 Tax A.B.C. 389.

Later, in the same judgment, he went on to say at pp. 5374 & 515:

. . . It is therefore quite clear that the CBC did not receive all of the rights which the distributor Vauban had received. In other words, the rights of the latter were distributor and user's rights while those of the former were solely user's rights.

To this argument, however, counsel for the Plaintiff replies that, although the CBC might not have received exactly the same rights, which the distribtuor Vauban had originally acquired, the latter in effect had divested itself (of) any remaining rights whatsoever by granting the Canadian Broadcasting Corporation the *exclusive* right to show the films for the whole of the period for which Vauban had any title to the films.

It is not necessary to decide whether this state of affairs is sufficient to constitute an absolue transfer as opposed to a leasing, for, when one compares paragraph 3*(f)* of the contract which is quoted above with paragraph 2 of Exhibit I (page 4 of the Agreed Statement of Facts), it appears quite evident that, in fact, Vauban did not transfer all that it had received.

And, in summation, the following comment is made with reference to certain quotations used in the judgment:

The three above-quoted clauses from the contract are completely consistent with the concept of a leasing of a right or the temporary assignment of part of the right to the Plaintiff and are inconsistent with an absolute sale. The fact that the consideration was paid in a lump sum and not by instalments does not alter the nature of the transaction.

[Payments were not rents or royalties]

The Board therefore finds that the payments in question in this matter, totalling

$175,000.00, cannot be classified as "rent" since, at the minimum, there is no element of "use for a certain time". With respect to whether or not they are "royalties", the Board finds that although there are references to "use" in the Agreement, they are not ones which the Board reads as relating to "degree of use", or "duration of the use". Such references to various instalments in the original contract, the changes made at the date of signing with respect to the points in time when instalments would be due, and even the fact that the required instalments were not made as required but in fact occurred over a period of some two years, relate only to the basis for payment of the total agreed amount, and do not indicate any period or passage of time in connection with use. The payments, therefore, are not regarded as royalties.

Under the relevant section of the Act, 212(1)(*d*), it remains to determine if the payment falls within " . . . . or a similar payment". The one apparent common denominator between "rent" and "royalty" appears to me to be the reference to time, and without this characteristic, one would certainly have serious reservations about classifying any amount as "a similar payment", whether it was made in a lump sum payment or by instalments. This view is not diminished, in my opinion, by the inclusion in the descriptive phrase in section 212(1)(*d*) of the words ". . . , any payment", since this phrase cannot be read to mean an enlargement of the basic term "rent, royalty, or a similar payment . . . ", but must be read as relating only to the types of payment to which the clause later refers. The Board rejects the position that it can be classified as a "similar payment".

In argument, counsel for the appellant stated that "the Dry Dock did acquire ownership of the information that it obtained from Com/Code, and even though it was restricted in its right to use the ownership, had the right to use the information at all times for its own purposes, and could therefore be considered, I suggest, as an owner of that information. Perhaps not the only owner, because Com/Code itself would still have the information, and indeed the other customers of Com/Code would have the same information possibly, but once the information was transferred to the Dry Dock pursuant to the License Agreement (Exhibit A-1), then that information fell permanently into the possession of the Dry Dock and it could be used for any purpose authorized by the contract itself". The agreement itself, however, in section VII. (C) points out, and I quote: "The Subscriber is not granted any copyright or any other literary or property rights on the technical information supplied by the Company." It is suggested that, to whatever degree the appellant Company became an owner, it was as owner of the property or the right granted in the licence itself, not of the technical information supplied to the appellant. Further, the responsibility of Com/Code according to section II. of the agreement seems to be to "furnish and disclose technical information". However, the Board accepts the argument made by counsel for the appellant to the degree that the right of the appellant to that which was granted was of an enduring and not of a temporary or of a periodic nature.

[*Appeal on second issue allowed*]

The Board finds that the payments in question made by the appellant to Com/Code which amounted to $175,000.00 were for a licence fee, transferring to the Company certain user's rights. Together with other amounts of $7,250.00 for installation and service, making a total of $182,250.00, they do not constitute payments made for rent, royalty or a similar payment under section 106(1)(*d*) of the *Income Tax Act*, R.S.C. 1952, c. 148 as amended, or under section 212(1)(*d*) of the *Income Tax Act*, S.C. 1970-71-72, c. 63 as amended.

The appeal is therefore allowed in part, with the portion of the appeal dealing with Com/Code Corporation in the amount of $182,250.00 being allowed, and the portion of the appeal dealing with Kongsberg Systems Incorporated in the amount of $10,925.00 being dismissed.

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Her Majesty the Queen (Plaintiff) v. Saint John Shipbuilding & Dry Dock Co. Ltd. (Defendant).

Federal Court—Trial Division, July 24, 1979. (Received from the Court, August 8, 1979.)

Non-residents—Withholding tax on payments to—Payment for computer data bank—Payments not rent or royalties — Payments were industrial and commercial profits — No liability for withholding tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 106(1)(d) and 109(5). (See S.C. 1970-71-72, c. 63, ss. 212(1)(d) and 215(6))—Canada—U.S. Tax Convention, Articles I and II.

The taxpayer paid money to a non-resident corporation in 1971, 1972 and 1973. The non-resident corporation then furnished to the taxpayer for an undefined period of time its computer data banks related to shipbuilding. The Minister assessed withholding tax against the taxpayer on such payments. The taxpayer appealed successfully to the Tax Review Board (76 DTC 1283), which held that the payments were not rent, royalty or a similar payment. The Crown then appealed to the Federal Court—Trial Division, contending that the payments were subject to withholding tax because (1) they were for the use or right to use the non-resident's property, or alternatively (2) they represented rents, royalties or similar payments. The taxpayer contended that no withholding tax was exigible because the payments (1) were not rents, royalties or similar payments, (2) they were not dependent on the use of or benefits from the operation of the data bank, and (3) they constituted industrial and commercial profits of the non-resident corporation which were not taxable in Canada by reason of a tax treaty.

***Held:* The Crown's appeal was dismissed. The Court decided that the payments were neither rent, since no time was fixed for termination of the agreement, nor royalties, since there existed no basis for calculating a royalty based on use or profit level. The payments were expended for "information concerning industrial, commercial or scientific experience" but did not meet the additional conditions of the relevant provision which would have imposed tax on them. Furthermore, the payments constituted industrial and commercial profits in Canada of the non-resident corporation, and were not taxable because of a tax treaty. The Crown's appeal was therefore dismissed.**

Counsel: L. B. Chambers and D. Friesen for the plaintiff; E. N. McKelvey, Q.C. and L. Burnham for the defendant.

Before: Walsh, J.

WALSH, J.: This is an appeal by Plaintiff from a decision of October 22, 1976 of the Tax Review Board [76 DTC 1283] to the effect that the amounts of $25,375.00, $50,000.00 and $81,875.00 were not amounts in respect of which non-resident tax was payable for the 1971, 1972 and 1973 taxation years respectively.

These sums arose from payments made by Defendant in the respective years to Com/Code Corporation, a United States company.

During the hearing in this Court the amount of $50,000.00 on which non-resident tax is claimed for the 1972 taxation year was corrected to read $75,000.00 by amendment granted by consent, this figure being the correct amount. These payments resulted from the acquisition by Defendant from Com/Code by agreement entered into on or about April 8th, 1971, of the right to use in Canada that company's Autokon-I System of computerized information in connection with Defendant's shipbuilding operation.

[*Statutory provisions*]

Plaintiff relies *inter alia* for the 1971 year on the provisions of Section 106(1)(*d*) of the *Income Tax Act,* R.S.C. 1952, c. 148, as amended and for the 1972 and 1973 taxation years upon Sections 212(1)(*d*) and 215(6) of the new *Income Tax Act,* S. of C. 1970-71-72, c. 63, as amended. In addition to disputing liability under the aforementioned sections of the Statute Defendant relies on Articles I and II of the *Canada - U.S. Tax Convention* and Clause 6(*a*) of the Protocol thereto and the *Canada-United States of America Tax Convention Act*, 1943—44 S. of C., c. 21. As the provisions of the sections in question which are relied on are identical in both taxation Acts it will be convenient in these Reasons for Judgment to merely refer to the sections of the new Act. Section 212(1)(*d*)(i) and (ii) read as follows:

212. (1) Every non-resident person shall pay an income tax of 25% on every amount that a person resident in Canada pays or credits, or is deemed by Part 1 to pay or credit, to him as, on account or in lieu of payment of, or in satisfaction of,

(*d*) rent, royalty or a 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, invention, trade name, patent, trade mark, design or model, plan, secret formula, process or other thing whatever,

(ii) for information concerning industrial, commercial or scientific experience where the total amount payable as consideration for such information is dependent in whole or in part upon

(A) the use to be made thereof or the benefit to be derived therefrom,

(B) production or sales of goods or services, or

(C) profits,

The amount of 25% is reduced to 15% with respect to payments made to residents of the United States by virtue of the provisions of the *Canada-U.S. Tax Convention.* Section 215(6) reads:

215. (6) Where a person has failed to deduct or withhold any amount as required by this section from an amount paid or credited or deemed to have been paid or credited to a non-resident person, that person is liable to pay as tax under this Part on behalf of the non-resident person the whole of the amount that should have been deducted or withheld, and is entitled to deduct or withhold from any amount paid or credited by him to the non-resident person or otherwise recover from the non-resident person any amount paid by him as tax under this Part on behalf thereof.

[*Crown's position*]

Plaintiff contends that the payments were made for the use of or right to use in Canada Com/Code Corporation's property, invention, trade name, patent, trade mark, design or model, plan, secret formula, process or other thing whatsoever, within the meaning of Section 212(1)(*d*)(i). Plaintiff claims that alternatively rents, royalties or similar payments were paid by Defendant for its acquisition of rights to Com/Code Corporation's Autokon-I System within the meaning of Section 212(1)(*d*) of the Act and that it is therefore liable to pay the 15% tax pursuant to Section 215(6) because it failed to deduct or withhold such tax from a non-resident.

[*Taxpayer's position*]

Defendant for its part contends that the agreement was to provide Defendant with information concerning industrial, commercial or scientific experience and the total amount payable as consideration for such information was not dependent in whole or in part upon the use to be made thereof or the benefit to be derived therefrom, production or sales of goods or services, or profits, within the meaning of Section 212(1)(*d*)(ii), and furthermore that the payments were industrial and commercial profits within the meaning of Articles I and II of the Convention and clause 6(*a*) of the Protocol thereto since Com/Code Corporation had no permanent establishment in Canada within the meaning of Article I and clause 3(*f*) of the Protocol. The aforementioned Articles I and II read respectively as follows:

ARTICLE I

An enterprise of one of the contracting States is not subject to taxation by the other contracting State in respect of its industrial and commercial profits except in respect of such profits allocable in accordance with the Articles of this Convention to its permanent establishment in the latter State.

No account shall be taken in determining the tax in one of the contracting States, of the mere purchase of merchandise effected therein by an enterprise of the other State.

ARTICLE II

For the purposes of this Convention, the term "industrial and commercial profits" shall not include income in the form of rentals and royalties, interest, dividends, management charges, or gains derived from the sale or exchange of capital assets.

Subject to the provisions of this Convention such items of income shall be taxed separately

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or together with industrial and commercial profits in accordance with the laws of the contracting States.

and clause 6(*a*) of the Protocol defines the term "rental and royalties" referred to in Article II of the Convention in the following manner:

The term "rental and royalties" referred to in Article II of this Convention shall include rentals or royalties arising from leasing real or immovable, or personal or movable property or from any interest in such property, including rentals or royalties for the use of, or for the privilege of using, patents, copyrights, secret processes and formulae, goodwill, trade marks, trade brands, franchises and other like property.

Defendant further states that the amounts paid were not rents, royalties or similar payments within the provisions of Section 212(1)(*d*) of the Act nor payments for the use of said property within the provisions of Section 212(1)(*d*)(i) and that while they were payments for information concerning industrial, commercial or scientific experience within the meaning of Section 212 (1)(*d*)(ii) they were not the type of payments subject to income tax within the meaning of the said subparagraph since they were not dependent in whole or in part upon the use to be made thereof, the benefit to be derived therefrom, the production or sales of goods or services or profits. In the alternative Defendant pleads that they were industrial and commercial profits payable to an enterprise of the United States of America which had no permanent establishment in Canada and therefore not subject to taxation in Canada under the provisions of the Tax Convention and Protocol thereto.

[*Facts*]

Evidence of witnesses confirmed by the agreement between Defendant and Com/Code dated April 8th, 1971 indicates that what Defendant acquired was the right to use a computerized system which might perhaps be considered as a bank of information relating to shipbuilding established by Com/Code. The use of this system eliminates a great many mathematical computations and calculations required in the construction of a ship. Before this system was adopted it was necessary in converting the plans of the naval architect or designer into construction drawings to construct each plate of the hull from the drawings reduced to one-tenth in size laid out on the loft floor. These drawings would then be photographed to 1-100 hundred size and from the negative the cutting tools could be guided to cut the steel plates. The plates of course had different shapes and curvatures and the process was a laborious one. The computer bank contains information based on the collection of shipbuilding designs from all over the world enabling, as one witness stated, detailed information to be obtained by feeding proper input data to the computer for the construction of anything from a rowboat to a warship. Moreover information can be obtained not only with respect to the hull plates but also cross girders and other steel required and the optimum pattern for cutting the hull plates from steel sheets on the loft floor so as to minimize wastage of steel by inaccurate layout of the plans on it. When the cutting tool is directed by the computerized information received the plates are also cut more accurately than under the old system. By using this information the time for this phase of the construction of a ship may be reduced from say two months to two or three weeks.

It is merely necessary to take the coordinates in three dimensions off the line plans of the ship and code them on a punch card which is then fed into the computer as input. The output data can be obtained in two forms, first a print-out giving in great technical detail the measurement and fairing of each plate and secondly on a punched tape which can be fed into the cutting machines.

[*Analysis*]

The bank of information is furnished confidentially by Com/Code to whatever computer system is designated by the customer—in this case Computel. The system was not furnished exclusively by Com/Code to Defendant, of course, but was also available to other shipyards in the United States and Canada who acquired the system. I have expressly avoided the use of the word "bought" or "leased" in connection with the acquisition of the right to use the system by Defendant and others who obtained it from Com/Code since it is the key to the whole problem. On the other hand Defendant cannot be considered as the purchaser of the system since the contract specifically provides that the information in it is solely for the use of Defendant and cannot be passed on by it to any third party. Defendant therefore cannot be considered as having rights of ownership which would imply the right to dispose of or use the information in any legal manner it might choose. On the other hand, having paid a lump sum for the use of the system with options and revisions of the system as provided in the agreement, over a period of three years, Defendant cannot be considered merely as the lessee of the system, or as having acquired it on a royalty payment basis, since the amount paid remains the same whether Defendant makes extensive use or not use whatsoever of the system and there is no fixed period of time at which the right to use the system terminates. Presumably Defendant can continue to use it as long as the information in it is usable and has not become obsolete. It was conceded that although Com/Code has undoubtedly gone to the great expense of assembling and computerizing all this information and by doing so provides an extremely useful service to shipbuilding, the information itself is not protected by patent or copyright and any shipbuilder could if its operations were extensive enough to justify the expense, assemble and computerize its own bank of similar information. The issue is not whether the payments made by Defendant to Com/Code were of a capital or income nature so far as Defendant is concerned, but merely whether 15% should have been deducted from them and remitted to the Minister of National Revenue from Com/Code pursuant to Section 215(6) of the new Act. Jurisprudence relating to the distinction between income and capital expenses is not directly pertinent. The agreement between Defendant and Computel called for the granting of "a non-exclusive licence" and the payment is referred to as being "for licence to use the system". Plaintiff contends that what was acquired was property within the meaning of Section 212(1)(*d*) (i) and in this connection refers to the case of *Rapistan Canada Limited v. Minister of National Revenue*[1] which was however a case dealing with whether a deed of gift whereby a U.S. company granted appellant company its "know-how, techniques, skills and experience" in order to enable it to carry on in Canada the particular manufacturing operation that was carried on in the U.S. by the U.S. company was capital in nature subject to deduction of capital cost allowance. In rendering judgment Chief Justice Jackett stated at Pages 6427-8:

> While the "Deed of Gift" purports to be a gift, grant and assignment of "know-how, techniques, skills and experience", as far as I know, under no system of law in Canada, does knowledge, skill or experience constitute "property" that can be the subject matter of a gift, grant or assignment except to the extent, if any, that it can be a right or a part of a right in respect of which there is property of the kind classified as industrial property. Therefore, as I understand the "gift" in this case in the light of the evidence, it must be construed as a promise by the donor that the appellant will be informed and instructed by the "donor" as to how to commence and carry on a certain manufacturing operation. Clearly, it is not based on any of the industrial property rights such as patents for inventions, copyright, trade marks and industrial designs. As I understand the law, knowledge or ideas, as such, do not constitute property.

Defendant contends however that the words in subparagraph (i) must be read in the light of the preamble to Paragraph (*d*) "rent, royalties or a similar payment, including but not so as to restrict the generality of the foregoing, any payment" and by applying the *ejusdem generis* rule, that all payments referred to specifically must have characteristics similar to rents or royalties. According to this argument the word "including" is not used in its extensory sense for the purpose of enlarging the meaning of the preceding words but rather for the purpose of defining the types of rents, royalties or similar payments to be taxed by the subparagraph. Reference was made to the case of *Commissioners of Customs and Excise v. Savoy Hotel Ltd.*[2] in which, in reviewing the words "manufactured beverages, including fruit juices" in Schedule 1 to the Purchase Tax Act 1963, Sach, J. stated at Page 302:

> . . . there is nothing here in the use of the word "included" that compels the court to say that "fruit juices" must be construed without reference to the two words with which the sentence begins and which should, where practicable, be given some effect in relation to the words that follow.

[*Rent*]

In contending that the payments made were in the nature of rent Plaintiff referred

[1] 74 DTC 6426.
[2] [1966] 2 All E.R. 299.

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to the case of *United Geophysical Co. of Canada v. Minister of National Revenue*[1] at Pages 1104-5 where Thurlow, J. (as he then was) dealt with the question under Section 106(1)(*d*) of the old Act of whether payments not having characteristics of rent, in view of there being no certainty in the agreement as to the amount to be paid or as to the time when the payment must be made, nevertheless came within the section. He stated:

> It is, I think, apparent from the use in the section of the wording which follows the words "rent" and "royalty" that Parliament did not intend to limit the type of income referred to in the subsection to either what could strictly be called "rent" or "royalty" or to payments which had all of the strict legal characteristics of "rent" or "royalty". Nor does the scope of the section appear to be restricted to payments of that nature in respect of real property for the word "property" appears in the section and that word is defined in very broad terms in s. 139(1)(*ag*) as including both real and personal property. It seems to me, therefore, that s. 106(1)(*d*) includes any payment which is similar to rent but which is payable in respect of personal property.

He was however dealing with the argument that rent must be limited to profits arising from real property, and in summing up his reasoning he also stated at Page 1105:

> Without attempting to determine just how wide the net of s. 106(1)(*d*) may be, I am of the opinion that the subsection does refer to and include a fixed amount paid as rental for the use of personal property for a certain time. (Emphasis mine.)

Certainly in the present case there is no limitation as to time. This distinction was referred to with approval by Cattanach, J. in *C. I. Burland Properties Limited v. Minister of National Revenue*[2] where he stated at Page 5292:

> From my brother Thurlow's remarks, I conclude that in his opinion (assuming the amount was paid for the use of property) there must be two attributes present to constitute a payment similar to rent, although without all other strict legal requirements thereof, (1) that it is a fixed amount and (2) that it is paid for a certain time. I would add that the amount is fixed if it is stated so that it can be ascertained with certainty.

[Royalties]

With respect to the word "royalties", Cameron, J. stated in the case of *May McDougall Ross v. M.N.R.*[3] at Page 778:

> . . . Royalties, in reference to mines or wells in all the definitions, are periodical payments either in kind or money which depend upon and vary in amount according to the production or use of the mine or well, and are payable for the right to explore for, bring into production and dispose of the oils or minerals yielded up.

In *M.N.R. v. Paris Canada Films Limited*[4] Dumoulin, J. stated at Page 1341:

> Proceeding by elimination, I incline to believe that a lump payment for rights irrevocably ceded, tantamount to an assignment in perpetuity, as in exhibit 11, can hardly be reconciled with the customarily accepted notions attaching to "rents or royalties", *id est*: limit of time, retention of *"jus in re"* by the lessor and periodical rentals by the lessee, either for fixed sums or an apportionment of receipts.

In the case of *Vauban Productions v. Her Majesty The Queen*[5] Addy, J. stated at Page 5372:

> The term "royalties" normally refers to a share in the profits or a share or percentage of a profit based on user or on the number of units, copies or articles sold, rented or used. When referring to a right, the amount of the royalty is related in some way to the degree of use of that right. This is evident from the various dictionary definitions of the word "royalty" when used in connection with a sum payable. Royalties, which are akin to rental payments, have invariably been considered as income since they are either based on the degree of use of the right or on the duration of the use, while a lump sum payment for the absolute transfer of a right, without regard to the use to be made of it, is of its nature considered a capital payment, although it may of course be taxable as income in the hands of the recipient if it is part of that taxpayer's regular business . . .

Plaintiff contends however, that the word "royalties" has not been restricted to payment for the use of the information since sub-paragraph 212(1)(*d*)(i) in referring to payment "for the use of" also adds the words "or for the right to use" and that what Defendant acquired was "the right to use". In support of this argument Plaintiff refers *inter alia* to the British case of *Rust-proof Metal Window Co. Ltd. v. Commissioners of Inland Revenue*[6] where Lord Greene, M.R. stated at Page 267:

> Returning to the argument of Counsel, I cannot understand why it should be said, as the proposition implies and was specifically

[1] 61 DTC 1099.
[2] 67 DTC 5289.
[3] 50 DTC 775.
[4] 62 DTC 1338.
[5] 75 DTC 5371, [appealed unsuccessfully, 79 DTC 5186.]
[6] 29 T.C. 243.

argued, that a sum received in respect of the right to use a patent which is payable whether or not the patent is in fact used and without reference to any question of user must necessarily be a capital receipt. A sum received in consideration of the grant of the right to use a patent, whether user does or does not take place, is surely just as capable of being an income receipt as a sum received in consideration of the grant of the right to use any other kind of property, for example, a motor-car. Whether or not it is an income or a capital receipt must, I should have thought, be ascertained by reference to all the relevant circumstances and not by some fixed rule of law such as is suggested.

Reference was also made to the case of *Murray (Inspector of Taxes) v. Imperial Chemical Industries, Ltd.*[1] in which at 983 Lord Denning, M.R. stated:

> Applying these criteria, in the present case it is quite clear that the royalties for the master C.P.A. patent and the royalties for the ancillary patents of the taxpayer company were revenue receipts. That is admitted. So far as the lump sum is concerned, I regard it as a capital receipt, even though it is payable by instalments. I am influenced by the facts: (i) that it is part payment for an exclusive licence, which is a capital asset; (ii) that it is payable in any event irrespective of whether there is any user under the licence; even if the licensees were not to use the patents at all, this sum would still be payable; (iii) that it is agreed to be a capital sum payable by instalments and not as an annuity or series of annual payments. In these circumstances I am quite satisfied that the lump sum was a capital receipt and the taxpayer company are (*sic*) not taxable on it.

In the case of *Jeffrey (H.M. Inspector of Taxes) v. Rolls-Royce, Ltd.*[2] which dealt with an agreement between Rolls-Royce and the Republic of China to license the Chinese to manufacture a Rolls-Royce jet aero engine and supply the necessary information and drawings, to advise them from time to time as to improvements and modifications in manufacture and design, and to instruct Chinese personnel of their works and to release one or two members of their own staff to assist in China with the manufacture of the engine in consideration of the payment of "a capital sum of fifty thousand pounds" plus royalties, it was held that the fifty thousand pounds was a revenue receipt despite being designated as capital payment. As previously indicated however these cases dealt with the distinction between capital and revenue receipts and the Court is not called upon to decide in the present case whether the payments made by Defendant to Com/Code were revenue receipts for Com/Code or whether they were capital or revenue payments by Defendant in order to interpret Section 212(1)(*d*) of the Act. In the case of *Farmparts Distributing Ltd. v. Her Majesty the Queen*[3] (which I am informed is now under appeal) my brother Gibson, J. decided that this distinction was necessary for the proper interpretation of Section 212(1)(*d*). He stated at Page 5196-7:

> The words "rent, royalty or other similar payment" used in section 212(1)(*d*) of the *Income Tax Act* require a determination categorizing the payments made in every case. This is so because the basic scheme and concept of the present *Income Tax Act* is that all categories of specific factual situations are provided for in its charging provisions. In other words, everything is considered to be covered.
>
> This is a fundamental change from the basic scheme and concept of the previous Act which employed general language in its charging provisions. It dealt with principles and standards. It left for judicial decision whether a particular factual situation fell within or without such general language in the charging provisions.
>
> [*Type of payments*]
>
> Therefore, in considering the categorization of the payments made in this case, it appears that in all of the subsections of section 212(1)(*d*) of the *Income Tax Act* (except section 212(1)(*d*)(v)) what is contemplated is payments on income account. It appears also that section 212(1)(*d*)(i) only may be applicable in these appeals. It appears also that the subject payments were lump sum payments, made once and for all, but that feature in the subject cases is not of material assistance in determining the categorization of such payments.

[*Payments not rent or royalties*]

While the question is not an easy one I am inclined to the view in the light of all the above jurisprudence that, even though the payments made by Defendant to Com/Code may have been and probably were, income receipts for that company, they certainly were not rental payments and that it stretches the word "royalties" to conclude that the lump sum payment (the fact that it was in three instalments does not alter this) even if it is considered as merely for the "right-to-use" the information should be considered as a royalty payment, although is in no way attached to the extent of use, or to the profits made by Defendant as a result of such use, and hence there is no basis on which a royalty payment could be calculated.

[1] [1967] 2 All E.R. 980.
[2] 40 T.C. 444.
[3] 79 DTC 5193.

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I am strengthened in this conclusion by the wording of subparagraph (ii) of Section 212(1)(*d*). It appears to me that what was acquired by Defendant can properly be classified under this subparagraph as "information concerning industrial, commercial or scientific experience". If this is the case then it clearly is not taxable under subparagraph (ii) since it is neither dependent on use to be made thereof, the benefit to be derived therefrom, the production or sales of goods or services, or profits within (A), (B) or (C) thereof. If it comes within one of the subparagraphs under which it would not be taxable it is not justifiable to attempt to classify under another subparagraph, by virtue of which it might be taxable. Having concluded that the tax is not required by virtue of Section 212(1)(*d*) of the *Income Tax Act*, nor Section 106(1)(*d*) of the former Act, this disposes of the matter and it is not really necessary to deal with Defendant's argument based on the Canada-U.S. Tax Convention. This second argument of Defendant was also thoroughly dealt with however by counsel for both parties and I will therefore also deal with it. This argument again raises the question of whether the payments made to Com/Code were "income in the form of rents and royalties" or "industrial and commercial profits" in Canada. The latter are not taxable in Canada but rentals and royalties from the sale or exchange of capital assets are excepted and therefore not exempt.

[*Canada-U.S. Tax Convention*]

The words "rentals and royalties" in the Protocol apply to "the use of, or for the privilege of using" which Plaintiff points out differs from the words in subparagraph 212(1)(*d*)(i) which reads "use of or for the right to use". I do not find any significant difference in the wording. However, I find the examples in the Protocol which refers to "patents, copyrights, secret processes or formulae, goodwill, trademarks, trade brands, franchises and other like property (emphasis mine) to be, if anything, somewhat more restrictive than Section 212(1)(*d*)(i) which uses the words "any property, invention, trade name, patent, trademark, design or model, plan, secret formulae, process or other thing whatever (emphasis mine) if one is to apply the *ejusdem generis* rule since what was acquired does not come within any of the items of property specified in Clause 6(*a*) of the Protocol nor is it "other like property".

Plaintiff relies on the case of *Western Electric Company Incorporated v. Minister of National Revenue*, 69 DTC 5204 affirmed in the Supreme Court 71 DTC 5068, under Section 106(1)(*d*) of the former *Income Tax Act* which held that confidential technical information supplied by an American company to a company in Canada constituted trade secrets which bore a close analogy to "secret processes and other like property" within the meaning of Section 6(*a*) of the Protocol. The present case can be distinguished however in that the information is in no way secret, but merely a compilation in useful form of information otherwise available. Furthermore in the *Western Electric* case royalty payments were definitely made, based on sales of goods manufactured by use of the information received. I also conclude therefore that under the provisions of the *Canada-U.S. Tax Convention* the payments made were not subject to the deduction of withholding tax as required by Section 215(6) of the Act.

[*Action dismissed*]

Plaintiff's action is therefore dismissed with costs.

Her Majesty The Queen (Appellant) v. Saint John Shipbuilding & Dry Dock Co. Ltd. (Respondent).

Federal Court of Appeal, July 8, 1980. (Received from the Court, July 15, 1980.)

Non-residents—Withholding tax on payments to—Payment for computer tapes containing technical data—Payments not rentals or royalties—Tax treaty exempted payments from taxation—Income Tax Act, R.S.C. 1952, c. 148, ss. 106(1)(d) and 109(5). (See S.C. 1970-71-72, c. 63, ss. 212(1)(d) and 215(6).)—Canada-U.S. Tax Convention, Articles I and II.

The taxpayer made payments to a non-resident corporation in 1971, 1972 and 1973. In return, the taxpayer received the use for an undefined period of time of computer tapes containing technical data related to shipbuilding. The Minister assessed non-resident withholding tax against the taxpayer, who then appealed successfully to the Tax Review Board (78 DTC 1283). When the Crown's appeal to the Federal Court—Trial Division (79 DTC 5297) was dismissed, the Crown appealed to the Federal Court of Appeal.

Held: **The Crown's appeal was dismissed. Because of the terms of a tax treaty, the payments in question were not subject to any form of Canadian taxation. The payments were plainly part of the non-resident's industrial and commercial profits and were therefore protected from tax in Canada. Furthermore, they did not represent rentals and royalties, as they had none of the characteristics associated with those types of payments. There was no time limit on the agreement with the non-resident and the payments were unrelated to any use that might be made of the property acquired. The payments were therefore not subject to withholding tax and the Crown's appeal was dismissed.**

Counsel: L. P. Chambers, Q.C. and C. G. Pearson for the appellant; E. N. McKelvey, Q.C. for the respondent. Solicitors: R. Tassé, Q.C., Deputy Attorney General of Canada for the appellant; McKelvey, Macaulay, Machum & Fairweather for the respondent.

Before: Thurlow, C.J., Ryan, J. and Kerr, D.J.

THURLOW, C.J.: The issue in this appeal is whether lump sum payments of $25,375, $75,000 and $81,875 made by the respondent in 1971, 1972 and 1973 respectively to Com/Code Corporation, a non-resident United States corporation, were amounts in respect of which the respondent was required by the applicable provisions of the *Income Tax Act*[1] to deduct and remit to the Receiver General of Canada non-resident income tax payable by Com/Code.

[*Facts*]

The amounts in question were paid by the respondent pursuant to a contract under

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1 For 1971 section 109, and for 1972 and 1973 renumbered section 215, provided in part:
SEC. 109.

(1) When a person pays or credits or is deemed to have paid or credited an amount on which an income tax is payable under this Part, he shall, notwithstanding any agreement or any law to the contrary, deduct or withhold therefrom the amount of the tax and forthwith remit that amount to the Receiver General of Canada on behalf of the non-resident person on account of the tax and shall submit therewith a statement in prescribed form.

. . .

(5) Where a person has failed to deduct or withhold any amount as required by this section from an amount paid or credited or deemed to have been paid or credited to a non-resident person, that person is liable to pay as tax under this Part on behalf of the non-resident person the whole of the amount that should have been deducted or withheld, and is entitled to deduct or withhold from any amount paid or credited by him to the non-resident person or otherwise recover from the non-resident person any amount paid by him as tax under this Part on behalf thereof.

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which Com/Code supplied to a Canadian computer service company for the respondent (it might alternatively have been for the respondent's own computer had it had one of the kind required) tapes containing technical data or material referred to as the Autokon-I System which, when combined with input data on a specific ship's hull, produced technical data for use in the construction of the hull. The items supplied by Com/Code included, as well, users' manuals, and programmers' manuals.

The information so obtainable by the use of the system was not secret. It was information that could have been worked out by competent technical personnel, as had formerly been necessary, by more laborious efforts and with the expenditure of much more time. Com/Code also made the system available to other shipbuilders at a price. The respondent was, however, bound by the contract to keep the information obtained by use of the system confidential and to use it only for the respondent's purposes. Subject to that, there was no contractual restriction on the respondent as to how many times or over what period of time information might be obtained or preserved or used and the amounts of the payments were in no way related to the extent of such use, or to revenues or profits attributable thereto or to the period of such use. Under the contract it was open to the respondent to continue indefinitely obtaining information from the computer and to keep the information as long and to use it as often as the respondent wished.

The contract does not purport to evidence a sale of the tapes and manuals to the respondent. Instead, it purports to be a grant of a non-exclusive licence to use the system in connection with the design and construction of the respondent's ships, the forming of sections of ships and for other industrial applications for which the system may be suitable. There is in the contract no reference to the ownership of the tapes or manuals so supplied nor is there any provision which give Com/Code any right in any circumstances to require that they be returned.

[*Statutory provisions*]

The statutory provision under which tax is claimed on the amount paid in the year 1971 was section 106 of the *Income Tax Act*, R.S.C. 1952, c. 148, and on the amounts paid in 1972 and 1973 was section 212 of the *Income Tax Act* as amended by Statutes of Canada 1970-71-72, c. 63. The relevant portions of section 106 read as follows:

SEC. 106.

(1) Every non-resident person shall pay an income tax of 15% on every amount that a person resident in Canada pays or credits, or is deemed by Part I to pay or credit, to him as, on account or in lieu of payment of, or in satisfaction of,

. . .

(*d*) rent, royalty or a 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, invention, trade name, patent, trade mark, design or model, plan, secret formula, process or other thing whatever,

(ii) for information concerning industrial, commercial or scientific experience where the total amount payable as consideration for such information is dependent in whole or in part upon

(A) the use to be made thereof or the benefit to be derived therefrom,

(B) production or sales of goods or services, or

(C) profits,

(iii) for services of an industrial, commercial or scientific character performed by a non-resident person where the total amount payable as consideration for such services is dependent in whole or in part upon

(A) the use to be made thereof or the benefit to be derived therefrom,

(B) production or sales of goods or services, or

(C) profits,

but not including a payment made for services performed in connection with the sale of property or the negotiation of a contract,

(iv) made pursuant to an agreement between a person resident in Canada and a non-resident person under which the non-resident person agrees not to use or not to permit any other person to use any thing referred to in subparagraph (i) or any information referred to in subparagraph (ii), or

(v) that was dependent upon the use of or production from property in Canada whether or not it was an instalment on the sale price of the property, but not including an instalment on the sale price or agricultural land,

but not including

(vi) a royalty or similar payment on or in respect of a copyright,

(vii) a payment in respect of the use by a railway company of railway rolling stock as defined in paragraph (25) of section 2 of the *Railway Act*,

(viii) a payment made under a *bona fide* cost-sharing arrangement under which the person making the payment shares on a reasonable basis with one or more non-resident persons research and development expenses in exchange for an interest in any or all property or other things of value that may result therefrom, or

(ix) a rental payment for the use of or the right to use outside of Canada any corporeal property;

The only material difference in the relevant wording of section 212 is that under it the tax is fixed at 25%. However, under the Convention referred to later in these reasons it is not to exceed 15% in situations to which the convention applies.

It will be observed that the net cast by sub-paragraph 106(1)(*d*)(i) is very broad. It includes not only "rent, royalty or a similar payment" but "any payment" for "the use of or for the right to use in Canada" any "property" (a word which is defined in the broadest of terms in paragraph 139(1)(*ag*) (now a part of subsection 248(1)) or any of the items enumerated in the wording that follows it, or "other thing whatever". This very broad wording came into effect in 1968. Prior to that the wording had been much narrower. *Western Electric Co. v. M.N.R.*[1] was decided on it.

[*Treaty provisions*]

With respect to payments to residents of the United States, however, the provisions of the *Income Tax Act* are, and have been since 1944. subject to the provisions of the *Canada-U.S. Reciprocal Tax Convention* and *Protocol* thereto signed in March 1942.[2]

Articles I and II of the *Convention* provide:

ARTICLE I

An enterprise of one of the contracting States is not subject to taxation by the other contracting State in respect of its industrial and commercial profits except in respect of such profits allocable in accordance with the Articles of this Convention to its permanent establishment in the latter State.

No account shall be taken in determining the tax in one of the contracting States, of the mere purchase of merchandise effected therein by an enterprise of the other State.

ARTICLE II

For the purposes of this Convention, the term "industrial and commercial profits" shall not include income in the form of rentals and royalties, interest, dividends, management charges, or gains derived from the sale or exchange of capital assets.

Subject to the provisions of this Convention such items of income shall be taxed separately or together with industrial and commercial profits in accordance with the laws of the contracting States.

Paragraph 6(*a*) of the *Protocol,* as renumbered in 1956, defines "rentals and royalties" as follows:

6. (*a*) The term "rentals and royalties" referred to in Article II of this Convention shall include rentals or royalties arising from leasing real or immovable, or personal or movable property or from any interest in such property. including rentals or royalties for the use of, or for the privilege of using, patents, copyrights, secret processes and formulae, good will, trade marks, trade brands, franchises and other like property:

Both the Tax Review Board [76 DTC 1283] and the Trial Division of this Court [79 DTC 5297] held that the amounts here in question did not fall within the wording of section 106 or 212 of the *Income Tax Act.* The Trial Division also held that the amounts did not fall within the meaning of "rentals and royalties" as defined in the *Protocol* to the *Convention* and were exempt under its provisions.

Assuming that the wording of subparagraph (1)(*d*)(i) of sections 106 and 212 is to have its full scope and is not to be restricted because of the presence of the subparagraphs which follow it, I am not satisfied that the provision is not broad enough to include the payments in question. It is not easy for a payment of the kind described to escape the definition of "any payment . . . for the use of or for the right to use in Canada any property . . . or other thing whatever". But I do not think it is necessary to reach a definite conclusion on the point since the *Convention* must prevail and, if because of its provisions, Com/Code was not liable for Canadian income tax in respect of the amounts, that is the end of the matter.

[*Rentals and royalties*]

As the amounts in question were plainly industrial and commercial profits of Com/Code they were exempted under the broad language of Article I of the *Convention* and could only be made subject to the Canadian

[1] [1969] 2 Ex. C.R. 175 [69 DTC 5204 and 5212]—Affirmed [1971] S.C.R. (vi) [71 DTC 5068].

[2] See *The Canada-United States of America Tax Convention Act, 1943,* Statutes of Canada 1943-44, c. 21.

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non-resident tax if they fell within the exception from industrial and commercial profits provided in Article II with respect to "income in the form of rentals and royalties". Moreover, the amounts could only be "income in the form of rentals and royalties" if they fell within the definition of "rentals and royalties" in the *Protocol.*

That definition appears to be intended to expand the scope of what would be covered by the ordinary meaning of rentals and royalties but it seems to me that the expansion is not in the meaning of the words but is by reference to the sorts of things in respect of which the rentals and royalties are paid. The expression is to include "rentals or royalties" from leasing both real or immovable and personal or movable property (all apparently of a corporeal nature) and is to include as well "rentals or royalties" for the use of or for the privilege of using a list of items of incorporeal property. Nowhere, however, is there any wording which could have the effect of expanding the definition by including payments that do not have the characteristics ordinarily associated with rentals or royalties. It was submitted for the appellant that the use of the words "or for the privilege of using" expanded the meaning but I do not think that is so. The wording is apt with respect to rentals[1] while the wording "for the use of" is apt with respect to royalties. There is therefore no justification for interpreting the definition so as to distort the ordinary meaning of either word.

In my opinion what Com/Code gave and the respondent received under the contract cannot be regarded as the use of or the privilege of using "patents, copyrights, secret processes and formulae, goodwill, trade marks, trade brands (or) franchises" within the meaning of the definition but it seems to me to be conceivable that it might fall within the meaning of "other like property". (Compare *Western Electric Co. v. M.N.R. supra.*) However, assuming that it does, I do not think that the payments made by the respondent can be regarded as "rentals or royalties" for its use or for the privilege of using it.

The payments have none of the characteristics of rentals or royalties. The word "rental" is not a familiar one to use in connection with property rights of the kinds enumerated but I see no reason to think that when used in reference thereto it would connote characteristics different from those it has in its more familiar use in relation to tangible property. A rental can, of course, be paid in a lump sum but in my opinion the word is inseparable from the connotation of a payment for a term, whether fixed in time or determinable on the happening of an event or in a manner provided for, after which the right of the grantee to the property and to its use reverts to the grantor. "Royalties", though a broad term, when used in the sense of a payment for the use of property, connotes a payment calculated by reference to the use or to the production or revenue or profits from the use of the rights granted. In Jowitt's Dictionary of English Law the term is defined thus:

> Royalty, a payment reserved by the grantor of a patent, lease of a mine or similar right, and payable proportionately to the use made of the right by the grantee. It is usually a payment of money, but may be a payment in kind, that is, of part of the produce of the exercise of the right. See RENT.
>
> Royalty also sometimes means a payment which is made to an author or composer by an assignee of licensee in respect of each copy of his work which is sold, or to an inventor in respect of each article sold under the patent.[2]
>
> . . .

Neither "rentals" nor "royalties", in the ordinary connotation, in my opinion, includes a lump sum payment for the use of or for the privilege of using property indefinitely.

It seems to me as well that the repetition of the expression "rentals or royalties" in the definition, which, with deference, appears to me to have an unusual grammatical construction, indicates that the authors had in mind that what was being dealt with was the taxation of income, as opposed to capital, and that the expression "rentals or royalties" is used, rather than "any payment", in order to ensure that no

[1] *Vide* Stroud's Judicial Dictionary Fourth Edition, p. 2328:
Rent: It has been said that the primary meaning of "rent" is the sum certain, in gross, which a tenant pays his landlord for the right of occupying the demised premises (see C. Litt 96 a, 141 b. 142 a; Jacob; Elph.; Woodfall).

[2] See also *M.N.R. v. Wain-Town Gas & Oil Co. Ltd.* [1952] 2 S.C.R. 377, per Kerwin J. (as he then was) at p. 382 [52 DTC 1138 at p. 1140].

payment that would not have the characteristics of "rentals or royalties" would be included.

Here there was no limit as to time with respect to use or the right to use. Nor were the payments proportionate to or in any way related to use or extent of use or to revenues or profits therefrom or to a period of use. The right to use the information and to keep the physical objects supplied by Com/Code, as well as what was produced by using them in the computer, continued in the respondent indefinitely.

It follows, in my view, that the payments were not rentals or royalties within the meaning of the Convention and Protocol and that Com/Code was not liable to non-resident tax in respect of them.

[*Appeal dismissed*]

The appeal therefore fails and it should be dismissed with costs.

RYAN, J.: I agree.

KERR, D.J.: I agree.

Her Majesty The Queen (Plaintiff) v. Guy Dumas (Defendant).

Federal Court—Trial Division, July 4, 1980. (Received from the Court, July 15, 1980.)

Capital gain or income—Taxpayer incorporated a company which then purchased land—Intention to build shopping centre—No major tenant available—Unsolicited offers to buy the land—Shares of taxpayer's company sold at profit—Profit considered income by Minister—Profit was income—Income Tax Act, R.S.C. 1952, c. 148, ss. 3, 4 and 139(1)(e). (See S.C. 1970-71-72, c. 63, ss. 3, 9(1), 38, 39, 40 and 248.1.)

This was an appeal from a decision of the Tax Review Board (78 DTC 1704) which allowed the taxpayer's appeal from his income tax assessment for the years 1969, 1970, 1971 and 1972. In 1961 the taxpayer incorporated V Ltd. which in 1968 purchased a parcel of land in order to develop a shopping centre. The taxpayer was unable to obtain a major tenant for the shopping centre and therefore, in November 1969, sold all his shares in V Ltd. for a profit of $199,486 which the Minister classed as income. The Tax Review Board allowed the taxpayer's appeal on the ground that the property had been purchased by the taxpayer solely for the purpose of erecting a shopping centre. The profit was accordingly held to be a capital gain. The Crown appealed to the Federal Court—Trial Division.

***Held:* The Crown's appeal was allowed. The taxpayer's intentions were not only those declared by him but also those which could be inferred from the circumstances surrounding the transaction. When he purchased the land, the taxpayer knew that if his plans for the land did not succeed, he could sell the land at a profit. He knew that his venture was risky. The profit realized was income in the hands of the taxpayer. The Crown's appeal was therefore allowed.**

Counsel: J. Delage for the plaintiff; J. Marier for the defendant. Solicitors: Monet, Hart, Saint-Pierre & Des Marais for the plaintiff; Létourneau, Stein, Marseille, Délisle & Larue for the defendant.

Before: Dubé, J.

LE JUGE DUBÉ: Il s'agit ici de l'appel d'une décision de la Commission de révision de l'impôt [78 DTC 1704] maintenant l'appel du contribuable relativement aux cotisations du Ministre pour les années d'imposition 1969, 1970, 1971 et 1972.

Le défendeur est un entrepreneur en construction domiciliaire de la région de Québec. En 1961 il forma la compagnie Villeneuve Construction Ltée ("Villeneuve") laquelle fit en 1968 l'acquisition d'un terrain appartenant à la Corporation des Frères des Ecoles Chrétiennes du Québec au prix de $1,385,650. Le 6 novembre 1969 le défendeur vendait toutes ses actions dans Villeneuve à M. Raymond Malenfant, un autre homme d'affaires de Québec, réalisant, selon le Ministre, un profit net de $199,486.85.

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