1961
Jan. 26, 30
Feb. 23

BETWEEN:

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

SUNBEAM CORPORATION (CANADA) LIMITED ..... RESPONDENT.

Revenue—Income—Income tax—Income Tax Act 1948, s. 37 enacted by Statutes of Canada 1952, c. 29, s. 13—The Income Tax Act, R.S.C. 1952, c. 148, s. 40—Income Tax Regulations 400, 401, 402, 411(1)(a)(b), (2)—Provincial tax credit—"Permanent establishment"—Requirements to constitute a permanent establishment—"Warehouse"—"Use of substantial machinery or equipment"—Appeals allowed.

In its income tax returns for the years 1952, 1953 and 1954 respondent deducted from the tax otherwise payable by it, an amount in respect of the taxable income earned by it in those years in the Province of Quebec. It claimed that it was entitled to do so for 1952 by virtue of s. 37 of the 1948 *Income Tax Act* and for 1953 and 1954 under the provisions of s. 40 of the *Income Tax Act* R.S.C. 1952, c. 148. Sections 400, 401 and 402 of the *Income Tax Regulations* are applicable to the 1952 and subsequent taxation years and provide *inter alia* that the Province of Quebec is the province prescribed for the purpose of s. 40 of the Act and that "where, in a taxation year, a corporation had no permanent establishment outside the province, the whole of its taxable income for the year shall be deemed to have been earned in the province" and "where, in a taxation year, a corporation had no permanent establishment in the province, no part of its taxable income for the year shall be deemed to have been earned in the province". Section 411(*a*) of the Regulations defines "permanent establishment" and section 411(*b*) provides "where a corporation carries on business through an employee or agent who has general authority to contract for his employer or principal or has a stock of merchandise from which he regularly fills orders which he receives, the said agent or employee shall be deemed to operate a permanent establishment of the corporation".

The Minister re-assessed respondent for its income tax for the taxation years in question by adding the amount which it had deducted.

Respondent is a company incorporated under the laws of Canada with its head office in Toronto, Ontario, where it manufactures a number of electrical appliances which are sold throughout Canada, including the Province of Quebec. In each of the taxation years in question it was within the prescribed class of corporation referred to in the Regulations and in each year paid taxes to the Province of Quebec. Its sales are made exclusively to wholesale distributors throughout Canada and during the years in question employed four full-time sales representatives at Vancouver, Winnipeg, Toronto and Montreal. It had goods stored in a public warehouse in Quebec and also hired an agent there who established an office of his own in his residence in a residential section of the city, received a stock of displays and mechanical adver-

tising devices, and stored them in the part of his home set aside for office use. He was paid a commission on net shipments made into Quebec with a guaranteed minimum annual amount. He was under no contractual obligation to establish such an office, the telephone directory did not list the employee's own residential telephone under the name of the corporation and there was no business sign on any part of the premises, nor did the agent pay business tax. He had no general authority to contract for his employer or to accept purchase orders.

Held: That the appeal must be allowed.

2. That the office established by the employee or agent was merely the office of the employee or agent and not that of the taxpayer respondent.

3. That for a warehouse to constitute a permanent establishment as per the Regulations it is necessary that the warehouse be in some manner under the control of the taxpayer and respondent had no control over the placement of its goods in the warehouse nor any control over the warehouse itself other than delivering goods to it and ordering goods shipped from it; therefore respondent did not have a "warehouse" within the province as provided in Regulation 411(1)(*a*) and therefore had no "permanent establishment".

4. That the provision in Regulation 411(2) that "the use of substantial machinery or equipment in a particular place at any time in the taxation year shall constitute a permanent establishment in that place for the year" refers to the "use" of heavy or large machinery or equipment by such persons as contractors or builders and placing samples of a total value from $4,000 to $11,000 with the sales representative who used them in live demonstrations to wholesalers and in retail stores and in training demonstrators did not constitute a use of substantial machinery or equipment by respondent.

APPEAL from the *Income Tax Act.*

The appeal was heard before the Honourable Mr. Justice Cameron at Toronto.

E. A. Goodman, Q.C. and *J. D. C. Boland* for appellant.

J. A. F. Miller, Q.C. and *J. A. Langford* for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

CAMERON J. now (February 23, 1961) delivered the following judgment:

This is an appeal by the Minister of National Revenue from a decision of the Income Tax Appeal Board dated June 19, 1958, which allowed the appeals of the respondent from re-assessments made upon it for its taxation years ending on December 27, 1952, December 26, 1953, and March 27, 1954. In its returns for those years, the respondent deducted from the tax otherwise payable by it, an

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amount in respect of the taxable income earned by it in the said years in the province of Quebec. The respondent claimed that it was entitled to make such a deduction for its 1952 taxation year under the provisions of s. 37 of the 1948 *Income Tax Act*; and for the 1953 and 1954 taxation years under the provisions of s. 40 of the *Income Tax Act*, c. 148, R.S.C. 1952.

Section 37 of the 1948 *Income Tax Act*, as enacted by s. 13 of c. 29, Statutes of Canada, 1952, and made applicable to the 1952 and subsequent taxation years, is as follows:

37. (1) There may be deducted from the tax otherwise payable by a corporation under this Part for a taxation year an amount equal to 5% of the corporation's taxable income earned in the year in a province prescribed by a regulation made on the recommendation of the Minister of Finance.

(2) In this section, "taxable income earned in the year in a province" means the amount determined under rules prescribed for the purpose by regulations made on the recommendation of the Minister of Finance.

Section 40, c. 148, R.S.C. 1952, as amended by Section 59(1), c. 40, of the Statutes of Canada for 1952-53 and made applicable to the 1953 and subsequent taxation years, reads as follows:

40. (1) There may be deducted from the tax otherwise payable by a corporation under this Part for a taxation year an amount equal to

(*a*) in the case of a corporation of a class prescribed by a regulation made on the recommendation of the Minister of Finance for the purposes of this paragraph, 5%, and

(*b*) in the case of any other corporation, 7%, of the corporation's taxable income earned in the year in a province prescribed by a regulation made on the recommendation of the Minister of Finance.

(2) In this section, "taxable income earned in the year in a province" means the amount determined under rules prescribed for the purpose by regulations made on the recommendation of the Minister of Finance.

In the re-assessments now under consideration, the Minister wholly disallowed the deductions claimed on the ground that the respondent did not have a permanent establishment in the province of Quebec in any of the taxation years in question. In so doing, the Minister relied, as he now does, on the *Income Tax Regulations*.

Sections 400, 401 and 402 of the *Income Tax Regulations*, as applicable to the 1952 and subsequent taxation years, were enacted by PC 1953-255 of February 19, 1953. Those sections were later amended by PC 1953-1773 of November 19, 1953, mainly in order to substitute references to

s. 40 of c. 148, R.S.C. 1952, for the original references to s. 37 of the 1948 *Income Tax Act*. These sections, as amended, are in part as follows:

400. (1) The Province of Quebec is the province prescribed for the purpose of section 40 of the Act.

(2) For the purpose of paragraph (*a*) of subsection (1) of section 40 of the Act, the following classes of corporations are prescribed:

(*a*) corporations that are taxable under the provisions of section 3 of the Quebec Corporation Tax Act and that are not taxable under the provisions of section 6 of the Quebec Corporation Tax Act, and

(*b*) —(not applicable)—

401. For the purpose of subsection (2) of section 40 of the Act, the amount of taxable income earned in a taxation year in a province shall be determined as hereinafter set forth in this Part.

402. (1) Where, in a taxation year, a corporation had no permanent establishment outside the province, the whole of its taxable income for the year shall be deemed to have been earned in the province.

(2) Where, in a taxation year, a corporation had no permanent establishment in the province, no part of its taxable income for the year shall be deemed to have been earned in the province.

Subsections (3) and (4) are rules for determining the amount of the taxable income earned in the year in the province (Quebec) where a corporation had a permanent establishment in that province and a permanent establishment outside that province. It is unnecessary to refer to them in detail as the parties are agreed that the deductions claimed by the respondent in each of the years in question have been computed in accordance with such rules.

The respondent is a company incorporated under the laws of Canada, having its head office at Toronto, in the province of Ontario. It manufactures there a number of electrical appliances which are sold throughout Canada, including the province of Quebec. During each of the years in question, it was within the prescribed classes of corporations referred to in s-s. 2(*a*) of Regulation 400 (*supra*), and in each year paid taxes to the province of Quebec.

The sole question for determination in this appeal is whether the respondent for the years in question had, or had not, a "permanent establishment" in the province of Quebec. If that question is answered in the negative, then by s. 402(2) of the *Income Tax Regulations* "No part of its taxable income for the year shall be deemed to have been earned in the province", and it follows that the deductions claimed must be disallowed.

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Section 411 of the Regulations reads in part as follows:

411. (1) For the purpose of this Part,

(*a*) "permanent establishment" includes branches, mines, oil wells, farms, timber lands, factories, workshops, warehouses, offices, agencies, and other fixed places of business;

(*b*) where a corporation carries on business through an employee or agent who has general authority to contract for his employer or principal or has a stock of merchandise from which he regularly fills orders which he receives, the said agent or employee shall be deemed to operate a permanent establishment of the corporation;

The facts are not in dispute, the only evidence adduced being that of Leo Fitzpatrick (sales-manager of the respondent during the years in question) and that of C. H. Dyke (a former salesman of the respondent who no longer is in its employ). The respondent manufactures electrical appliances, animal clipping and shearing machines, garden and lawn equipment, and parts thereof, at its Toronto plant. Its sales are made exclusively to wholesale distributors throughout Canada and during the years in question it employed four full-time sales representatives at Vancouver, Winnipeg, Toronto and Montreal.

Exhibit 2 is the contract entered into on March 31, 1952, with J. B. Comtois, its salesman at Montreal. His territory included the province of Quebec and all four Maritime provinces. The contract was to run from March 31, 1952, to December 27, 1952, but was subject to renewal, and Comtois remained as the respondent's sales representative in that area until February 10, 1953. By the terms of the contract he was to be paid a commission "on net shipments into your territory" on the basis set out, but by the terms of the yearly guarantee, "You will be guaranteed $7,000 per annum out of which you will pay all of your own expenses". Other terms of the agreement were as follows:

All demonstrations involving Company expense must be approved by us before arrangements are concluded. In the event any demonstrators are employed with our approval in the above territory, we will pay such demonstrator expense ourselves. However, in the event the total of such demonstration expense in the fiscal year exceeds one-half of 1% of the net shipments into the above territory, we will charge you for the excess cost beyond one-half of 1%. It is understood that the cost of any merchandise given away by you is to be charged, at distributor prices, one-half to ourselves and one-half to you; and that such charge will be deducted from such commissions due you. It is understood that the giving of such merchandise must meet with our approval in each case. All arrangements for such demonstrations and their carrying to conclusion are to be attended to by you, after approval has been given.

Should any junior salesmen be employed in your territory, they will be employed only on our authorization, and we will pay such junior men a stipulated weekly salary and a fixed expense allowance which we may, however, from time to time increase or diminish. Should such juniors be required by you to do any special work which incurs expenses beyond those authorized and fixed by us, such expenses are to be paid by you.

You agree to devote your entire time, best effort, and full and undivided attention to the sale of our products as specified, in the territory outlined above; you further agree to follow our instructions and expressed wishes in carrying out this work.

Exhibit 1, dated April 10, 1953, is a copy of the contract of employment between the respondent and the witness, Colin Dyke, who followed Mr. Comtois as sales representative at Montreal. But for the differences in dates and the amount of the guaranteed income, it is in the same form as Exhibit 2. His employment commenced on April 12, 1953, and while the contract expired on December 26, 1953, it was continued to July, 1956.

Mr. Dyke stated that there was no agreement with the respondent by which he was required to set up an office, but he found it convenient to do so as "I had to have an office to conduct business". Immediately after his appointment, he purchased at his own expense desks, filing cabinets, a typewriter, etc., and put them in the basement of his residence at 35 Riverside Drive, St. Lambert—a municipality to the south of the St. Lawrence River and opposite the city of Montreal. This equipment remained his property throughout and he received no compensation for it. The respondent paid him no rent for the use of any part of his home. It did, however, supply him with company stationery and literature, price sheets, catalogues, sales promotion material, and inter-office memoranda. He also was supplied with substantial quantities of samples of the respondent's products to be used in demonstrations and in promoting sales, the value of which samples varied from $4,700 to $11,000. His home was in a residential part of St. Lambert and no business tax was paid by anyone in respect of the operations carried on there. The telephone directory did not list Dyke's residence as the respondent's place of business and there was no business sign of any sort on the premises. The respondent did supply him with calling cards showing that he was their representative.

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About 20 to 25 per cent. of the total sales of the respondent were to distributors in the province of Quebec, including Montreal. The main duty of Mr. Dyke was to call on some twenty-five wholesalers in that province, demonstrate his samples and endeavour to secure orders. When an order was received, he had no authority to accept it; he merely forwarded it to Toronto and, if accepted there, the goods were shipped direct to the purchaser. Other duties of Mr. Dyke were to secure and train demonstrators and to arrange for and supervise live demonstrations of the respondent's goods at department and hardware stores. The demonstrators were interviewed and trained at his residence and at times Mr. Dyke took orders for goods at his home. He was responsible for the telephone charges except for long distance calls.

Mr. Comtois was not called as a witness, but it is apparent from the evidence of Mr. Fitzpatrick that there was no essential difference between his duties and operations and those of Mr. Dyke, except that Mr. Comtois used part of his residence on Twenty-Third Avenue, Rosemount, near the city of Montreal, and that the maximum value of the samples he had on hand was about $4,000.

Mr. Fitzpatrick also stated that in June, 1953, the respondent placed large quantities of its goods, valued at about $120,000, in the warehouse of Consolidated Warehouse Corporation in Montreal, and that orders for Quebec Province were regularly filled from that source from June, 1953 until November, 1953 when all had been shipped. Exhibit 3 is the invoice of that warehouse company to the respondent for storage space. Mr. Fitzpatrick stated that his company had no employees at that warehouse, but the handling of goods there was carried out by the warehouse personnel; that the respondent had no control over any part of the warehouse, its goods being placed as desired by the warehouse company, and that the public would have no knowledge that the respondent's goods were stored there. The goods of many other persons were also stored in the same warehouse.

The onus of proving that the assessments under appeal are incorrect either in fact or in law is upon the taxpayer (see *M.N.R. v. Simpson's Ltd.*[1]).

[1] [1953] Ex. C.R. 93.

The first submission is that on the facts which I have stated, it should be found that the respondent had "a permanent establishment" in the province of Quebec because it had "a branch . . . office . . . agency . . . warehouse . . . or other fixed place of business" there (s. 400(1)(*a*) of the Regulations). It is suggested that as the deductions were authorized in order to limit somewhat the effect of double taxation, those words should be construed liberally. In *Lumbers v. M.N.R.*[1]—a decision of the President of this Court—it was held:

> That the exemption provisions of a taxing act must be construed strictly and a taxpayer cannot succeed in claiming an exemption from income tax unless his claim comes clearly within the provisions of some exemption section of the Income War Tax Act; he must show that every constituent element necessary to the exemption is present in his case and that every condition required by the exemption section has been complied with.

That judgment was affirmed by the Supreme Court of Canada[2].

In my opinion, the respondent did not have a branch, office, agency or other fixed place of business (excluding for the moment consideration of the word "warehouse") in the province for any of the years in question. All that was done by the contracts (Exhibits 1 and 2) was to appoint a sales representative and provide for his duties and remuneration. There was no provision that the respondent would provide an office for the sales representative. It was entirely a matter for him to decide whether or not he would have an office and where it would be located. Each of the two agents did establish an office in his own home, but that was his office, equipped with his own furniture and maintained entirely for his own use and at his own expense. Had he so desired, the sales representative could have moved his office to any other suitable location without the consent of the respondent. The contracts of employment permitted either party to terminate the agreement arbitrarily by giving two weeks' notice to the other party. The offices so established by the sales representatives for their own convenience were in reality their offices and not those of the respondent.

[1] [1943] Ex. C.R. 202. [2] [1944] S.C.R. 167.

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Reference may be made to *Grant v. Anderson & Co.*[1] The headnote is in part as follows:

Order XLVIII. A., r. 1, provides that persons liable as co-partners and carrying on business within the jurisdiction may be sued in their firm name, and rule 3 of the same order provides for service of the writ in such cases at the principal place within the jurisdiction of the business of the partnership upon any person having the management of the business there.

The defendants were a firm of manufacturers carrying on business in Glasgow, all the members of which were domiciled and resident in Scotland. They employed an agent in London to procure orders for them on commission. For that purpose he occupied an office in London, the rent of which he paid himself, and at which he kept samples of the defendants' goods. His duty was to receive and transmit orders to the defendants at Glasgow, and he had no authority to conclude contracts for the defendants, except upon express instructions. A writ was issued against the defendants in the name of their firm, and served upon the agent at the above-mentioned office:—

Held, by the Court of Appeal (affirming the Queen's Bench Division), that the defendants did not carry on business, and had no place of business, within the jurisdiction, and therefore the writ and service must be set aside:—

In addition to the facts stated above, it seemed that the London agent (McCallum) occupied an office consisting of two small rooms (one of which was his sample room), the rent of which he paid himself. The name of his employer (the defendant) appeared on a brass plate at the entrance to the buildings and on a board on the stairs leading to the office (in each case with the agent's name underneath) and on the windows of the office.

All the learned Judges in the Court of Appeal agreed that the defendant had no place of business in London. At p. 116, Lord Esher M.R. said in part:

The defendants, who are Scotchmen, and who reside in Scotland and not in England, are manufacturers of flannels in Glasgow. The whole of their manufacturing appears to be done in Scotland. They are also of course sellers of the flannel which they manufacture. They employ a man named McCallum to obtain orders for them in London. For what he does, he is paid by them a commission, not on the orders obtained, but on the business done. If he gets an order which they accept, he gets a commission; but if they do not accept it, he gets no commission. When he gets an order, he has no power himself to accept it; all he has to do is to send it on to Scotland, that the defendants may say whether they will accept it or not; and in most cases, if they do accept it, they deal directly with the person giving the order. Again, the agent does not appear to deliver the goods, if the order is accepted. The goods are not always to be delivered in London. In the present case, the delivery of the goods was not in London, and McCallum had nothing to do with the matter except

[1] [1892] 1 Q.B.D. 108.

as regards sending on the order. His business is to obtain orders which are in law and in fact mere proposals. The defendants then consider whether they will accept them. If they do, they make a contract with the principal. McCallum, no doubt, has a good deal to do in this way for the defendants. He does not, in fact, obtain orders for other people, and it may very well be that by the terms of the arrangement he cannot and ought not to do so—at any rate for other flannel manufacturers. The amount of the commission he earns I dare say makes it worth his while to act only for the defendants. He cannot get orders without shewing samples; he therefore has taken two rooms in Milk Street, one of which he uses as an office, and the other as a small room in which he keeps the samples. The samples are the only things which are kept there. He pays the rent in respect of the rooms. It does not appear that it is essential that he should have an office at all. For aught we know he may keep the samples at his residence, or he may take an office where he pleases. What is the inference to be drawn from these facts? I agree with the view taken by the Divisional Court that this office is not the office of the defendants, but of McCallum only. Consequently the defendants have no place of business in London, and it follows that the writ could not be served at this office, and therefore the service is bad and must be set aside. Then, do the defendants carry on business in London? The only thing done for them in London is this obtaining of orders by McCallum. Is that carrying on business in London? It is doing an act which goes towards carrying on business. But we must deal with the expression "carry on business" as used in the rules in the ordinary business sense. One might as well say that the defendants carry on business in any place through which their goods pass while being sent to their customers. The same considerations, which shew that the office is not their office, go to shew that they do not carry on business in London. Therefore the writ was improperly issued, and must be set aside, as well as the service.

The respondent does not come within the provisions of s. 411(1)(*b*) of the Regulations (*supra*). It is therein provided that when a corporation carries on business through an employee or agent, the said agent or employee shall be deemed to operate a permanent establishment of the corporation, subject, however, to the requirements that such agent or employee must have general authority to contract for his employer or principal, or have a stock of merchandise from which he regularly fills orders which he receives. The evidence is clear that neither of these requirements was met at any time by the respondent's employees or agents, Comtois and Dyke.

A further submission on behalf of the respondent was that in any event it qualified for the deduction in its 1953 taxation year since in that year it had a warehouse in the province of Quebec and hence had a permanent establishment in that province (s. 411(1)(*a*) of the Regulations—*supra*). The salient facts on this point have already been

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stated. There can be no doubt that in that year the respondent did place a very substantial quantity of its goods in storage in a warehouse in the province of Quebec and paid the customary storage charges. But in order to qualify for the deduction thus claimed, the respondent must have *"had* a permanent establishment", namely, a "warehouse" in the province.

It seems to me that "to *have* a warehouse" implies having some measure of control over the warehouse. Here the exclusive control of the warehouse was by its owner—Consolidated Warehouse Corporation—the respondent having no control whatever over it. It will be recalled that the corporation could place the respondent's goods in any part of the building it desired or move them about in the building from time to time, and that all the work of storing, handling and shipping there was done by the Consolidated Warehouse Corporation personnel. As stated by Mr. Fitzpatrick, the respondent's only requirement was that the storage space to be used for the respondent's goods should be "good and dry". The only control held by the respondent was in respect of the goods stored, in that it retained ownership thereof and could direct the warehouse corporation to forward or deliver them from time to time to addresses furnished by the respondent. To use the facilities of another's warehouse for the storing of goods in the manner I have mentioned is, in my opinion, quite a different thing from "having a warehouse". In view of these findings, I am unable to agree with the submission that the respondent in its 1953 taxation year had a warehouse in the province.

Finally it is submitted that the respondent falls within s-s. (2) of s. 411 of the Regulations, which reads:

> 411. (2) The use of substantial machinery or equipment in a particular place at any time in a taxation year shall constitute a permanent establishment in that place for the year.

It is urged that the placing of samples ranging in value from $4,100 to $11,000 with the sales representatives and the use made of them in showing them to the wholesalers, and in live demonstrations to wholesalers and in retail stores, and in training demonstrators, was "the use of substantial machinery or equipment in a particular place at any time in a taxation year", and therefore constituted a "permanent establishment in that place in that year".

In my opinion, that section cannot be found to apply to the facts of this case. While some of the samples of the goods manufactured by the respondent and supplied to the sales representatives may perhaps fall within the category of "machinery and equipment", I do not think that they constitute "substantial machinery or equipment" or that their use for training demonstrators or for live demonstrations, or for exhibition to possible purchasers, of like goods, is such a "use" as is contemplated by the section. It seems to me that the section refers rather to the "use" of heavy or large machinery or equipment by such persons as contractors or builders who, as is well known, may move such equipment from one province to another in carrying out their normal operations.

For the reasons which I have stated, the appeals of the Minister for each of the years in question will be allowed, the decision of the Income Tax Appeal Board set aside and the re-assessments made upon the respondent will be affirmed. The appellant is also entitled to his costs after taxation.

Judgment accordingly.