Carrying On Business in Canada

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PRÉCIS

Un nombre important de non-résidents du Canada exercent leurs activités au Canada directement, par l'entremise de succursales. L'alinéa 2(3)b) de la Loi de l'impôt sur le revenu prévoit qu'une personne qui n'a pas résidé au Canada durant une année d'imposition mais qui «a exploité une entreprise au Canada» à tout moment durant cette même année ou durant une année antérieure verra son revenu imposable, gagné au Canada au cours de cette année, assujetti à l'impôt sur le revenu en vertu de la Partie I de la Loi. Dans la plupart des cas, il est nécessaire d'établir si une entreprise est exploitée au Canada pour déterminer s'il existe un établissement stable aux fins des conventions fiscales conclues par le Canada. Exception faite de la présomption figurant à l'article 253, la Loi est silencieuse sur ce qui constitue «l'exploitation d'une entreprise au Canada». Il est donc nécessaire de s'appuyer sur la jurisprudence abondante ayant trait à cette notion, tant au Canada qu'au Royaume-Uni. Le concept d'«exploitation d'une entreprise au Canada» demeure une question de fait et son sens varie en fonction du type de secteur et d'activité.

Cet article analyse la notion «d'exploitation d'une entreprise au Canada», telle qu'elle est définie dans la Loi et la jurisprudence du Canada et du Royaume-Uni. Les principes tirés de cette analyse sont ensuite appliqués à différentes activités commerciales. En raison des contraintes de longueur, l'article n'examine pas distinctement chacune des composantes fondamentales de cette notion, à savoir, les définitions des termes «Canada», «entreprise» et «exploitation d'une entreprise».

ABSTRACT

Non-residents of Canada carry on a considerable volume of business activities in Canada directly, through branch operations. Paragraph 2(3)(b) of the Income Tax Act provides that where a person who was not resident in Canada for a taxation year "carried on a business in Canada" at any time in the year or a previous year, income tax under part I of the Act shall be paid upon his taxable income earned in Canada for the year. Furthermore, a determination of carrying on business in Canada is in most cases necessary in order that one may ascertain whether a permanent establishment exists for the purposes of applying Canada's

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income tax conventions. The Act provides no indication, apart from a deeming rule in section 253, of what constitutes "carrying on business in Canada." Consequently, one must seek guidance from the substantial jurisprudence on this concept, both in Canada and in the United Kingdom. The determination of "carrying on business in Canada" is a question of fact. Its meaning therefore changes from one industry and activity to another.

This articles analyzes the concept of "carrying on business in Canada" as it has been defined in the Act and in the UK and Canadian jurisprudence. The principles derived from this analysis are then applied to various business activities. A detailed examination of the basic components of the concept—namely, the definitions of "Canada," "business," and "carrying on business"—is beyond the scope of this article.

INTRODUCTION

Although non-residents of Canada[1] typically operate in Canada through the intermediary of Canadian corporations, a considerable volume of their business activities in Canada is also carried on directly, in their own right, through branch operations. The importance of branch operations to the Canadian economy may be illustrated by the fact that, at the end of 1994, foreign direct investment in Canada amounted to $148 billion, of which 7 percent, or more than $10 billion, was in Canadian branch operations.[2] Considering that foreign-controlled enterprises earned 27.6 percent of all Canadian operating revenue in 1992,[3] a reasonable estimate is that 7 percent of such foreign-controlled revenue, or approximately 2 percent of all Canadian operating revenue, is earned annually by non-residents through Canadian branch operations.

[1] A reference to a "non-resident" in this article is a reference to a person, be he an individual, corporation, trust, or other recognized entity, who is not resident in Canada for Canadian tax purposes. For convenience, the generic pronoun "he" is used throughout this article.

[2] Statistics Canada, *Canada's International Investment Position, 1994*, catalogue 67-202, Minister of Industry Canada, 1995. For these purposes, "foreign direct investment" is considered to represent the book value, at a point in time, of long-term capital owned by foreign direct investors in subsidiaries, affiliates, and branches in Canada, which are referred to as foreign direct investment enterprises. The size and nature of this investment allow the investor, on a lasting basis, to influence or to have a voice in the management of the foreign direct investment enterprise in Canada. This investment is normally identified by ownership of at least 10 percent of the equity of the foreign direct investment enterprise in Canada. Statistics Canada calculates foreign direct investment (as well as foreign direct investment in Canadian branches of foreign corporations) by adding the net amount of yearly foreign direct investment to the stock outstanding at the end of the previous year. The stock outstanding is at book values. The market valuation should therefore result in substantially higher amounts since many of these investments have been in existence for several years.

[3] Statistics Canada, *Foreign Control in the Canadian Economy 1989 to 1992*, catalogue 61-220.

Paragraph 2(3)(b) of the Income Tax Act[4] provides that where a person who was not resident in Canada for a taxation year "carried on a business in Canada" at any time in the year or a previous year, income tax under part I of the Act shall be paid upon his taxable income earned in Canada for the year.[5] This basic rule of Canadian tax liability, which gradually developed through the common law and legislative experimentation, represents an internationally accepted compromise between two recognized principles of international taxation: the first of these is the right of the country of income origin to tax the proceeds of business activities carried on within its boundaries, and the second is the right of the country of residence of the taxpayer to tax his total income, no matter where it originates.

Although Canada's income tax conventions generally provide that the profits of a person residing in one state shall be taxable in another state only to the extent of profits attributable to a permanent establishment situated in the other state, the concept of "permanent establishment" is basically defined for such purposes as a fixed place of business through which the business of an enterprise is wholly or partly carried on.[6] Accordingly, it is necessary to determine whether a business is carried on in Canada in order to determine whether a permanent establishment exists for treaty purposes.

The scope of this article is limited to an analysis of the concept of "carrying on business in Canada" as it has been defined in the Act and in the UK and Canadian jurisprudence.

In order to establish whether a non-resident is carrying on business in Canada in such a way as to become subject to Canadian income tax under the Act, it is necessary to determine, in the first place, whether he "carries on a business" and, in the second place, whether he carries on that business "in Canada." In other words, there must be a "business" (as opposed to an employment or a passive undertaking giving rise to property income or capital gains);[7] the business must be "carried on" (that is,

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[4] RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act.

[5] For these purposes, subparagraph 115(1)(a)(ii) and paragraph 115(1)(c) provide that such "taxable income" is computed as if the non-resident had no income or losses, respectively, other than "from business carried on by him in Canada." Because of the use of the words "or a previous year" in paragraph 2(3)(b), a non-resident is subject to tax on his Canadian source business income even if that income is not realized until, or is deferred to, a year in which he is no longer carrying on business in Canada.

[6] See, for example, article 5(1) of Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (Paris: OECD) (looseleaf). The Canadian government has negotiated most of Canada's income tax conventions on the basis of this model.

[7] The term "business," as defined in subsection 248(1), includes a profession, calling, trade, manufacturing operation, or undertaking of any kind whatever and, generally, an adventure or concern in the nature of trade, but does not include an office or employment.
(The footnote is continued on the next page.)

it must be habitually or systematically exercised);[8] and the business must be carried on "in Canada" (within the geographical boundaries of Canada and according to jurisprudential and statutory situs rules).[9] These basic conditions, applied in the UK context, were stated as follows in *Werle v. Colquhoun*:

> It is a question of fact which is divided into two. Is there a trade carried on and, if so, is that trade carried on in England?[10]

The Act provides no indication, other than a deeming rule contained in section 253 (discussed below), of what constitutes "carrying on business in Canada." Consequently, one must resort to the principles that have

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[7] Continued . . .
The scope of the meaning of the term "business" may best be delineated by distinguishing this source of income from the other traditional sources—that is, employment, capital gains, and property. For additional information, see John Durnford, "The Distinction Between Income from Business and Income from Property, and the Concept of Carrying On Business" (1991), vol. 39, no. 5 *Canadian Tax Journal* 1131-1205.

[8] In order to determine whether a non-resident is carrying on business in Canada, it must first be ascertained that he is "carrying on business." Although the phrase "carrying on business" is used in numerous provisions of the Act, its primary use is still arguably in the context of establishing the jurisdictional origin of business income in the expression "carrying on business in Canada." The phrase "income from a business in Canada" is at best ambiguous; therefore, the Act usually refers to a business that is "carried on" in a particular place when it wishes to distinguish the territorial origin of business income. In *Tara Exploration*, infra footnote 153, it was held that an adventure in the nature of trade does not constitute "carrying on business" because it does not involve continuity of time or operations. However, this conclusion seems to apply only to isolated transactions that are not part of the taxpayer's ordinary business. In all other cases, it appears that activities that constitute a "business" are considered to be "carried on" for the purposes of the Act. For additional information, see Durnford, supra footnote 7.

[9] In order for a non-resident to "carry on a business in Canada," it is essential, as a preliminary condition, that his business be carried on within the territorial boundaries of "Canada" for Canadian tax purposes. Since the geographical land mass of Canada is precisely defined and not in dispute, the issues concerning the determination of the territorial boundaries of "Canada" for these purposes relate principally to those businesses that operate along Canada's coastlines. These issues are partially resolved by the statutory extension of the definition of "Canada" provided in section 255, which declares that, for the purposes of the Act, the term "Canada" includes and has always included the sea bed and subsoil of the submarine areas adjacent to the coasts of Canada (basically Canada's continental shelf) in respect of which the government of Canada or of a province grants a right, licence, or privilege to explore for, drill for, or take any minerals, petroleum, natural gas, or any related hydrocarbons, as well as the seas and airspace above the submarine areas in respect of any activities carried on in connection with the exploration for or exploitation of the minerals, petroleum, natural gas, or hydrocarbons. Generally, it may be concluded that the expression "in Canada," for Canadian income tax purposes, means Canada's land mass and bordering oceans, including the overlying airspace and underlying seabed, to 12 nautical miles from Canada's coasts, and extends to the farther edges of the continental shelf, but only in respect of the activities referred to in section 255 of the Act. For further information, see H. Heward Stikeman, ed., "In Canada," *Canada Tax Letter*, no. 308 (Scarborough, Ont.: Carswell, November 20, 1979), and "In Canada—An Update," *Canada Tax Letter*, no. 314 (Scarborough, Ont.: Carswell, March 10, 1989); see also the decision in *Mersey Seafoods Limited v. MNR*, 85 DTC 731 (TCC).

[10] (1888), 2 TC 402, at 408 (CA), per Esher M. The facts of this case are discussed below.

evolved over more than a century from the substantial jurisprudence on this concept, both in Canada and in the United Kingdom.[11]

MEANING DEVELOPED UNDER COMMON LAW

Question of Fact

The territorial situs of a business is a question of fact that must be determined on an examination of all of the circumstances surrounding each case. This principle was established by the English Court of Appeal in *Erichsen v. Last*, as follows:

> [It] would be first of all nearly impossible and secondly wholly unwise to attempt to give an exhaustive definition of when a trade can be said to be exercised in this country. The only thing that we have to decide is whether upon the facts of this case it can be said that this Company is carrying on a profit earning trade in this country.[12]

This view was confirmed by the English House of Lords in *Firestone Tyre & Rubber Co., Ltd. v. Lewellin (HM Inspector of Taxes)*, as follows:

> The question whether a trade has been exercised within the United Kingdom is a question of fact in this sense, that, although the law must rule whether any given set of the facts can amount to such an exercise, it is for the Special Commissioners, within those limits, to decide in the particular case before them whether a trade has or has not been so exercised. That done, there remains only the question whether they made any error of law in the decision that they came to.[13]

The courts of the United Kingdom and Canada have been called upon to determine the territorial situs of a business in numerous factual situations and, in so doing, have ascertained the indicia that, in their view, link a business to a particular place. Thus, although it remains a question of fact, it is possible to determine the territorial situs of a business in most circumstances by applying these criteria to the facts in issue in order to determine the place or places[14] where a business is carried on.

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[11] Caution should be exercised in relying on the UK jurisprudence on this subject. One reason is the existence of section 253 of the Act (discussed below), which has no counterpart in the UK legislation and which substantially modifies the case law in this area. Another reason is that the English decisions on this matter are based on statutory wording that differs somewhat from the wording used in the Act. Nevertheless, owing to the similarity of certain terms used in the Act ("business" and "carrying on business in Canada") to the corresponding terms used in the UK Income Tax Act ("the UK Act") ("trade" and "exercising trade within the United Kingdom"), it is suggested that decisions interpreting the English terms may be instructive in considering the meanings of the corresponding Canadian terms. Indeed, in *Grainger and Son v. Gough (Surveyor of Taxes)* (1896), 3 TC 462, at 472 (HL), Lord Morris stated that the term "exercising a trade," under the UK Act, is merely another way of expressing "carrying on a business." Although this analogy was not directed to the Canadian taxing provisions, it does indicate the similarity between the two expressions, which renders the English decisions useful, if not authoritative, for purposes of the present analysis.

[12] (1881), 4 TC 422, at 425 (CA), per Brett LJ.

[13] (1957), 37 TC 111, at 141 (HL), per Lord Radcliffe.

[14] In the following cases, it was held that a business may be carried on in more than one place: *Erichsen*, supra footnote 12; *Werle*, supra footnote 10; and *International Harvester*, infra footnote 105, at 351.

Carrying On Business "with" Rather Than "in" Canada

Since only the income derived by a non-resident from carrying on business "in Canada" is taxable under the Act, a preliminary distinction must be drawn between carrying on business "in" Canada and carrying on business "with" Canada. While the former results in Canadian tax liability, the latter does not. This fundamental distinction was first promulgated by Lord Herschell in *Grainger*, as follows:

> [T]here is a broad distinction between trading *with* a country, and carrying on a trade *within* a country. Many merchants and manufacturers export their goods to all parts of the world, yet I do not suppose anyone would dream of saying that they exercise or carry on their trade in every country in which their goods find customers. . . . Something more must be necessary in order to constitute the exercise of a trade within this country.[15]

The nature of that "something more" has been explored in this and other cases in which the territorial situs of a business has been in issue. The discussion that follows examines the factors that the courts have considered pertinent in making this determination.

Common Law Factors

The common law courts have distinguished several factors that connect a business to a particular place. As many of the cases deal with the determination of carrying on business in the context of specific types of business activities, the various factors are examined below in relation to such activities.

The Place Where a Contract Is Made

Generally, the courts have emphasized that a business is carried on in the country where the essential or profit-producing contracts of the business (for example, contracts of sale) are habitually entered into. This factor is usually considered definitive in establishing the nexus between a business and a place, and it often provides a strong indication that the business is carried on in that place.

The place where a contract is made was originally established as the chief factor in determining the territorial situs of a business by the British Court of Appeal in *Erichsen*.[16] The business in question was the Great Northern Telegraph Company of Copenhagen, which habitually made contracts in England for the receipt and transmission of telegraphs. It usually received payment in England for messages sent from abroad. It maintained an office, agent, and employees in England, and two of its telegraph wires terminated there. The Master of the Rolls and Brett LJ both found that the non-resident company exercised a trade within the United Kingdom. However, unlike the Master of the Rolls, Brett LJ concluded that the determining factor in this regard was the place where the contracts were made:

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[15] Supra footnote 11, at 467.

[16] Supra footnote 12.

> [W]herever profitable contracts are habitually made in England by or for a foreigner with persons in England, because those persons are in England, to do something for or supply something to those persons, such foreigners are exercising a profitable trade in England, even although everything done by or supplied by them in order to fulfil their part of the contract is done abroad.[17]

The British Court of Appeal was again seized with this problem a few years later in one of the so-called wine cases, *Werle v. Colquhoun*.[18] In that case, French wine merchants had agents in England who solicited orders there and were paid by commission there. The contracts were made in England, and the deliveries were made f.o.b. directly to the English customers. Furthermore, the French merchants were listed in the London directory. Quoting with approval the above statement of Brett LJ in *Erichsen*, Esher M concluded that the French wine merchants exercised a trade within the United Kingdom on the sole basis that the contracts of sale, which in his opinion constituted the foundation of the wine trade, were entered into there:

> I have not a doubt that here there was a trade carried on in England, because the contracts were made in England. The making of a contract in such business as this is the whole substance and essence of a trade, and therefore the Appellants carry on business in England.[19]

Both Fry LJ and Lopes LJ agreed with Esher M's conclusion, although they expressly avoided specifying which factor was conclusive; in the words of Fry LJ:

> Now, putting all those facts together, and I repeat without attempting to determine which of them are essential, if any are. . . .[20]

This issue was considered for the first time by the House of Lords in the most famous of the wine cases, *Grainger and Son v. Gough (Surveyor of Taxes)*.[21] Grainger and Son was an English firm that was commissioned to solicit orders in England on behalf of a French wine merchant. The English firm took orders from English clients and transmitted them to the French merchant, who decided whether to accept them or not. The firm was not authorized to accept the orders on behalf of the French merchant. All the contracts of sale were concluded in France. When an order was accepted, the wine was delivered directly to the English client, who made payment for it either to the English representative or directly to the French merchant. The French merchant's name and business were inserted in the London post office directory. In deciding this case, four of the five Lords held that the wine merchant was not exercising a trade within the United Kingdom, primarily on the basis that the contracts of sale were concluded in France. They arrived at this conclusion even though it was acknowledged

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[17] Ibid., at 425.

[18] Supra footnote 10.

[19] Ibid., at 412.

[20] Ibid., at 414.

[21] Supra footnote 11.

that the activities performed in England were essential to the success of the business.

It appears that this decision generally stands for the proposition that if the contract is entered into, delivery made, and payment received outside the United Kingdom, the business is not exercised in the United Kingdom. However, Lord Herschell confirmed that the place where the contract is entered into is the principal test of the situs of a business. He commented:

> In all previous cases contracts have been habitually made in this country. Indeed, this seems to have been regarded as the principal test, whether trade was being carried on in this country.[22]

Furthermore, in the subsequent English case of *Crookston Bros. v. Furtado*, Lord Dundas expressed the following conclusion on this decision:

> I consider that it follows by necessary implication from the opinions delivered by the noble and learned Lords in the important case of *Grainger & Son v. Gough* . . . that, if the contracts are concluded in this country, that fact alone will be sufficient to constitute an exercise of trade here.[23]

In *Wilcock v. Pinto & Co.*,[24] an Egyptian firm sold cotton in the United Kingdom through an individual residing in England. The contracts were made in England when the individual communicated the Egyptian firm's acceptance there. Payment was received by the individual in England, but delivery was made in Egypt. The Court of Appeal decided that the place of completion of the contract and the place of payment were more important connecting factors than the place of delivery, and accordingly held that the Egyptian firm was exercising a trade within the United Kingdom. In so doing, Scrutton LJ declared that

> the making of contracts in this country for the sale of goods by a non-resident through an agent is the exercising of a trade in this country.[25]

In *MacLaine & Co. v. Eccott*,[26] both contracts of sale and payments were made in the United Kingdom. The House of Lords held that these two factors alone were sufficient to constitute exercise of a trade there. Lord Shaw even implied that the place where the contract is completed is the definitive factor:

> [I]t is now too late in the day, in a case with all its circumstances, such as that now under consideration of the House, where the contracts were made in London by regular agents in London, to deny that that crucial and fundamental fact conclusively affirms the proposition that sales thereunder were in the exercise of a trade within the United Kingdom.[27]

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[22] Ibid., at 466.

[23] (1910), 5 TC 602, at 615 (Scot. Ex. Ct.).

[24] (1924), 9 TC 111 (CA).

[25] Ibid., at 134.

[26] (1926), 10 TC 481 (HL).

[27] Ibid., at 581.

In the last of the English cases on this issue, *Belfour v. Mace*,[28] the English agent of an Italian silk merchant solicited orders in England; transmitted those orders to Italy; and, on receiving authorization from the Italian merchant, communicated its acceptance to the English customer, thereupon concluding the contract. Both deliveries and payments were made in Italy. In holding that the Italian merchant exercised a trade within the United Kingdom, Scrutton LJ stated:

> [I]f you find a series of contracts made in England, it will be very difficult to escape liability for a trade exercised in England. In my view it is not impossible, but it would be very difficult.[29]

Although Canadian cases on this point are few, the importance attributed to this factor in the foregoing UK cases has been recognized in at least one Canadian decision, that of *Geigy (Can.) v. Comm'r, Soc. Serv. Tax*.[30] Geigy (Canada) Ltd. manufactured drugs in Montreal, where its head office was located. It sold annually a substantial quantity of drugs to British Columbia, where it employed representatives who were engaged in promotion but not in direct sales. All orders from British Columbia were accepted at the head office in Montreal. The issue in the case was whether Geigy was "carrying on business" in British Columbia. The Supreme Court of British Columbia held that Geigy was not carrying on business in British Columbia on the basis, first, that the contracts were made in Montreal and, second, that there was no other convincing evidence that Geigy was carrying on business in British Columbia. In arriving at this decision, Wilson CJ concluded that

> the law is clear, viz. that in the absence of other evidence that the appellant is carrying on business in British Columbia the evidence as to the place where its contracts are made is decisive.[31]

Thus, the courts, particularly in the United Kingdom, have established that the place where the contracts are made is the most important factor in determining the territorial situs of a business. However, this criterion is not always decisive, although there seem to be no cases holding that trade is not exercised or business is not carried on in a place if the principal contracts are not made in that place. Accordingly, it may be concluded that where contracts of sale alone are made in Canada, irrespective of other circumstances, it is probable that business is carried on in Canada.

It should be noted that only the profit-producing contracts (for example, sales contracts) are considered by the courts in determining the situs of a business. Contracts that are entered into as a precursor to business

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[28] (1928), 13 TC 539 (CA).

[29] Ibid., at 558.

[30] [1969] CTC 79 (BC SC).

[31] Ibid., at 84. See also *Ross*, infra footnote 151, in which it was held that a non-resident stockbroker carried on business in Canada because it completed securities transactions in Canada through two Canadian securities traders. See below for additional commentary on this case.

operations, or that are preliminary and ancillary to the final contracts out of which profit arise (for example, leases, purchases of supplies, and labour contracts), are not considered by the courts in this regard and therefore will not as a rule affect the locality of the actual business. For example, in *Lovell & Christmas, Limited v. Commissioner of Taxes*,[32] although agency contracts were made in New Zealand, it was held that the trade was carried on in London since the sales were completed there. Another example may be found in *Cutlers Guild*, in which the Federal Court—Trial Division found that

> the purchasing of goods in the Orient and the financing thereof in the United States, as well as the general planning and accounting in New York, were preliminary and ancillary phases of the plaintiff 's business.[33]

The Location of the Operations from Which the Profits Arise

Although the place where the profit-making contracts are entered into has been recognized by the courts as the principal factor connecting a business to a place, the significance of other factors cannot be overlooked. In effect, the courts have frequently looked beyond the conclusion of the sales contracts on the basis that business income is attributable to the sum total of business activity. Furthermore, it cannot be denied that the completion of the final contracts of sale may involve matters arising before the sales (for example, purchases, manufacture or production of goods, or solicitation of orders), as well as matters arising after the sales (for example, delivery and payment). As a result, in several circumstances where the sales or other business contracts were not entered into in a particular place, the courts nevertheless held that a business was carried on there because other significant business operations or actions were exercised there. These decisions were justified on the basis that a business is carried on, or a trade is exercised, in the place where the operations from which the profits arise are located.

This concept was first promulgated in *F.L. Smidth & Co. v. F. Greenwood*,[34] in which a Danish manufacturer sold goods in England. Although it had an office and a full-time employee in England, the contracts of sale and delivery of the goods were made in Copenhagen. The Court of Appeal and the House of Lords held that the Danish firm did not exercise a trade within the United Kingdom. In arriving at this conclusion, however, Atkin LJ of the Court of Appeal clearly indicated that the place of completion of the contract is not always determinative of the territorial situs of a business:

> There are indications in the case cited [*Grainger*[35]] and other cases that it is sufficient to consider only where it is that the sale contracts are made which

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[32] [1908] AC 46 (PC).

[33] Infra footnote 40, at 5095, per Dubé J.

[34] (1922), 8 TC 193 (HL).

[35] Supra footnote 11.

> result in a profit. It is obviously a very important element in the enquiry. . . . But I am not prepared to hold that this test is decisive. I can imagine cases where the contract of re-sale is made abroad, and yet the manufacture of the goods, some negotiation of the terms, and complete execution of the contract take place here under such circumstances that the trade was in truth exercised here. I think that the question is, *where do the operations take place from which the profits in substance arise* [emphasis added]?[36]

In *Firestone*,[37] the subsidiary of a US company entered into sales contracts, made deliveries, and received payments, all in the United Kingdom. The House of Lords held that the US company exercised a trade within the United Kingdom through its subsidiary. In arriving at this decision, Lord Radcliffe made the following statement, which reflects the present position of the English jurisprudence and reversed the trend toward a simplistic rule that a trade or business is exercised where the sales contracts are made:

> My Lords, no one can doubt that in considering what are the legal requirements of the phrase "trade exercised within the United Kingdom" Courts of law have ruled that the place where sales or contracts of sale are made is of great importance when it is a merchanting business that is in question. . . . [T]he place where the contract is made has been spoken of as the "crucial" test or, again, as the "most vital" element.
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> Speaking for myself, I do not find great assistance in the use of a descriptive adjective such as "crucial" in this connection. It cannot be intended to mean that the place of contract is itself conclusive. That would be to rewrite the words of the taxing Act, and could only be justified if there was nothing more in trading than the act of sale itself. There is, of course, much more. But, if "crucial" does not mean as much as this, it cannot mean more than that the law requires that great importance should be attached to the circumstance of the place of sale. It follows, then, that *the place of sale will not be the determining factor if there are other circumstances present that outweigh its importance or unless there are no other circumstances that can* [emphasis added].[38]

In Canada, the significance of factors other than the place where the contracts are made is perhaps best illustrated by *In re Proctor and Gamble Co*.[39] In that case a manufacturing company whose head office was in Toronto was held to be carrying on business in Saskatchewan, even though the sales contracts were entered into in Toronto, because the orders were not binding until accepted by the head office. This decision was based on the facts that the company advertised its products extensively in Saskatchewan, employed two salesmen in Saskatchewan who took orders there without acceptance, and stored its perishable goods in public warehouses in Saskatchewan.

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[36] Supra footnote 34, at 203-4.

[37] Supra footnote 13.

[38] Ibid., at 142.

[39] [1935-37] CTC 334 (Sask. KB).

In *Cutlers Guild Ltd. v. The Queen*,[40] the plaintiff was a company incorporated in Canada ("Cutlers"), which carried on the business of purchasing silverware in the Orient and selling it to retailers in Canada. In order to pay for its purchases, Cutlers gave its suppliers letters of credit from a US bank. Cutlers was assessed a withholding tax on the interest it paid to the US bank on this financing. The issue before the Federal Court—Trial Division was whether Cutlers was carrying on business in a country other than Canada, in which case it would not be liable to the withholding tax. General planning and bookkeeping for Cutlers were performed in New York; however, Cutlers maintained an office and a warehouse in Canada, staffed by several employees engaged in preparing the goods for delivery to customers. In holding that Cutlers was not carrying on a business in a country other than Canada, but rather was carrying on a business in Canada, Dubé J summarized the relevant jurisprudence as follows:

> Courts have ruled that the place where sales, or contracts of sale, are effected is of substantial importance. However, the place of sale may not be the determining factor if there are other circumstances present that outweigh its importance.
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> Another test emanating from the jurisprudence is "Where do the operations take place from which the profits arise?" Soliciting orders in one country may only be ancillary to the exercise of a trade in another county. Certain authorities establish that activities and operations other than contracts for sale constitute the carrying on of a business, especially where these respective activities and operations produce or earn income. While income may be realized through sales, it may not arise entirely from that one activity or operation.[41]

The Federal Court of Appeal applied this reasoning in *The Queen v. Gurd's Products Company Limited*.[42] Gurd's Products Company Limited ("Products") was incorporated in Canada in 1932 and was completely inactive from 1946 to 1969. In 1969, the US parent of Products, Grantison Holdings Inc. ("Crush USA"), which had been unable to infiltrate the soft-drink market in Iraq because of strained political relations between Iraq and the United States, reactivated Products so as to serve as a Canadian "address of convenience" and conceal US involvement in dealings with the Iraqis. Following negotiations by employees of Crush USA, Products entered into a franchise agreement with an Iraqi company, under which it purchased soft-drink concentrates from a related Canadian manufacturer, and then sold the concentrates to the Iraqi company. An employee of the related Canadian manufacturing company redirected mail between Products and the Iraqis and performed other minor functions necessary to fool the Iraqis into believing that they were dealing only with Products. All problems, credit arrangements, trademark matters, and accounting were handled by Crush USA. At trial, it was accepted that the central management and

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[40] 81 DTC 5093 (FCTD).

[41] Ibid., at 5095.

[42] 85 DTC 5314 (FCA), rev'g. 81 DTC 5153 (FCTD).

control of Products was in the United States. The issue was whether Products had carried on business in Canada at any time after April 26, 1965. If it had, it would be deemed to be a resident of Canada pursuant to paragraph 250(4)(c) of the Act; it would accordingly be taxable on its worldwide income; and its parent, Crush USA, would be liable to withholding tax on dividends remitted to it by Products.[43]

The Federal Court of Appeal held that Products carried on business in Canada during the relevant period. This conclusion was based on the following jurisprudential principle for determining the territorial situs of a business:

> The review of these cases is sufficient, I think, to express the view that one of the principles applicable in cases where it is alleged that income derived from transactions in which non-residents are involved is taxable, generally speaking, is [that such income is taxable] in the jurisdiction where the operations take place from which the profits arise.[44]

Urie J relied upon several distinct factors in rendering his decision. First and foremost,

> the very nature of the activities envisaged to foster the scheme [that is, the facade created to deceive the Iraqis], of necessity required the carrying on of a business in Canada. They were indeed vital to the realization of the export sales. Without them, no business could have been done with the Iraqis.[45]

A second factor was the establishment of a bank account by Products in Canada, primarily for the receipt of money derived from sales to foreign customers, without deduction of commission at the place of delivery. Third, substantial profits earned from the sale of goods purchased in Canada were at least momentarily in Canada. Fourth, although the employee of the related Canadian manufacturing company had limited authority,

> he was the official agent of Products in Canada, . . . [and] the sham could not have been successfully achieved without his complete involvement in every facet thereof in this country.[46]

Finally, the corporations in the group were not dealing with each other at arm's length. Application for leave to appeal this decision to the Supreme Court of Canada was denied.

These and other judgments[47] thus established a new, comprehensive rule that a non-resident carries on business or exercises trade in the place where the operations from which the profits arise are located. The result

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[43] See also the related case of *The Queen v. Grantison Holdings Inc.*, 85 DTC 5322 (FCA), rev'g. 81 DTC 5153 (FCTD), in which the issue was whether Crush USA was liable to part XIII tax in respect of dividends remitted to it by Products.

[44] Supra footnote 42, at 5321 (FCA), per Urie J.

[45] Ibid.

[46] Ibid., at 5322.

[47] See, for example, *Capitol Life Insurance*, infra footnote 147.

is that the locus of the contracts, although still determinative in itself, is no longer the only factor to be considered by the courts in establishing the territorial situs of a business, but simply one factor to be evaluated along with all the operations of the non-resident's business. Consequently, where the business contracts are not entered into in the country under consideration, the link between the business and the country may nevertheless be sufficient to justify a finding that the business is carried on there. Conversely, where business contracts are entered into in a particular place, the existence of other connecting factors elsewhere may indicate that the business is carried on elsewhere. Thus, the door was opened for judges to consider other factors, which, although not determinative in themselves, may, in combination with one another, constitute sufficient nexus between a business and a particular place to justify a holding of carrying on business in that place.

Accordingly, aside from the place where a contract is made, which is recognized as being by far the most important indicium, the courts have considered the following non-exhaustive list of factors in determining whether a non-resident exercises a trade within the United Kingdom or carries on a business in Canada:

- the place of delivery;
- the place of payment;
- the place where purchases are made;
- the place of manufacture or production;
- the place from which transactions are solicited;
- the location of an inventory of goods;
- the location of a bank account;
- the place where the non-resident's name and business are listed in a directory;
- the location of a branch office; and
- the place where agents or employees of the non-resident are located.

The importance attributed to each of these factors varies with the circumstances of each case, as evidenced by the jurisprudence reviewed below.

The Place of Delivery

In several UK and Canadian cases, the place where a non-resident person delivers goods has been considered the most important factor, after the place where the sales contracts are concluded, in determining whether the non-resident carried on business there. Some courts have even gone so far as to attribute equal emphasis to these two factors. For example, in *Thomas Turner (Leicester) Limited v. Rickman (Surveyor of Taxes)*,[48] a US company sold its goods in England through English agents. These agents solicited

[48] (1898), 4 TC 25 (QB).

offers to purchase in England and forwarded them to the US firm, which decided whether to accept them or not. If the orders were accepted, the US firm authorized the English agents to communicate the acceptance to the English customer, thereupon concluding the contracts. The agents then transported the goods to the United Kingdom, at their own cost, and delivered them to the customers. In holding that the US firm exercised a trade within the United Kingdom, Wills J emphasized that the place where the goods were delivered was as important a factor as the situs of the making of the contracts, thus implying that delivery alone, if effected in a place, is sufficient to constitute the exercise of a trade there.[49]

In *Crookston*,[50] Lord Dundas, in his dissenting judgment, indicated that the place of delivery is the second most important connecting factor in determining the territorial situs of a business:

> In the first place, if contracts are concluded by or on behalf of a foreigner, and the goods delivered, and payment made, all within the United Kingdom, it seems clear that the foreigner will be held to exercise a trade in this country. Next, I think the result will be the same if the contracts are concluded and the deliveries made in this country, though the payments are received abroad.[51]

Generally, however, the courts have considered the place of delivery as secondary in importance to the place of conclusion of the contracts when determining the territorial situs of a business. Furthermore, it appears quite settled that the place of delivery, in itself, is insufficient to establish the territorial situs of a business.[52]

The Place of Payment

Several court decisions have cited the place where payment is made as a factor in determining where a business is carried on.[53] In fact, a number of judgments have held that where contracts for the sale of a non-resident's goods are habitually made, goods are delivered, and payments are received by or for the non-resident, all in one place, a business is clearly carried on in that place.[54] In *Maclaine*,[55] the House of Lords held that a

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[49] Other decisions in which the place of delivery was considered significant in determining the territorial situs of a business include *Werle*, supra footnote 10; *Grainger*, supra footnote 11; *Smidth*, supra footnote 34; *John Deere*, infra footnote 87; *Proctor and Gamble*, supra footnote 39; *Firestone* (1942), infra footnote 88; and *Ross*, infra footnote 151.

[50] Supra footnote 23.

[51] Ibid., at 615.

[52] This conclusion flows indirectly from several judgments, including that of the English Court of Appeal in *Wilcock*, supra footnote 24, and that of Lord Dundas of the English House of Lords in *Crookston*, supra footnote 23.

[53] These decisions include, inter alia, *Pommery and Greno v. Apthorpe* (1886), 2 TC 182 (QB); *John Deere*, infra footnote 87; *Firestone* (1942), infra footnote 88; and *Ross*, infra footnote 151.

[54] See, for example, *Crookston*, supra footnote 23; *Watson*, infra footnote 85; *Turner*, supra footnote 48; *Weiss*, infra footnote 86; and *Wilcock*, supra footnote 24.

[55] Supra footnote 26.

trade is exercised in the United Kingdom where only the contracts of sale and payments are made there. However, the mere receipt of payments in Canada by or for a non-resident from persons in Canada, where the contracts of sale are made and otherwise wholly carried on outside Canada, is not sufficient to constitute the carrying on of business in Canada.[56]

The Place Where Purchases Are Made

The mere purchasing of goods in Canada by or for a non-resident for the purpose of export and resale outside Canada does not, in itself, constitute carrying on business in Canada. This principle was first established in *Sulley v. Attorney General*,[57] in which the partner in a firm of merchants carrying on business in the United States purchased goods in the United Kingdom and shipped them to the United States for resale at an increased price. In holding that there was no exercise of a trade within the United Kingdom, Cockburn CJ stated:

> Wherever a merchant is established, in the course of his operations his dealings must extend over various places; he buys in one place and sells in another. But he has one principal place in which he may be said to trade, viz., where his profits come home to him. That is where he exercises his trade. It would be very inconvenient if this were otherwise. If a man were liable to income tax in every country in which his agents are established, it would lead to great injustice. . . . It would be most impolitic thus to tax those who come here as customers.[58]

This position has clearly been adopted by the Canadian courts. For example, in *Cutlers Guild*, the Federal Court—Trial Division held that the mere

> [p]urchasing of merchandise in one country (i.e. Japan) with the view of trading in it elsewhere (Canada) does not, of course, constitute an exercise of the trade in the former country.[59]

Furthermore, in *Gurd's Products*, the Federal Court—Trial Division held that a company did not carry on business in Canada owing to the mere purchase of goods in Canada for export, stating:

> At common law, the mere purchase of goods for export, coupled with the preparation of the required export documents, does not constitute the "carrying on of business" in the Country from which the goods are purchased. (See *Sulley v. the Attorney General*. . . .) . . . . Products bought the concentrate from Crush Canada who manufactured the goods and sold them to Products and undoubtedly paid Canadian income taxes on the profit of 20% realized on the sale. Products obviously should not be taxed merely because it purchased the concentrate in Canada for the purpose of re-sale by it in Iraq.[60]

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[56] This was established in *Werle*, supra footnote 10, and *Grainger*, supra footnote 11.

[57] (1860), 2 TC 149 (Ex. Ct.).

[58] Ibid., at 149-50. This decision was referred to with approval in *Lovell*, supra footnote 32.

[59] Supra footnote 40, at 5095, per Dubé J.

[60] Supra footnote 42, at 5160 (FCTD), per Addy J.

Although the Federal Court of Appeal reversed this decision, it did so on the basis of the existence of other factors not considered by the trial judge, and not in disapproval of the established authorities, including the preceding principle. In fact, Urie J referred to this principle with approval and dismissed its application in this case on the basis of the particular facts involved.[61]

It should be noted that, as Cockburn CJ pointed out in his decision in *Sulley*,[62] this position is based on economic reality more than on any legal principle. In the first place, it would be very difficult in most cases to determine the portion of the eventual profit, realized upon the resale of goods purchased in Canada and sold elsewhere, which should be taxable in Canada. In the second place, to hold that the mere purchase of goods in Canada should render a non-resident subject to Canadian tax would penalize Canadian exporters and adversely affect Canada's balance of trade.

The Place of Manufacture or Production

The jurisprudence has established that to the extent that goods are manufactured or produced in one jurisdiction, a business is carried on there, even if the goods are then exported. This was clearly established by the English House of Lords in *Commissioners of Taxation v. Kirk*.[63] In that case, two non-resident companies extracted ore and converted it into a marketable product in New South Wales for export. The House of Lords held that insofar as income from the sale of the goods was attributable to the extraction of ore and its manufacture, as opposed to its sale and the receipt of money therefrom, it was taxable in New South Wales.

The Place from Which Transactions Are Solicited

The solicitation of business in a place has been considered to constitute a connecting factor of the business to that place in a number of common law decisions.[64] For example, in *Proctor and Gamble*,[65] the fact that a company advertised its products extensively in Saskatchewan was considered to be a determinative factor in the finding that the company exercised business there. However, in *Grainger*, Lord Herschell, following his statement regarding the distinction between carrying on business *with* and *within* a country (discussed above), concluded, for the purpose of that distinction, that the mere solicitation of business in a place does not constitute the carrying on of business there:

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[61] Supra footnote 42, at 5322 (FCA).

[62] Supra footnote 57.

[63] [1900] AC 588 (PC).

[64] Such decisions include, inter alia, *Tischler v. Apthorpe* (1885), 2 TC 89 (QB); *Pommery*, supra footnote 53; and *Werle*, supra footnote 10.

[65] Supra footnote 39. See below for additional commentary on the facts of this case.

> If all that a merchant does in any particular country is to solicit orders, I do not think he can reasonably be said to exercise or carry on his trade in that country.[66]

The Location of an Inventory of Goods

Several judgments have cited the location of an inventory of goods as an indicium of where business is carried on.[67] For example, in *Watson*, Grantham J held that the previous wine cases, in which business was essentially found to be exercised in the place where the contracts of sale were entered into, were not as "strong" as this case (that is, their facts were not as clearly indicative that a trade was exercised within the United Kingdom as the facts in this case are) because an inventory of goods was located in England before any dealing took place there.[68] Furthermore, in *Proctor and Gamble*,[69] the fact that a company stored its perishable goods in public warehouses in Saskatchewan was considered to be a determinative factor in the conclusion that the company exercised business there.

The Location of a Bank Account

A few cases have considered the location of a bank account used in a business to be an indication that the business is carried on in that place.[70] For example, in *Gurd's Products*,[71] the fact that substantial profits earned from the sale of goods purchased in Canada were at least momentarily in a Canadian bank account was considered by the Federal Court of Appeal to be one of several determinative factors in its holding that Products carried on a business in Canada.

The Place Where a Business Is Listed in a Directory

Finally, the place where a business is listed in a telephone or other directory has been considered a factor connecting that business to that place.[72] For example, in *Grainger*, Lord Morris delivered the only dissenting judgment of the House of Lords in holding that the non-resident was exercising a trade within the United Kingdom primarily on the basis that its name and business were inserted in the London post office directory:

> I am very clearly of opinion on the facts, that he [the non-resident] is exercising his trade in England, and I consider the insertion in the Directory is a most material and important fact, . . . [T]he statement in the Post

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[66] Supra footnote 11, at 467.

[67] Such cases include, inter alia, *Pommery*, supra footnote 53; and *Ross*, infra footnote 151.

[68] Infra footnote 85, at 614-15.

[69] Supra footnote 39.

[70] Such cases include, inter alia, *Pommery*, supra footnote 53; *Pullman*, infra footnote 158; and *GLS Leasco Inc. et al. v. MNR*, 86 DTC 1484 (TCC).

[71] Supra footnote 42, at 5322 (FCA), per Urie J.

[72] See, for example, *Pommery*, supra footnote 53; *Smidth*, supra footnote 34; and *Ross*, infra footnote 151.

> Office Directory under the head of "Trades," wine merchants, as follows:—"Roederer [the non-resident], Louis, Rheims, champagne merchant, . . . 21 Mincing Lane, E.C."—[is] an averment . . . that Roederer [the non-resident] carries on the business of a wine merchant at 21, Mincing Lane.[73]

The Location of a Branch Office

The location of a branch office has been cited in some cases as an indicium of where a business is carried on.[74]

Carrying On Business Through Intermediaries

General Principle

It is not essential that a non-resident carry on business in Canada himself or directly in order to incur Canadian income tax liability; he may do so if he carries on business through or in the name of another person—that is, an employee or agent.[75] The courts have clearly established that where a person employs a representative to carry on business in a place on his behalf, he is carrying on business there in his own right.[76] The basis of this principle lies in the legal relationship that subsists between an agent and his principal. Under general agency law, a contract of sale is made in Canada when the agent of a non-resident person accepts an offer in Canada, whether with or without the approval of the principal.[77] The contract may also be made in Canada where the acceptance is communicated to a purchaser by an agent in Canada.[78]

When business is carried on in Canada through an intermediary, the issue becomes whether the intermediary is a dependent agent of the non-resident or an independent contractor carrying on business in Canada on his own behalf. For example, where the business in question involves the sale of goods, the intermediary will either sell the goods on the non-resident's behalf or purchase the goods from the non-resident and

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[73] Supra footnote 11, at 473.

[74] See, for example, *Erichsen*, supra footnote 12; and *Tara Exploration*, infra footnote 153.

[75] The concept of "agency" has been described generally as "the relationship that exists between two persons when one, called the agent, is considered in law to represent the other, called the principal, in such a way as to be able to affect the principal's legal position in respect of strangers to the relationship by the making of contracts or the disposition of property." G.H.L. Fridman, *The Law of Agency*, 4th ed. (London: Butterworths, 1976), 8, cited in William J. Bies, "Agency in Canadian Income Tax Law," in *Report of Proceedings of the Thirty-Fourth Tax Conference*, 1982 Conference Report (Toronto: Canadian Tax Foundation, 1983), 927-39, at 927.

[76] Such cases include, inter alia, *Pommery*, supra footnote 53; *Erichsen*, supra footnote 12; *Werle*, supra footnote 10; *Turner*, supra footnote 48; *Smidth*, supra footnote 34; *Proctor and Gamble*, supra footnote 39; *Peery Estate*, infra footnote 136; *United Geophysical*, infra footnote 92; *Ross*, infra footnote 151; *Masri*, infra footnote 125; *Rutenberg*, infra footnote 133; *Abed*, infra footnote 127; *Pullman*, infra footnote 158; *Gurd's Products*, supra footnote 42; and *Twentieth Century Fox Film Corp. v. The Queen*, 85 DTC 5513 (FCTD).

[77] See, for example, *Watson*, infra footnote 85; *Weiss*, infra footnote 86; and *Wilcock*, supra footnote 24.

[78] See, for example, *Turner*, supra footnote 48; and *Belfour*, supra footnote 28.

resell them on his own account. In the former situation, the non-resident is carrying on business in Canada and the agent is merely acting on his behalf, whereas in the latter case, it is the intermediary who is carrying on business in Canada while the non-resident is carrying on business *with* Canada.

This distinction was clearly illustrated in the English case of *Crookston*.[79] Crookston Bros. were English agents who sold phosphates in England for a French company that mined them in Algeria. The English agents were authorized to sell at or above stipulated prices. The contracts for sale were made in England. Deliveries were made in Algeria or at sea. Payments were made directly to the French company, or by cheque payable to it and endorsed and forwarded to it by the English agents. In holding that the French company did not exercise trade within the United Kingdom, Clerk LJ stated:

> To me it appears that they [the non-residents] fall within the distinction expressed by Lord Herschell [in *Grainger*[80]] when he spoke of the difference between doing business "with a country" and doing business "within a country."[81]

Lord Ardwall expressed this sentiment in the following manner:

> I am of the opinion. . . . that the [non-resident] Company did not exercise a trade within the United Kingdom with regard to these goods, but that the Appellants [that is, the non-resident's agents] did carry on a trade as commission agents. . . . Were it to be affirmed that in this Case the [non-resident] Company were liable as exercising a trade within the United Kingdom, it appears to me that on similar grounds every foreign manufacturer, mine owner, or merchant who consigns goods to a commission agent in this country might be held liable in Income Tax as carrying on a trade here.[82]

Whether the local representative of a non-resident constitutes an agent of the non-resident or an independent contractor is a question of fact that usually depends upon the arrangement between the parties and the degree of control actually exercised by the non-resident over the activities of his representative. For example, in *Crookston*, Lord Ardwall made the following distinction:

> I cannot hold that the word "representative" covers independent commission agents such as the Appellants in this Case. It would cover a manager or a servant of the Company, but not independent agents who do commission business for their own profit and under a limited authority.[83]

The mere description of a person as agent or as an independent contractor is not conclusive. In order for a person to be considered an independent agent with respect to his dealings with another person, it is

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[79] Supra footnote 23.

[80] Supra footnote 11.

[81] Supra footnote 23, at 628.

[82] Ibid., at 612.

[83] Ibid., at 613.

generally accepted that he must act in the ordinary course of his business when acting on behalf of the other person.

Most of the common law cases in this area concern the issue whether an alleged principal is selling his goods through an agent in the jurisdiction in question so as to be held to carry on business there. This issue boils down to the determination whether the agreement between the parties is one of agency or one of purchase and sale.

An interesting issue that arises in the present context is whether a company that sells all that it produces to another company is thus acting as agent of that other company. This contention appears to be unfounded if the two companies are otherwise unrelated. For example, in *The King v. BC Brick and Tile Co. Ltd.*,[84] it was held that the mere fact that two companies had business relations with each other did not make one company an agent of the other.

Distributorships

Canadian distributors of goods frequently act as representatives of their non-resident suppliers. The Canadian tax liability of the non-resident therefore depends on the characterization of the distributor as an agent or an independent contractor. This is determined by applying the laws of agency to the facts of each particular case. Generally, the characterization depends on the degree of legal and factual control exercised by the non-resident over the distributor's operations. Some of the factors that have been considered relevant by the courts in determining whether a distributor is acting as an independent contractor or as an agent of the non-resident are whether the distributor

- sells goods in his own name or in the name of the non-resident;
- maintains an inventory of goods from which orders are filled or places an order with the non-resident only after having received an order himself;
- can accept orders without authority from the non-resident;
- can fix the price at which goods are sold;
- is paid a commission based on the sale price or according to the quantity of goods sold;
- receives title to the goods and bears risk of loss upon delivery to him or only upon sale to a customer;
- pays for goods received whether or not they are subsequently sold, or pays for them only if they are sold;
- places amounts paid to him with his personal funds or in a separate trust account until these amounts are remitted to the non-resident; and
- is referred to as an independent contractor rather than as an agent.

[84] [1936] Ex. CR 71.

For example, in *Watson v. Sandie and Hull*,[85] a US company consigned foods to an English firm of commission merchants, which sold them at prices that it alone set. The English firm guaranteed, received, and remitted all payments, less charges and commissions, to the US company, which assumed the risk of profit or loss on all the transactions. The Queen's Bench Division held that the US exercised a trade within the United Kingdom through the English firm because the latter was its agent there in such transactions.

In *Weiss, Biheller and Brooks, Ltd., v. Farmer*,[86] a Dutch company secured an English company to be the exclusive vendor of its products in Great Britain. Pursuant to the agreement between them, the Dutch company received 10 percent plus costs, the English company took a 5 percent commission, and the balance of profits was split equally. The English company was to sell at the best prices obtainable and was guaranteed payment on all sales. Title to the goods passed to the English company on delivery, and it sold the goods as its own. It was held that the English company was an agent for the Dutch company and that the Dutch company was accordingly exercising a trade in the United Kingdom, even though there was no contractual relationship between the Dutch company and the ultimate customers. It is interesting to note that the arrangement in this case had several partnership characteristics.

In *John Deere Plow Co. v. Agnew*,[87] a Manitoba manufacturing company gave exclusive rights to a British Columbia distributor to buy and sell its products within a defined area of British Columbia. Shipments of goods were delivered f.o.b. at Calgary and thereafter the goods were at the risk of the distributor, although the manufacturer retained property in the goods until payment was received. The distributor was required to sell the goods at prices specified by the manufacturer. The Supreme Court of Canada held that the distributor was not the agent of the manufacturer and that the manufacturer was therefore not carrying on business in British Columbia. The Supreme Court was again faced with the same issue some 30 years later in *Firestone Tire and Rubber Co. Ltd. v. Commissioner of Income Tax*.[88] In that case, an Ontario manufacturing company delivered its products to a BC distributor under a "distributor's warehouse contract," which gave the distributor the exclusive right to sell in British Columbia at prices determined by the Ontario manufacturer. As in the preceding case, the manufacturer retained title until sale. The majority of the court held, following its earlier decision, that the relationship was one of purchase and sale rather than of agency, and that the Ontario manufacturer was therefore not considered to have earned income in British Columbia.

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[85] (1897), 3 TC 611 (QB).

[86] (1922), 8 TC 381 (CA).

[87] (1913), 48 SCR 208.

[88] [1942] SCR 476.

Subsidiaries as Agents for Their Parents

The foregoing discussion raises the possibility that a non-resident corporation may be considered to carry on business in Canada where its Canadian subsidiary acts on its behalf. An extreme example is the situation where a Canadian subsidiary is a shell or puppet corporation through which its non-resident parent operates the Canadian business. The agency or puppet corporation principle manifests itself in situations where the business of a corporate parent or affiliate so fully pervades the business of a corporate subsidiary that the independent existence of the latter is overlooked. Thus, agency will arise where the non-resident parent so completely dominates the affairs of its Canadian subsidiary as to effectively make the business of the Canadian subsidiary its own.[89]

The English case of *Firestone*[90] is an example of a case in which a non-resident company was held to be carrying on business through its subsidiary company, which was acting as its business agent. In that case, a US company that was engaged in the manufacture and sale of tires entered into a distribution agreement with a Swedish company under which it would supply the Swedish company with tires at specified prices and terms. The US company then entered into a second agreement with its UK manufacturing subsidiary whereby, in consideration of payments from its parent, the UK subsidiary would fulfil orders received by the US company in accordance with its instructions with respect to price and other conditions. In practice, however, the UK subsidiary received the orders directly from the Swedish company, and the sales contracts were effectively made in England when it accepted them. The products were delivered in the United Kingdom, and payment was received there and credited to the US company after deducting costs plus 5 percent. The House of Lords disregarded the formal agreements between the parties and looked instead at the practice between them. On this basis, their Lordships held that the US company was exercising a trade within the United Kingdom through the UK subsidiary, which was acting as its agent. Their Lordships concluded that the UK subsidiary was acting on behalf of the US company rather than on its own account, owing to the fact that its profits were limited to 5 percent of its costs, as follows:

> It is true that the goods sold belonged to Brentford and not to Akron, but this does not show conclusively that Brentford was selling the goods on its own behalf and not as agent.[91]

The courts, however, have been somewhat reluctant to deem a subsidiary to be acting as agent for its parent, since this would effectively entail the lowering of its corporate veil. Consequently, the courts have generally held that the business of the subsidiary should not be considered the business of its parent unless it is found that the subsidiary carries on

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[89] See, for example, *Dominion Bridge Co. Ltd. v. The Queen*, 75 DTC 5150 (FCTD), aff'd. 77 DTC 5367 (FCA).

[90] Supra footnote 13.

[91] Ibid., at 141, per Lord Morton.

business as the agent of the parent. A case in which this reluctance was taken to an extreme is that of *United Geophysical Co. of Canada v. MNR*.[92] In that case, the Canadian subsidiary of a non-resident company rented equipment from its parent and claimed that its parent should be taxable on the rental payments under the predecessor of part I of the Act, rather than the predecessor of part XIII, on the basis that its parent was carrying on business in Canada through its agency. The Exchequer Court rejected this argument and held that the non-resident parent did not carry on business in Canada through the agency of its subsidiary. In arriving at this decision, Thurlow J stated:

> While it is clear that a business can be carried on by a company as agent for a disclosed or an undisclosed principal, unless the company which carried on the business is nothing but a sham the mere fact of ownership by a person of all the shares of that company will not make the company's business that of the owner of the shares, nor will complete and detailed domination by that owner of every move the company makes be sufficient to make the company his agent or the business his own, for the company, if legally incorporated, has a legal existence and personality of its own, distinct from that of the owner or owners of its shares.[93]

Partnerships

Under the partnership laws of all the provinces, partners are implied agents of one another. Hence, a partnership is considered to carry on business in every jurisdiction in which any of its partners carries on business on its behalf. Conversely, each member of a partnership is considered to carry on business in every jurisdiction in which the partnership carries on business. In other words, each member of a partnership is considered to carry on business in every jurisdiction in which any of the partners carries on business on behalf of the partnership. Accordingly, a non-resident of Canada who is a member of a partnership operating a business in Canada shall be considered to carry on business in Canada, even though he may not participate directly in that business. This conclusion is confirmed by the jurisprudence.[94]

The term "partnership" is not defined in the Act. For guidance on whether a particular arrangement at a particular time constitutes a partnership, Revenue Canada suggests that reference should be made to the relevant provincial law on the subject.[95] Generally speaking, under Canadian provincial law, a partnership is the relation that subsists between persons carrying on business in common with a view to profit. This does not imply that every joint activity constitutes a partnership. For example, in order to constitute a partnership, it is essential that the activity constitute

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[92] 61 DTC 1099 (Ex. Ct.).

[93] Ibid., at 1102.

[94] See, inter alia, *Sulley*, supra footnote 57; *Tischler*, supra footnote 64; and *Hollinger v. MNR*, 73 DTC 5003 (FCTD), aff'd. 74 DTC 6604 (FCA).

[95] Paragraph 2 of *Interpretation Bulletin* IT-90, "What Is a Partnership," February 9, 1973.

a business. As a result, the mere co-ownership of one or more properties not associated with a business (which might be a joint tenancy or a tenancy in common under common law) does not constitute a partnership, and this is so regardless of any arrangement to share profits or losses. Furthermore, a partnership will not arise unless the participants conduct business in common rather than as their own separate business.

The expression "joint venture" does not appear in the Act. Under provincial law, a joint venture agreement is generally considered to subsist where two or more persons agree that each provides his or her own property to perform a specific task or transaction and receives a specific division of profits from such a task. A joint venture may be considered a partnership as regards such profits.[96]

Whether an agreement constitutes a partnership or a joint venture apparently makes little difference to the determination of the Canadian tax liability of a non-resident who is a party to the agreement. In both cases, a non-resident is considered to carry on a business in every place in which his partners or joint venturers carry on a business in common. For example, in *Entreprises Blaton-Aubert Société Anonyme v. MNR*,[97] the appellant, a Belgian construction company, entered into a joint venture agreement with a Canadian construction company for the sole purpose of entitling the Canadian company to build the Belgian Pavilion at Expo 67. Although the Belgian company did not participate in any active way in Canada in the construction of the pavilion, it carried out several minor associated functions in Belgium, such as obtaining and expediting the delivery of granite for the floor of the pavilion and brick for the walls. Moreover, the appellant provided financial assistance and made available its knowhow or expertise in the event that something went wrong. The joint venture agreement provided for an equal division of profits or losses. On the other hand, the appellant had no office in Canada during the performance of the construction contract, nor any employees or construction equipment. The appellant's counsel argued that the joint venture did not constitute a partnership and that, therefore, the appellant could not be regarded as carrying on a business in Canada. Without determining whether the joint venture was a partnership or not, Noël J held that the appellant was in fact carrying on business in Canada. He appeared to base his decision principally on the fact that, according to the terms of the joint venture agreement, if things went badly, the appellant was obliged to take

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[96] Ibid., at paragraph 4. Under Quebec civil law, for example, in the Superior Court judgment in *Cam Meyers and Cedric Marsh v. The Royal Bank of Canada*, October 29, 1985, Montreal, 500-05-013939-838, Mr. Justice Steinberg concluded that where a joint venture exists for the common profit of the partners, each of whom must contribute something to it (property, credit, skill, or industry), the expression is simply a synonym for partnership, and most joint ventures constitute particular partnerships according to the definition of this expression in article 1862 of the (now replaced) Civil Code of Lower Canada (Quebec). However, he also stated, at 19, that a relationship that consists of a simple sharing of expenses, parallel activity, grouping, or other association for mutual convenience should not be characterized as a joint venture, but rather as a co-ownership.

[97] 69 DTC 121 (TAB), aff'd. 73 DTC 5009 (FCTD).

the place of the Canadian company in order to complete the job. Thus, it could have become as active a participant as the Canadian company. Significantly, Noël J considered that the joint venture arrangement was a normal way for a construction company to operate in the performance of its business activities.

Another case involving a joint venture is *Atlas-Gest Inc. et al. v. MNR*.[98] In that case, three corporations, two of which were resident in the United States, formed a joint venture to construct an interceptor sewer in Montreal. The Tax Court of Canada found that the two non-residents were carrying on a business in Canada and that equipment rentals paid to them by the joint venture fell within the scope of this business.

A Canadian case in which the existence of a partnership was determinative in subjecting a non-resident to Canadian income tax is *Sandhu et al. v. The Queen*.[99] In that case, two Canadian residents established a money exchange partnership in Canada and used the services of a non-resident to assist in establishing contacts for the delivery of money in India. The Federal Court—Trial Division held that the non-resident, who played an active role in the business and demanded a one-third interest in the net earnings of the business, was also a partner and therefore carrying on business in Canada.

In *Randall v. The Queen*,[100] Randall, a non-resident of Canada, was a silent partner of a family partnership that had originally operated concessions at race tracks in Canada but had assigned a half interest in the business to a Canadian resident in exchange for one-half of that person's similar active business. Following the assignment, Randall was not actively involved in the business but received half of the profits from it. The Federal Court—Trial Division found that although Randall did not actively participate in the concession operation, he was taxable as a non-resident carrying on a business in Canada. In effect, since he participated in the profits, his interest in the business was not a mere investment.[101] It is interesting to note that, in reaching his conclusion, Walsh J considered whether a silent partner may be considered to carry on a partnership business in the same capacity as an active partner. He decided that there was no difference and quoted the following statement as justification:

> A non-active or silent partner who is quite content to leave the handling of the business to another partner is in no different position than that of the active partner.[102]

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[98] 85 DTC 430 (TCC).

[99] 80 DTC 6097 (FCTD).

[100] 85 DTC 5208 (FCTD).

[101] See also the decision in *Loeck*, infra footnote 134, which is to the same effect.

[102] Supra footnote 100, at 5213. This statement was made by Heald J in *Weiss v. MNR*, 72 DTC 6231, at 6231-32 (FCTD).

The foregoing decisions indicate that the existence or non-existence of a partnership or a joint venture in any given situation is a question of fact. The factors mentioned above are not necessarily decisive in themselves but merely serve as objective criteria in this determination. As a result, the courts are not prevented from considering an arrangement to be a partnership or a joint venture merely because the parties have called it something else (for example, a "cooperative agreement").

LEGISLATIVE EXTENSION OF MEANING

It is evident from the foregoing analysis that the common law courts have not established a simple, clear, and objective test for determining when business is carried on in a country. In order to clarify this issue and to enlarge Canada's taxing jurisdiction, legislators have enacted rules deeming a non-resident to carry on business in Canada in certain factual circumstances. These provisions, which are now contained in section 253 of the Act,[103] supersede or overrule the common law principles set out above where they differ. As discussed below, certain activities in Canada that would clearly not constitute "carrying on a business in Canada" pursuant to the common law meaning of the concept are deemed to do so under section 253.

Section 253 is not, however, exhaustive in specifying the circumstances in which a non-resident may be considered to carry on business in Canada. The case law is still solely determinative in many situations involving this issue. For example, in *Gurd's Products*,[104] both the Federal Court—Trial Division and the Federal Court of Appeal (which reversed the decision of the Trial Division on the basis of other factors) reached the conclusion that section 253 of the Act was not applicable to Products since Products neither produced goods nor solicited orders in Canada. Both courts therefore looked to the common law tests of carrying on business, and on this basis the Federal Court of Appeal found that Products had indeed carried on business in Canada.

Furthermore, there still remain many activities that are not considered to constitute the carrying on of a business in Canada under the common law and are not deemed to do so under section 253. The most obvious example is the activity of purchasing goods in Canada for export without first processing them. In effect, neither paragraph 253(a) nor paragraph 253(b) is applicable, the former because the non-resident does not produce or manufacture the products, and the latter because the non-resident does not solicit orders or offer anything for sale in Canada.

Note that where a non-resident is subject to Canadian income tax by virtue of solely his manufacturing or solely his selling activities in Canada,

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[103] These provisions were originally contained in section 3 of the Income War Tax Act, SC 1917, c. 28; then in sections 26(1) and 27(A) of the Income War Tax Act, RSC 1927, c. 97; in section 127(6) of the Income Tax Act, SC 1948, c. 52; in subsection 139(12) of the Income Tax Act, RSC 1952, c. 148; and, finally, in the present section 253 of the Act.

[104] Supra footnote 42.

it will be necessary to apportion the profits realized between the manufacturing and the selling activities. This principle was illustrated in *Int. Harvester Co. v. AG Sask.*,[105] a case that was decided under provisions of Saskatchewan legislation that were identical to the predecessor of section 253 of the Act.[106] In that case, International Harvester, a non-resident of Saskatchewan, manufactured machinery in Ontario and sold some of it in Saskatchewan. It was taken for granted that the company carried on business in Saskatchewan. The issue therefore was whether the company's "manufacturing profit" not attributable to its business in Saskatchewan could be excluded from its income subject to tax in Saskatchewan. The Privy Council held that it could, on the following basis:

> Sections 23 and 24 show that the legislature contemplated, in the case of a non-resident person, a charge of tax on an apportioned part of income which, although it might be received outside the Province of Saskatchewan, could fairly be regarded as having been partially earned inside that Province. In their Lordships' view it would be reasonable to suppose that in the present case the legislature would regard a proportion of the profit received by the appellant in Saskatchewan as "arising" from its manufacturing business carried on outside that Province, and as being, in consequence, exempt from taxation under the Act.[107]

Thus, the House of Lords approved the dissenting judgment of Duff CJC, in the Supreme Court of Canada, who stated:

> It is not the profits received in Saskatchewan that are taxable; it is the profits arising from its business in Saskatchewan, not the profits arising from the company's manufacturing business in Ontario and from the company's operations in Saskatchewan taken together, but the profits arising from the company's operations in Saskatchewan.[108]

In *Prov. Treas., Man. v. Wrigley Co. Ltd.*,[109] on facts similar to those in the foregoing case, and under a similar statutory scheme (except under Manitoba legislation this time), the Privy Council followed its decision in *International Harvester*, holding that the profits attributable to sales in the province imposing the tax must be apportioned as between the manufacturing activities and the selling activities in order to exclude the former.

Production in Canada

Paragraph 253(a) of the Act provides that a non-resident is deemed to have been carrying on business in Canada in a taxation year where he

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[105] [1940-41] CTC 280 (Sask. CA), rev'd. [1940-41] CTC 294 (SCC), rev'd. [1948] CTC 307 (PC).

[106] Specifically, the case was decided under Saskatchewan's Income Tax Act, SS 1932, c. 9 and SS 1936, c. 15, sections 23 and 24 of which were identical to sections 26 and 27A, respectively, of the Income War Tax Act, 1917, SC 1917, c. 28 (the original predecessors of sections 253(a) and (b) of the Act), except that the word "Saskatchewan" was substituted for the word "Canada."

[107] Supra footnote 105, at 320 (PC), per Lord Morton of Henryton.

[108] Supra footnote 105, at 300 (SCC).

[109] [1949] CTC 377 (PC).

"produces, grows, mines, creates, manufactures, fabricates, improves, packs, preserves or constructs, in whole or in part, anything in Canada whether or not the person exports that thing without selling it before exportation." All of the activities enumerated in this provision have in common the expenditure of labour in relation to property; and wherever the labour is performed in Canada, in whole or in part, that business activity is deemed to be carried on in Canada.

To the extent that such activities of a non-resident person take place entirely in Canada, paragraph 253(a) of the Act simply reflects the state of the common law. However, this provision was apparently enacted in order to ensure that, where such activities take place partly in and partly outside Canada, the UK common law on this issue, as established particularly in *Kirk*,[110] also prevails in Canadian income tax law.

For practical purposes, the distinction between trading with Canada and trading within Canada is considerably curtailed by this provision. In effect, the mere purchase of goods in Canada by a non-resident does not in itself amount to the carrying on of business in Canada, whereas it does by virtue of paragraph 253(a) where the goods are purchased *and* finished in Canada before their export.

As a result of this provision, a non-resident may be considered to carry on business in Canada not only through a sales agent, but also through an agent for the manufacturing or processing of goods.

Soliciting Sales or Offering Anything for Sale in Canada

Paragraph 253(b) of the Act provides that a non-resident is deemed to have been carrying on business in Canada in a taxation year where he "solicits orders or offers anything for sale in Canada through an agent or servant whether the contract or transaction is to be completed inside or outside Canada or partly in and partly outside Canada."

Under the common law, as explained above, the mere solicitation of orders or making of offers for sale in a country would not constitute the carrying on of business in that country. This principle was established by the House of Lords in *Grainger*.[111] Paragraph 253(b) overrides this principle to the extent that orders are solicited or offers are made through an agent or servant; thus, it substantially modifies the common law on this issue. Under paragraph 253(b), where orders are solicited or anything is offered for sale in Canada, a business will be considered to be carried on in Canada regardless of the place where the contract is made or completed. Since the place where a contract is completed may be easily manipulated, this provision is in the nature of an anti-avoidance rule. Paragraph 253(b) deems most selling operations conducted in Canada by non-residents to constitute the carrying on of business in Canada.

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[110] Supra footnote 63.

[111] Supra footnote 11.

As pointed out above, however, paragraph 253(b) is not exhaustive in establishing the circumstances in which a non-resident is considered to carry on business in Canada. For example, it does not apply where the resident intermediary is not acting in the capacity of an agent in relation to the non-resident supplier, but rather as an independent contractor. It also does not apply where the non-resident does not solicit orders or offer anything for sale in Canada. In these situations, the common law will govern.

One case in which the application of paragraph 253(b) was at issue is *Sudden Valley Inc. v. The Queen*.[112] In that case, the appellant was a US company that was engaged in the business of selling land in the United States. Its only Canadian activity was luring Canadians to visit Sudden Valley, where they would be approached by the company's representatives and attempts would be made to sell them land. The company leased office space in Vancouver, hired telephone operators, contacted various people, and set up meetings to persuade Canadians to visit Sudden Valley and become interested in purchasing property there. Offers were made and accepted and deposits taken only in the United States. The company had no agent or representative in Canada who had any authority to accept an offer or bind it. The company had no licence to sell real estate in Canada, and in fact not one sale was made in Canada. The minister assessed the company tax under part XIII of the Act on the interest portion of the payments made by the Canadian residents in regard to mortgages and agreements for sale. The company argued that it was carrying on business in Canada pursuant to the predecessor of paragraph 253(b) of the Act, and that it therefore should not be subject to part XIII tax. The Federal Court, however, held otherwise on the basis that a mere invitation to treat was not within the purview of the words "solicited orders or offered anything for sale in Canada" in paragraph 253(b). Addy J stated this conclusion as follows:

> In considering whether the Plaintiff was "soliciting orders" in Canada, I do not agree that the words can be extended to include "a mere invitation to treat." Soliciting orders means that orders must be sought and attempts made to obtain them within the jurisdiction and the word "offer," in my view, must be given its ordinary meaning in contract law, that is, a binding offer which, if accepted, creates a contract between the offeror and the offeree.[113]

Several other cases in which the application of paragraph 253(b) was at issue are examined below.

Dispositions of Canadian Resource and Real Property

Section 253 of the Act was recently amended[114] by the addition of paragraph (c), which provides that a non-resident shall be deemed to have been carrying on business in Canada in a year during which he disposes of

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[112] 76 DTC 6178 (FCTD), aff'd. 76 DTC 6448 (FCA).

[113] Ibid., at 6180 (FCTD).

[114] By SC 1994, c. 7, schedule II, section 197(1), applicable with respect to dispositions after February 20, 1990, other than dispositions pursuant to agreements in writing entered into before February 21, 1990.

(i) Canadian resource property, except where an amount in respect of the disposition is included under paragraph 66.2(1)(a) or 66.4(1)(a),

(ii) property (other than depreciable property) that is a timber resource property or an interest therein or option in respect thereof, or

(iii) property (other than capital property) that is real property situated in Canada, including an interest therein or option in respect thereof, whether or not the property is in existence.

The technical notes issued by the minister of finance in respect of this amendment merely state that it is designed to ensure that a non-resident who disposes of property (other than capital property) that is Canadian real estate or timber resource property (including any interest or option with respect to such property) will be considered to carry on business in Canada and therefore be subject to Canadian tax under subsection 2(3) of the Act, in respect of such disposition.

The real effect of paragraph 253(c) was to clarify a situation that had become unclear since the *Tara Exploration*[115] decision and its application in *Fergusson*[116] (both of which are discussed below). Before the decision rendered in *Fergusson*, several Canadian decisions were to the effect that a non-resident who carries on the business of buying and selling real estate situated in Canada is carrying on business in Canada. In some of these decisions, this conclusion was based on the common law factors,[117] but in others it was based on paragraph 253(b).[118]

In *Fergusson et al. v. MNR*,[119] the non-resident taxpayers each held a 50 percent interest in a partnership that purchased a single parcel of land in Canada and carried on a parking lot business on the land. Without further development—that is, in its existing state—the property could be operated only at a loss. Some years later, the taxpayers disposed of the property, still undeveloped, and realized a gain on the sale. Bonner J of the Tax Court of Canada found that the taxpayers had not shown that an intention to develop the property motivated its purchase to the exclusion of an intention of selling the property at a profit. Therefore, he concluded that the gain realized on the resale was income from an adventure in the nature of trade. Indicating that he was bound to follow Jackett P's decision in *Tara Exploration*,[120] and having observed that "there was no continuity of Canadian operations which would support a conclusion that [the partnership] carried on business in Canada,"[121] Bonner J held that the taxpayers

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[115] Infra footnote 153.

[116] Infra footnote 119.

[117] See, inter alia, *Rhodesia*, infra footnote 122; *Abed*, infra footnote 127; and *Loeck*, infra footnote 134.

[118] See, for example, *Masri*, infra footnote 125; *Thea*, infra footnote 123; and *Neuberger*, infra footnote 124.

[119] 84 DTC 1107 (TCC).

[120] Infra footnote 153.

[121] Supra footnote 119, at 1109.

were not carrying on business in Canada in this respect and that the gain on the sale of the property was not subject to Canadian income tax.

New paragraph 253(c) now prevents such a conclusion. A taxpayer can no longer succeed in arguing that an isolated sale of a property specified in that paragraph by a non-resident does not constitute the "carrying on" of a business in Canada.

Another likely reason for the enactment of paragraph 253(c) of the Act was the perceived abuse of the common law concept of carrying on business in Canada as it applies to Canadian real estate transactions. Although it is a recognized international principle of tax liability that gains realized on dispositions of real estate may be taxed by the jurisdiction in which the real estate is situated, this is true under Canadian tax law in respect only of real estate that constitutes capital property for the non-resident who disposes of it. In that case, the real estate constitutes "taxable Canadian property" pursuant to paragraph 115(1)(b), and any gain realized by a non-resident on its disposition is therefore subject to Canadian income tax under paragraph 2(3)(c).

Before the enactment of paragraph 253(c), gains realized on dispositions of real estate that constituted inventory to the non-resident owner would be subject to Canadian tax only if the real estate was disposed of by the non-resident in the course of "carrying on business in Canada" according to the common law concept and the provisions of paragraphs 253(a) and (b). However, pursuant to the foregoing analysis, if a non-resident merely purchased real estate situated in Canada, then offered to sell it, and negotiated and entered into contracts of sale for the real estate, all outside Canada, then the non-resident was not "carrying on business in Canada" and was therefore not subject to Canadian income tax. It is therefore reasonable to assume that paragraph 253(c) was adopted in order to prohibit this exception to Canada's tax liability rules, which exception was frequently relied upon by non-residents in recent years.

Certain Specific Applications

Real Estate

Purchase and Sale

Non-residents have traditionally invested significantly in Canada's real estate market. Several court decisions have held that a non-resident who carries on the business of buying and selling real estate situated in Canada is carrying on business in Canada.

In *Liquidator, Rhodesia Metals, Ld. v. Commissioner of Taxes*,[122] an English company purchased mining rights (which constitute immovable or real property) in southern Rhodesia, developed them, and sold them at a profit. The contract of sale was concluded in England, and payment was also received there. The Privy Council held that the English company was

[122] [1940] AC 774 (HL).

subject to southern Rhodesian income tax on the transaction on the basis that the income was from a source within the territory.

In *Thea Corporation v. MNR*,[123] a Quebec corporation purchased and sold a 75 percent interest in a Canadian property. The Tax Appeal Board found that this constituted the carrying on of a business and, further, that the company was acting as an agent in this respect on behalf of a non-resident individual. Accordingly, the court held that the non-resident individual carried on business in Canada. Similarly, in *Neuberger v. MNR*,[124] a non-resident individual who purchased and sold Canadian real estate through a Canadian agent was held to be carrying on business in Canada and accordingly was taxable on the profits from the business.

In *Masri v. MNR*,[125] the appellant and three others purchased five parcels of land in Quebec and eventually sold four of them, realizing substantial profits in the process. Heald J of the Federal Court—Trial Division held that the appellant carried on business in Canada, stating that the predecessor of paragraph 253(b) of the Act

> is wide enough to cover the facts of this case where it is clear that the appellant, along with his partners, offered their real property for sale in Canada through real estate agents, knew that said agents were in fact advertising said property for sale by erecting "for sale" signs on the property, and, on consummation of said sales, paid their agents a commission for said sales.[126]

Therefore, by necessary implication, Heald J held that the word "anything" in the predecessor to paragraph 253(b) includes realty.

In *Abed v. MNR*,[127] Abed was one of the three partners mentioned in *Masri*,[128] the facts of which were accepted, mutatis mutandis. However, contrary to Heald J's conclusion in *Masri*, Walsh J of the Federal Court—Trial Division held that vacant land is not a "thing" and therefore the extended definition of carrying on business in the predecessor of section 253 of the Act was not applicable. Walsh J nevertheless concluded that Abed was "carrying on business in Canada" on the basis of the predecessor of paragraph 2(3)(b) of the Act and the common law meaning of that expression.

In *Birmount Holdings Ltd. v. The Queen*,[129] the taxpayer company was incorporated in Ontario in 1960 for the sole purpose of acquiring and holding real estate in Canada. In the same year, the company purchased a single parcel of land in Ontario, which it leased out as farmland for a

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[123] 67 DTC 175 (TAB).

[124] 69 DTC 127 (TAB).

[125] 73 DTC 5367 (FCTD).

[126] Ibid., at 5371 (FCTD).

[127] 71 DTC 131 (TAB), aff'd. 78 DTC 6007 (FCTD), aff'd. (sub. nom. *Abed Estate v. MNR*) 82 DTC 6009 (FCA).

[128] Supra footnote 125.

[129] 77 DTC 5031 (FCTD), aff'd. 78 DTC 6254 (FCA). Similar reasoning may be seen in *Abed*, supra footnote 127, and *Loeck*, infra footnote 134.

negligible amount. In 1972, the company sold the land pursuant to an unsolicited offer, thereby realizing a substantial profit, which was assessed as business income. Sweet DJ of the Federal Court—Trial Division concluded by applying the secondary intention principle, that the property was not acquired as an investment and that the transaction was an adventure in the nature of trade. This was confirmed by the Federal Court of Appeal. Sweet DJ then concluded that the company, in selling the land, was carrying on business in Canada in 1972 within the meaning of paragraph 250(4)(c) of the Act and that, consequently, the company was resident in Canada in 1972. In effect, in contrast to the situation in *Tara Exploration*,[130] the plaintiff in this case had no business other than that associated with the real estate. In fact, the company's only stated object according to the wording of its letters patent was "to acquire by purchase" the land in question. On this basis, Sweet DJ concluded:

> In my opinion, the result is that the plaintiff did more than just engage in an adventure in the nature of trade. It carried on business in and with the land. In doing so, it performed the very business function anticipated by the wording of its letters patent. . . .
>
> The dealing by Birmount with the land was not merely part of the business carried on by it. It was all of it.[131]

On appeal to the Federal Court of Appeal, Heald J affirmed this decision but on a different basis—namely, that the company was resident in Canada in actual fact, so that it was not necessary to apply the deeming provision of paragraph 250(4)(c) and to determine whether the company carried on business in Canada. However, without expressly agreeing with the conclusion of Sweet DJ, Heald J implicitly confirmed it by declaring that the fact that, as distinguished from an investment, certain activities have been found to constitute an adventure in the nature of trade does not, of itself, preclude a finding that those activities amount to carrying on business.[132]

In *Rutenberg v. MNR*,[133] a non-resident who entered into 14 real estate transactions in Quebec conceded at trial that he was carrying on a business in Canada.

In *Loeck v. The Queen*,[134] the non-resident appellant, together with a Canadian resident individual who acted on his behalf on authority of a power of attorney, purchased four parcels of real estate in Canada and sold two of them. The court considered that the non-resident carried on the business of selling real property in Canada.

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[130] Infra footnote 153.

[131] Supra footnote 129, at 5039-40 (FCTD).

[132] Supra footnote 129, at 6263 (FCA).

[133] 78 DTC 6140 (FCTD), aff'd. 79 DTC 5394 (FCA).

[134] 78 DTC 6368 (FCTD), aff'd. 82 DTC 6071 (FCA).

Finally, in *Fergusson*,[135] the Tax Court of Canada held that the acquisition and resale of a single parcel of land in Canada constituted an adventure in the nature of trade since there was no continuity of operations, and that the non-resident was not "carrying on" business in Canada, as this concept is defined by the common law and for the purposes of the extended definition of paragraph 253(b) as well. As indicated above, the basis for this conclusion has been removed by the enactment of paragraph 253(c).

Leasing

A few cases have dealt with the question whether renting or leasing real estate constitutes the carrying on of business in Canada. For example, in *D.H. Peery Estate Inc. v. MNR*,[136] a non-resident receiving rent in kind (that is, crop shares) from farmland in Canada that it owned and leased was held not to be carrying on a business and therefore not to be carrying on a business in Canada. On the other hand, in *Rubinstein v. MNR*,[137] a non-resident who received rent from two buildings in Montreal that he co-owned with another non-resident was held to be carrying on business in Canada. It was noted that a real estate broker and an accountant devoted a significant portion of their time to looking after these buildings for the non-residents.

Services

A services business is usually considered to be carried on in the place where the services are rendered. In effect, Revenue Canada has affirmed that

> [w]here a corporation's business involves the rendering of services, that business is carried on in Canada only to the extent that services are rendered in Canada, necessitating an apportionment of net business income on a reasonable basis."[138]

However, it is not always a simple matter to determine, first, whether a services business is being carried on and, second, if one is carried on, in what place the services are rendered.

Personal

A non-resident individual who renders services in Canada as a professional or a performing artist (that is, an independent contractor) and not as an employee will be considered to be carrying on a business in Canada and, accordingly, will be subject to Canadian tax on his net income from such services.

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[135] Supra footnote 119.

[136] 52 DTC 202 (TAB).

[137] 62 DTC 100 (TAB).

[138] *Interpretation Bulletin* IT-73R4, "The Small Business Deduction—Income from an Active Business, a Specified Investment Business and a Personal Services Business," February 13, 1989, paragraph 7.

Technical

Whether a non-resident performing technical service operations in Canada is carrying on business in Canada depends on the nature and extent of the services—that is, whether they are ancillary to sales or whether they constitute an independent profit-making activity. In the United Kingdom, this issue was considered in *Smidth*,[139] in which a Danish manufacturing firm maintained an office in England staffed by a qualified engineer whose duty was, among other things, to transmit to Denmark technical requirements for particular orders, including samples for testing, and to assist English purchasers with installation and initial operation of the machinery. Furthermore, at the purchaser's request, the Danish firm occasionally sent another supervising engineer from Copenhagen. The House of Lords considered these services insufficient to justify a finding that the Danish firm exercised a trade within the United Kingdom, since they were ancillary to the purchase and sale and not the principal object of the business.

In Canada, the issue was considered by the Supreme Court of Canada in *Linde Canadian Refrigerator Co. v. Saskatchewan Creamery Co.*,[140] in the context of determining whether the appellant was required to take out an extraprovincial licence under the Foreign Companies Act[141] in order to maintain an action in the province. The appellant company, whose head office was in Quebec, sold machinery to purchasers in Saskatchewan. The machines were ordered, shipped, and delivered in Montreal, where the sales were completed. Under the sales contracts, however, an engineer employed by the company installed the machines in Saskatchewan. Idington J found that the company did not carry on business in Saskatchewan, stating that

> I do not think that the mere installation of the machinery so ordered, shipped and delivered, fairly falls within the meaning of the carrying on business in Saskatchewan. I cannot think it was intended to apply to the mere setting up and starting of machinery by a company doing no more in way of carrying on business than such acts involve.[142]

However, Anglin J found that the company was carrying on business in Saskatchewan on the basis that, although

> the installing of the plant may in the present case have been a comparatively insignificant part of that which the plaintiffs contracted to do, it was a substantial part of the consideration which they agreed to give to the defendants in return for their money.[143]

He also based his finding on the fact that "other plants had been installed by the plaintiffs in the province."[144] Notwithstanding this finding, Anglin J

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[139] Supra footnote 34.

[140] (1915), 51 SCR 400.

[141] RSS 1909, c. 73.

[142] Supra footnote 140, at 404.

[143] Ibid., at 406.

[144] Ibid., at 407.

went on to allow the appeal as Idington J did, but for a different reason. Thus, neither position represented the majority position of the court.

These two cases indicate that where technical assistance and supervisory service operations in Canada are ancillary to sales, the non-resident vendors are probably not carrying on business in Canada since such services are probably not, in themselves, sufficient to constitute a separate business aside from the sales business.

Query, however, whether in installing machinery and providing startup assistance, a non-resident "produces, . . . creates, manufactures, fabricates, improves, . . . or constructs . . . anything in Canada" so that he is deemed to carry on a business in Canada within the meaning assigned to these terms under paragraph 253(a) of the Act. It is arguable that none of these words would apply to the mere installation of machinery, but that they may apply to the actual creation of the machinery as a product that is ready for sale. The use of the words "whether or not the person exports that thing without selling it before exportation" in this provision lends support to such an interpretation, since they indicate that the foregoing activities are directed toward creating goods for sale or at least improving the marketability of existing products. The installation of an already finished and sold object would accordingly not be within the purview of this provision. Thus, technical service operations that are ancillary to sales, taken alone, should not constitute the carrying on of business in Canada under either the common law or the Act.

On the other hand, where a non-resident or his agent performs technical service operations in Canada that are not related to a sale of goods, but rather constitute the very object of a transaction, the non-resident will be considered to carry on business in Canada. It is a question of fact in each case whether technical services performed in Canada are merely ancillary to a sale of goods, in which case the non-resident is not carrying on business in Canada, or whether they constitute business or profit-producing activities on their own, in which case the non-resident is carrying on business in Canada. For example, if the sale of an object and its installation or after-sales service are the subjects of separate contracts negotiated separately and have separate prices, it is possible, if not likely, that the technical services are sold independently of the object and should therefore constitute the carrying on of a separate business, which, if performed in Canada, will have its situs there. Cases in which non-residents performing services in Canada, independent of any sales, were held to be carrying on business in Canada include *International Harvester*,[145] which concerned manufacturing operations, and *Randall*,[146] which concerned the operation of food and beverage concessions.

[145] Supra footnote 105.

[146] Supra footnote 100.

Insurance

An insurance business consists of providing insurance. Insurance is not generally provided at the situs of the insured object. The situs of an insurance business should therefore reside at the place where the insurance contracts are concluded and where the payments are made.

In *Capitol Life Insurance Company v. The Queen*,[147] an insurance company incorporated in the United States obtained the requisite federal and provincial registrations and licences and complied with other government requirements in view of expanding its insurance business into Canada. However, the company subsequently decided not to expand its business into Canada, although it maintained its registration in force. The company did issue five group insurance contracts to affiliated companies under which the lives of Canadian residents were insured. These policies were not solicited for in Canada. The applications for the contracts were made in the United States, and the contracts were issued from there. The Federal Court—Trial Division held that the company was not carrying on a business in Canada. In particular, Addy J held that paragraph 253(b) of the Act was not applicable because the company "never solicited in Canada or offered for sale in Canada through any agent or servant any policy of insurance." The Crown also failed in establishing that an affiliated finance company was not an insured but really an agent of the company, in which case the company would have been carrying on business in Canada through that finance company.

Furthermore, in *London Life Insurance Company v. The Queen*,[148] the taxpayer was a life insurance company carrying on business in Canada. In 1976, the taxpayer took certain measures with a view to expanding its business to Bermuda, including the appointment of an agent to solicit contracts and perform administrative duties. The taxpayer claimed that it was carrying on business in Bermuda that year in order to benefit from favourable tax treatment that was then available. The court found that the taxpayer was carrying on business in Bermuda since the contracts of insurance were made there, its sales operations were conducted there by an agent, and it solicited residents of Bermuda to enter into life insurance contracts there.

International Communication and Transportation

The courts have generally applied the same principles to international communication and transportation businesses as to international sales of movable property. The factors considered most pertinent in determining the situs of such businesses include the place of completion of the contract for transmission or carriage, the place of payment, the place of transmission or embarkation, and the place of receipt or disembarkation.

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[147] 84 DTC 6087 (FCTD), aff'd. 86 DTC 6164 (FCA).

[148] 87 DTC 5312 (FCTD), aff'd. 90 DTC 6001 (FCA).

With respect to international communication businesses, the English common law is represented by *Erichsen*.[149] In that case, a Danish company was held to carry on business in England on the basis that contracts for transmission were habitually concluded in England, messages were sent from and received there, and payments were made there.

The same principles were applied in the common law shipping cases. For example, in *James Wingate & Co. v. Webber*,[150] the House of Lords held that a non-resident company was carrying on business in Scotland because it chartered ships and received payments there.

Securities

According to a literal interpretation of paragraph 253(b) of the Act, any non-resident trading in Canadian securities through a broker or other agent may be considered to be carrying on business in Canada. Thus, non-resident investors in Canadian securities, including institutional investors, may be considered to be carrying on business in Canada even if they are not classified as brokers, traders, or speculators. In practice, however, it appears that Revenue Canada does not apply this provision in this manner.

In *Ross & Company Ltd. v. MNR*,[151] a stock broker incorporated in the Bahamas sold some speculative shares in Canada through two Canadian securities dealers, which performed the following activities in Canada on behalf of the Bahamian company:

> maintenance of a share inventory; readiness to sell or buy shares at a moment's notice; considering bid prices; watching the movement of prices; entering into contracts of purchase or sale when the price seemed right; delivering or taking delivery of shares; paying for shares purchased or collecting for shares sold.[152]

The Tax Appeal Board found that the Canadian securities dealers were agents of the Bahamian company because the small profit percentage realized by them on the transactions suggested a dealer commission rather than profit from dealing on their own account, and because they sometimes bought shares below the market price pursuant to the non-resident's instructions, thus indicating a scheme to transfer accumulated profits into its hands. Accordingly, and primarily on the basis that the transactions took place in Canada, the board held that the Bahamian company carried on business in Canada through the agency of the two dealers. This decision thus indicates that the place where a securities transaction is completed is a primary factor in determining the territorial situs of a securities business, and that a non-resident will be considered to carry on business in Canada if it sells shares there through Canadian agents.

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[149] Supra footnote 12.

[150] (1897), 3 TC 569 (HL).

[151] 67 DTC 421 (TAB).

[152] Ibid., at 427.

In *Tara Exploration and Development Co. Ltd. v. MNR*,[153] the taxpayer was a corporation whose principal business was exploring for minerals in Ireland. It raised money in Canada for the purpose of this business, but it used some of these funds on an interim basis to buy shares in a company formed to develop an Irish mining property adjacent to its own. The taxpayer subsequently sold these shares at a profit, which the minister assessed. Jackett P of the Exchequer Court decided that this transaction constituted an adventure in the nature of trade. This conclusion was based on the following observations:

- the corporation was in a position to know that the shares were a good speculation;
- since the corporation had borrowed the money to use in its business, it could not have meant to hold the shares for more than a short period of time; and
- the transaction was not part of the business of the taxpayer for which it raised the capital and which it was actually carrying on.

His Lordship then considered the issue whether the extended definition of business also had the effect of enlarging the concept of "carrying on business in Canada." On the basis of his finding that the transaction constituted an adventure in the nature of trade, Jackett P concluded, with considerable hesitation, that

> the words "carried on" are not words that can apply to be used with the word "adventure." To carry on something involves continuity of time or operations such as is involved in the ordinary sense of a "business." An adventure is an isolated happening. One *has* an adventure as opposed to *carrying on* a business.[154]

Thus, he held that the transaction did not, in and by itself, constitute the carrying on of a business, since an adventure in the nature of the trade cannot be "carried on." The Supreme Court of Canada affirmed the Exchequer Court's decision but on a different basis, namely, that the company was exempt from Canadian income tax by virtue of the Canada-Ireland income tax agreement.

Owing to the "considerable doubt" with which Jackett P reached his conclusion on this point, it is submitted that the Exchequer Court's decision in *Tara Exploration* should not serve as undisputed authority for the proposition that an isolated adventure in the nature of trade cannot constitute the carrying on of a business.[155] Indeed, Jackett P himself implied that if the adventure in the nature of trade were part of the business

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[153] 70 DTC 6370 (Ex. Ct.), aff'd. 72 DTC 6288 (SCC). Furthermore, in *Grainger*, supra footnote 11, at 472, Lord Morris stated that "the words 'exercising a trade' . . . [which] is only another mode of expressing 'carrying on a business,' . . . certainly carries with it the meaning that . . . it cannot apply to isolated transactions."

[154] *Tara*, supra footnote 153, at 6376 (Ex. Ct.).

[155] See Gweneth McGregor's commentary on this decision in "Too Many Ifs," Around the Courts feature (1971), vol. 19, no. 1 *Canadian Tax Journal* 19-23.

otherwise carried on by the taxpayer, it might well have been treated differently.[156] The following commentary casts further doubt on Jackett P's conclusion on this point:

> With the greatest respect for the view expressed by Mr. Justice Jackett, we do not feel compelled to conclude that "carried on" necessarily implies a continuity of activity. The words "carry on" in their ordinary meaning can be taken to imply nothing more than the fact that a transaction has been conducted or completed. Such an interpretation seems more consistent with the overall scheme of the Act which, after all, specifically includes an isolated transaction within the notion of "business." In the absence of a compelling reason to the contrary, a more satisfactory result is reached if "carried on" is allowed to have its ordinary meaning and not narrowed down in the manner suggested in the *Tara* case. So on this point, we find ourselves in agreement with the result reached by Mr. Justice Sweet [in *Birmount*].[157]

Money Lending

The question when a money-lending business can be said to be carried on in Canada has been examined by the Federal Court—Trial Division in *Pullman v. The Queen*.[158] In this case, a non-resident participated in almost 300 international money-lending transactions in Canada through the services of a Canadian loan broker. The Canadian broker would offer the non-resident participation in loans in Canada and elsewhere, and the non-resident was free to accept or reject any one of them. The non-resident maintained a bank account in Canada for the purposes of the loan transactions, and he gave the Canadian broker a power of attorney to complete these transactions through the account. The non-resident never solicited loans himself and did not maintain an office in Canada. The court found that the non-resident was indeed carrying on a money-lending business, but not in Canada. In effect, Dubé J found that the non-resident was not actively buying or selling anything in Canada, and himself performed no act in Canada. He simply participated from abroad in bridge financing through a Canadian broker. Furthermore, whereas the Canadian broker had a power of attorney to complete loan transactions, he was not in law an agent of the plaintiff. Dubé J summarized his ratio decidendi as follows:

> The basic administrative decisions, the acceptance or rejections of financing opportunities, were executed outside Canada. The only Canadian ingredients in the transactions, namely the bank account, the power of attorney and the book-keeping, were ancillary and merely for the purpose of convenience. Loaning money to Canadians (or Americans, Puerto Ricans and Britishers) does not by itself constitute the exercise of a business in Canada, whether the transactions are numerous, complex or otherwise. That type of transaction is dealt with under Part XIII of the Act and subject to a withholding tax. . . .

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[156] *Tara*, supra footnote 153, at 6374 (Ex. Ct.).

[157] T.E. McDonnell, "Residence of Corporations—Isolated Transactions Held To Be Carrying On Business in Canada," Current Cases feature (1977), vol. 25, no. 2 *Canadian Tax Journal* 127-31, at 129.

[158] 83 DTC 5080 (FCTD).

> In my view, it cannot be said that the Plaintiff was soliciting orders or offering anything for sale in Canada through an agent, or servant, or otherwise. The Plaintiff did not solicit orders in Canada and did not have to. He remained in Switzerland and was solicited there by a broker offering him participation in money lending activities. Neither can it be said that loans can be offered for sale.[159]

Investments

The mere maintenance of investments in a jurisdiction should not constitute the carrying on of a business there if the non-resident does not actively deal with the assets there.

SUMMARY

On the basis of the foregoing analysis of the common law jurisprudence and the provisions of section 253 of the Act, it may be concluded that any one of the following activities will almost certainly denote that a non-resident is carrying on business in Canada:

- he produces or manufactures anything in Canada that will eventually be sold or otherwise used to make a profit;
- he solicits orders or offers anything for sale in Canada through an agent or employee, whether or not the contract or the transaction is completed in Canada;
- he disposes of property (other than capital property) that is Canadian real estate or timber resource property;
- he habitually concludes or completes contracts in Canada, or they are thus made in Canada on his behalf, particularly in conjunction with delivery of the goods and/or payment of the price in Canada;
- he maintains an inventory of goods in Canada in which his ownership remains fully vested, and from which orders are filled in satisfaction of contracts either directly or through an agent; or
- he renders services in Canada.

It may also be concluded from the foregoing analysis that certain types of business activity carried on in relation to Canada do not constitute "carrying on business in Canada," under either the common law or section 253. Examples of such activities include the following:

- Providing after-sales services such as customer advice and installation services following a sale of goods in Canada, which activities do not, in themselves, constitute a separate business.
- Purchasing goods in Canada and exporting them out of Canada in the same form—that is, without any processing, refinement, or manufacture. This activity may not qualify as carrying on business in Canada even where ownership of the goods is transferred before they are exported pursuant to arrangements made elsewhere.

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[159] Ibid., at 5084.

• Purchasing and owning property in Canada as a passive investment and deriving income from the investment in the form of interest, dividends, rents, or royalties.

The concept of "carrying on business in Canada," which is fundamental in establishing Canadian tax liability both under the Act and under Canada's tax conventions, is a question of fact. Its meaning therefore changes from one industry and activity to another. Hence, there is a need for greater precision in the meaning of this term in the Act, perhaps by further amendment of section 253.