Date: 20070921

Docket: A-217-06

Citation: 2007 FCA 302

CORAM: **NOËL J.A.**
SEXTON J.A.
PELLETIER J.A.

BETWEEN:

GULFMARK OFFSHORE N.S. LIMITED

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Ottawa, Ontario, on September 18, 2007.

Judgment delivered at Ottawa, Ontario, on September 21, 2007.

REASONS FOR JUDGMENT BY: NOËL J.A.

CONCURRED IN BY: SEXTON J.A.
PELLETIER J.A.

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REASONS FOR JUDGMENT

NOËL J.A.

[1] This is an appeal from a decision of Miller J. of the Tax Court of Canada, confirming in part the reassessment issued with respect to Gulf Offshore N.S. limited's ("GONS") 1999 taxation year on the basis that GONS was carrying on business in Canada through a permanent establishment. By the same decision, Miller J. confirmed the Minister of National Revenue's (the "Minister") disallowance of GONS' interest expenses, but referred the reassessment back to the Minister for reassessment on the basis that GONS was entitled to deduct its salary and travel expenses, as claimed.

[2] GONS maintains that the Tax Court Judge committed a variety of errors in holding that it was carrying on business in Canada in 1999, through a permanent establishment. In the alternative, GONS contends that the interest expenses, which it claimed, were properly allocated to its permanent establishment, and that the Tax Court Judge erred in refusing to allow this deduction.

RELEVANT FACTS

[3] The appellant, GONS, is an offshore transportation corporation, resident in the United Kingdom.

[4] In 1999, the appellant owned and operated a fleet of 27 supply vessels, one of which was the M.V. Highland Pride (the "Highland Pride"). The Highland Pride was built in 1992, at a cost of £ 12,000,000.00, specifically to carry pipe on deck for use in the laying of pipeline offshore. The appellant borrowed £ 11,000,000.00, pursuant to a ten-year term loan, to finance its construction (Reasons, para. 3).

[5] In 1998, the parent company, Gulfmark Offshore Inc., consolidated all the debts of its subsidiaries (including GONS) in order to obtain a better financing rate. As part of this refinancing arrangement, GONS borrowed approximately £ 37,000,000 from Gulfmark Offshore Inc. The money borrowed was for the construction of new ships in addition to the refinancing of GONS' outstanding debts (Reasons, paras. 12 and 13).

[6] In 1998, the appellant entered into a Charter Party Agreement with Allseas Canada Limited ("Allseas") to provide a ship, the Highland Pride, for transportation of pipes and other supplies (materials, equipment, marine gas oil), in Canadian coastal waters. The charter price was £ 21,500 per day, excluding fuel and import duties.

[7] In addition to supplying the ship, GONS supplied the master, crew and an engineer. GONS subcontracted the crew for the Highland Pride from a related non-resident company, Guernsey Ship Limited and an arm's length Canadian resident company.

[8] In conformity with the Charter Agreement, the Highland Pride worked for 88 days in 1999 transporting pipe joints and other material from Nova Scotia to the installation area offshore Nova Scotia, that is between Country Harbor and Sable Island. During this time, Allseas furnished all instructions and sailing directions and the Master and the Engineer of the Highland Pride kept full and correct logs of the vessel's whereabouts. GONS maintained daily contact with the ship (Reasons, para. 20).

[9] GONS filed an income tax return for the year under appeal, claiming an exemption under article 8 of the *Canada-UK Tax Convention* (the "Treaty") and seeking a refund of the withholding tax it had paid. On that occasion, GONS submitted an income and expense statement in British pounds setting out salary and travel expenses in the amount of £ 169,793 and interest expenses in the amount of £ 194,876.

[10] This interest expense ($461,856.00 when converted into Canadian dollars) represented 22.93% of the interest expense incurred by GONS' for its worldwide operations during the 88 days that the Highland Pride operated in Canada. This percentage was determined by taking the Highland Pride's revenue for the 88-day period and dividing it by GONS' revenue from all its vessels for the same period (Reasons, para. 13).

[11] The Minister assessed GONS as a non-resident corporation carrying on business in Canada within the meaning of section 248 of the Act relying on article 27A of the Treaty. In computing the income subject to tax in Canada, the Minister denied the appellant one-half of its deductions for salaries and travel expenses and all of its interest-financing charges.

[12] GONS appealed to the Tax Court of Canada. As previously noted, Miller J. held that GONS was carrying on business through a permanent establishment (as per article 27A of the Treaty) and so, was liable to pay income tax in Canada on the income earned through its permanent establishment. He further held that GONS had not discharged of the onus of demonstrating that the interest expense claimed was properly allocated to its permanent establishment in Canada. However, Miller J. allowed the half portion of the deduction of salaries and travel expenses, which the Minister had disallowed.

TAX COURT DECISION

[13] The Tax Court Judge identified the issues before him as whether GONS was carrying on a business through a permanent establishment within the meaning of the Treaty and if so, whether the

salary, travel and interest expenses claimed were deductible in computing GONS' income derived from the permanent establishment during the relevant period.

[14] The Tax Court Judge found that GONS carried on business in Canada (based on the ordinary meaning of the term) for the 88 days. As the business was carried on in connection with exploration and exploitation of the sea bed, the underlying activities came within article 27A of the Treaty. Consequently, GONS was liable to pay tax on income earned as a result of these activities. In so holding, the Tax Court Judge rejected GONS' contention that it had entered into a passive or bare boat lease and that Allseas operated the Highland Pride during the relevant period. Specifically, the Tax Court Judge found that GONS was carrying on the activity of operating a ship, supplying the crew and transporting pipes, supplies and personnel to an offshore sight. Further, GONS' head office was in daily contact with the ship and there was no evidence that Allseas' personnel ever boarded the ship (Reasons, paras. 17-20).

[15] The Tax Court Judge went on to find that salary and travel expenses were deductible but the interest expenses were not. He noted that the taxable income of a business carried on through a permanent establishment is to be calculated as if the establishment was a separate business and recognized that given the number of vessels that GONS operates, it was necessary to apportion salary and travel costs. The Tax Court Judge found that GONS' use of the standard costing method was an acceptable method for apportioning such costs (Reasons, para. 22).

[16] However, with respect to interest expenses, the Tax Court Judge held that GONS had failed to show what portion, if any, of the interest paid under the consolidated loan was used to finance the operation of the Highland Pride during the period in issue (Reasons, para. 25).

ALLEGED ERRORS IN THE DECISION UNDER APPEAL

[17] With respect to the first issue identified by the Tax Court Judge, the appellant alleges that the Tax Court Judge failed to construe the Treaty liberally with a view to implementing the intention of the parties and the policy of the Treaty, referring to the *Vienna Convention on the Law of Treaties*, 23 May 1969, 1155 U.N.T.S. 33, arts. 31-33 (the "*Vienna Convention*"). In particular, the appellant submits that the Tax Court Judge defined the term "activity" in a manner that required literally no action on its part. According to the appellant, this goes against the purpose of the Treaty, which is to provide relief against double taxation. In this respect, the appellant maintains that the foreign tax credit to which it is entitled under U.K. tax laws will not fully compensate it for the taxes assessed in Canada.

[18] The appellant further alleges that the Tax Court Judge made a series of overriding and palpable errors in concluding that GONS rather than Allseas operated the Highland Pride during the 88 days that the Highland Pride was in Canadian waters.

[19] With respect to the interest expenses, the appellant maintains that the amounts claimed were computed in accordance with well-accepted business and accounting principles. The method used provides a reasonable basis for the allocation of these expenses amongst the 27 vessels and it was

for the Minister to establish that it did not provide an accurate picture of the income (*Candarel Limited v. Her Majesty the Queen* [1998] 1 S.C.R. 147, (*"Candarel").*

ANALYSIS AND DECISION

[20] Dealing with the first issue, it is apparent from the wording of article 27A that this provision was added to the Treaty in order to deem persons working in the sea bed exploration and exploitation industry to be carrying on business through a permanent establishment in circumstances where they would not otherwise be caught by the definition of permanent establishment under the Treaty.

[21] As applied to the facts at hand, article 27A of the Treaty makes any U.K. resident, carrying on activities in Canada in connection with the exploration and exploitation of the sea bed, subsoil and natural resources for more than 30 days, liable to Canadian taxation as if it were carrying on a business through a permanent establishment. The appellant alleges that it was not "carrying on activities" but rather was passively involved as a result of having leased the ship to Allseas; a lease that was equivalent to a bareboat charter. The appellant conceded before the Tax Court Judge that if it was "carrying on activities", those activities were connected with the exploration and exploitation of the seabed, subsoil and natural resources. Consequently, the only issue in this appeal is whether the Tax Court Judge could properly hold that GONS was "carrying on activities" pursuant to article 27A of the Treaty.

[22] There is no definition of what constitutes “carrying on activities” within the meaning of article 27A of the Treaty. The appellant argues that the Tax Court Judge gave a literal interpretation of the term “carrying on activities”, which was not in keeping with the legislative intent and the intention of the parties to the Treaty. However, as the respondent suggests, there is no reason why the relevant words of the Treaty should not be given their ordinary meaning, as the Tax Court Judge did (Reference is made to article 31(1)(a) of the *Vienna Convention*). I can detect no error in the Tax Court Judge’s understanding of the relevant words of the Treaty.

[23] Nor do I accept that the Tax Court Judge made an overriding or palpable error in his appreciation of the evidence. As the Tax Court Judge found, the appellant did not enter into a bareboat lease with Allseas. A bareboat lease is one whereby a ship is supplied without a crew.

[24] The fact that Allseas obtained the costal trading license, gave sailing instructions to the captain and determined which supplies were transported on the ship is not inconsistent with the Tax Court Judge’s finding that GONS was operating the Highland Pride. In my view, the fact that GONS supplied the crew, was in daily contact with the ship, had the captain keep logs of the ship’s whereabouts and was responsible for maintaining the ship throughout provides ample support for the Tax Court Judge’s conclusion that GONS was operating the ship.

[25] The appellant has identified no reviewable error with respect to the Tax Court Judge’s conclusion that GONS carried on activities in Canada, pursuant to article 27A of the Treaty.

[26] Turning to the second issue, I agree with Counsel for the Minister that no question of law arises with respect to the computation of profit proposed by the appellant in this appeal (*Candarel, supra*). The issue in this case is an evidentiary one, pertaining to the interest expense incurred by the appellant that properly relates to the Highland Pride.

[27] A *Candarel* type of issue could have arisen if the appellant had shown that its interest expense under the consolidated loan could be viewed as a general overhead expense benefiting all 27 ships. In such a case, the interest expense would have to be allocated on some basis, and it may be that, absent a better suggestion by the Minister, the method proposed by the appellant would have to be found appropriate.

[28] However, not only was this demonstration not made, but the record shows that the consolidated loan was used to finance a new ship (not “ships” as the Tax Court Judge said at para. 12 of this reasons), and the appellant was unable to identify the portion of the loan that was put to that use (Cross-examination of Mr. Guthrie, Appeal Book, Vol. II, at p. 321).

[29] Consequently, I can find no error in the Tax Court Judge’s conclusion that GONS did not meet the evidentiary burden of showing that its proposed method for apportioning the interest expenses was acceptable for establishing the expenses of the Highland Pride as a separate business.

[30] I would dismiss the appeal with costs.

"Marc Noël"

J.A.

"I agree
J. Edgar Sexton J.A."

"I agree
J.D. Denis Pelletier J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-217-06
(APPEAL FROM A JUDGMENT OR ORDER OF THE TAX COURT OF CANADA DATED APRIL 21, 2006, DOCKET NUMBER 2004-3596(IT)G)	
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CONCURRED IN BY:	SEXTON J.A. PELLETIER J.A.
DATED:	September 21, 2007

APPEARANCES:

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