

BETWEEN:

KINGUK TRAWL INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on common evidence with the appeals of *Farocan Incorporated*
(*Successor to Aqviq Trawl Incorporated*) (2000-671(IT)G)
on October 14, 2003, at Halifax, Nova Scotia.

Before: The Honourable Justice T.E. Margeson

Appearances:

Counsel for the Appellant: Edwin C. Harris

Counsel for the Respondent: John P. Bodurtha

JUDGMENT

Further to my Judgment and Reasons for Judgment issued on January 22, 2002, and further to the decision of the Federal Court of Appeal referring this matter back to the Tax Court of Canada for determination of the portion of the interest credited by the Appellant to Uhrenholt that properly relates to the business carried on by it in a foreign country pursuant to clause 212(1)(b)(iii)(E) of the *Income Tax Act*;

And further to oral and written submissions by both parties, the Court orders as follows:

- (1) The portion of the Appellants' total interest expenses for the years in question that is subject to withholding tax be calculated in accordance with the formula agreed to by the parties;

- (2) For the purpose of the formula, qualifying expenses incurred outside of Canada, and deemed to have been incurred in the course of carrying on a business in a country other than Canada, consist of packaging expenses, supplies and services for the vessels in foreign ports, and half of the legal expenses for the years in question;
- (3) The interest on the unpaid withholding tax that is determined by the application of the formula be calculated in the manner agreed to by the parties; and
- (4) The Appellants are entitled to one set of costs in respect of these proceedings.

Signed at Ottawa, Canada, this 14th day of November 2003.

"T.E. Margeson"

Margeson, J.

Docket: 2000-671(IT)G

BETWEEN:

FAROCAN INCORPORATED,
(Successor to Aqviq Trawl Incorporated),

Appellant,

and

HER MAJESTY THE QUEEN,

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"T.E. Margeson"

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Citation: 2003TCC842
Date: 20031114
Docket: 2000-674(IT)G

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KINGUK TRAWL INC.,

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Docket: 2000-671(IT)G

BETWEEN:

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REASONS FOR JUDGMENT

Margeson, J.

[1] These matters were referred back to the Tax Court of Canada for determination of the portion of the interest credited by the Appellants to Uhrenholt that properly relates to the business carried on by them in a foreign country pursuant to clause 212(1)(b)(ii)(E) of the *Income Tax Act* ("Act").

[2] The Federal Court of Appeal also directed that there should be one set of costs in the Federal Court of Appeal and in the Tax Court of Canada. At the time of the submissions following the decision of the Federal Court of Appeal the parties indicated that the formula for calculating the portion of the interest expense that was subject to withholding tax was agreed upon and that formula for each year was $(1 - \frac{B}{c}) A = D$.

[3] By that formula, A is the total interest expense credited to Uhrenholt; B is the total of "embedded expenses" and qualifying "expenses incurred outside Canada"; C is the total credits to the inter-company account of the Appellant in question plus the "embedded expenses"; and D is the interest subject to withholding taxes, not being exempt under clause 212(1)(b)(iii)(E) of the *Act*.

[4] The withholding tax is 15 per cent of D.

[5] At the subsequent hearing the parties agreed on the amounts to be included in the application of the formula except for the portion of "expenses incurred outside Canada" that can reasonably be regarded as having been incurred "in the course of carrying on a business in a country other than Canada". The result of the decision of the Federal Court of Appeal was to establish that the Appellants were carrying on part of their business "in a country outside Canada".

[6] The expenses in question consisted of:

- (1) Supplies and services for vessels while in foreign port.
- (2) Vessel insurance.
- (3) Packaging supplies.
- (4) Vessel, engine, and factory maintenance and other.
- (5) Protection and indemnity insurance.
- (6) Fishing gear.
- (7) Fuel and lube oil.
- (8) Crew travel.
- (9) Legal and professional.

[7] In submissions before the Tax Court of Canada at the time of trial, counsel for the Respondent agreed to accept all of the packaging expenses and half of the legal expenses, but would not accept any of the other expenses, in the foregoing list.

[8] At the time of submissions following the Federal Court of Appeal decision, the Appellants were prepared to accept the Respondent's position with one exception: "Supplies and Services for Vessel in Foreign Port". Counsel for the Appellants submitted that these expenses should also be accepted as representing expenses incurred in the course of carrying on business in a country other than Canada. In essence, his position in this matter was that they were incurred in carrying on business outside of Canada.

[9] It was the Appellants' submission that during the period in question, the two vessels, Aqviq and Kinguk, left Canada to land catch and to be repaired in Greenland and also went to Denmark for major repair and refit.

[10] He further submitted that the Federal Court of Appeal in this decision established that the selling aspects of the Appellants' business were carried on, through their agent, outside Canada. Therefore, it was submitted that, by reason of the need for the vessels to go to Greenland and Denmark in the course of carrying on the fishing aspect of their business, that aspect of their business was, in part, also carried on in one or more countries other than Canada. Part of the business that involved the operation of the vessels took place, and therefore was carried on, in countries outside Canada.

[11] Counsel further submitted that the decision of the Federal Court of Appeal must be taken to have rejected the Respondent's argument that, where the most significant aspects of a business are carried on in a country, all of the business must be regarded as being carried on there.

[12] Counsel referred to the decision of the Federal Court of Appeal herein, at paragraphs 39 to 42. In particular he relied upon the findings in *London Life Insurance Company v. The Queen*, 87 DTC 5312 (Trial Division) and *The Queen v. London Life Insurance Company*, 90 DTC 6001 (Appeal Division – *London Life*) in support of his proposition that the cost of "Supplies and Services for Vessel in Foreign Port" were expenses incurred in the course of carrying on business in a country other than Canada. All of these expenditures were related to an essential part of the fishing operation of the Appellants.

Argument on behalf of the Respondent

[13] Counsel for the Respondent asked the following question: "What was the purpose of the payments? What did the payments relate to? Further, do the expenses in issue relate to catching the fish or selling the catch?"

[14] It was argued that just because the activities were an essential part of the fishing operation, this does not mean that the Appellants were "carrying on a business outside of Canada".

[15] To reiterate, they are an essential part of the fishing operation but they do not amount to "carrying on a business".

[16] Counsel agreed, as indicated before, with points (1) and (3) of the Appellants' submission and all of point (2) with the exception of the supplies and services for the vessel while in a foreign port.

[17] It was the position of counsel for the Respondent that there are two main actions of the Appellants in this case: (1) the selling in Denmark and (2) the catching in Canada. As of needs be, the items in issue must relate to the catching in Canada because they do not relate to the selling in Denmark and therefore these expenses do not qualify for the exemption.

[18] Further, counsel argued that the Respondent should have its costs of this proceeding because this is a new proceeding and is not covered by the judgment of the Federal Court of Appeal.

[19] In reply, counsel for the Appellants said that there is no jurisdiction to give costs to the Respondent in this case. According to the decision of the Federal Court of Appeal, there is to be one set of costs in these proceedings and the Appellants should be entitled to costs incurred at this time.

[20] Further, it was counsel's position that fishing involved not only harvesting fish but also the other operations including operations which led to the expenses in question. They landed the catch in a foreign country. This was an integral part of the fishing business in general, being carried on outside of Canada. These actions were not "*de minimis*".

[21] The Federal Court of Appeal did not address the issue of what business was carried on outside of Canada. However, the actions which led to the expenses in issue were not incidental to a business being carried on outside of Canada, but were an essential part of the business of the company, which was fishing and this business has been carried on outside and inside Canada.

Decision

[22] The point made by counsel for the Respondent that the expenses in question did not relate to the selling is a neat point but the Court is satisfied that it interprets the decision of the Federal Court of Appeal too narrowly. The Federal Court of Appeal decided without question that some aspects of the operations of the Appellants were carried on outside of Canada even though they did not specify

what the business was that was being carried on outside of Canada. In paragraph 42 of the decision the Court stated as follows:

Indeed, the whole of the sales functions, from the marketing of the catch to the making of the contracts, was conducted by Uhrenholt. Having regard to the fact that selling the catch was an essential component of the appellants' business and that these activities took place in Denmark and perhaps elsewhere, I conclude that they were carrying on business in a foreign country within the meaning of clause 212(1)(b)(iii)(E) of the Act.

[23] In referring to *London Life Insurance Company, supra*, as they did, they indicated that the activities of Uhrenholt appeared to go beyond the extent of operations present in that case, where the agent was only responsible for conducting a portion of the sales functions. In making expenditures for supplies and services for the vessels in foreign ports, Uhrenholt, as agent for the Appellants, was going even further than what the Federal Court of Appeal had in mind in reference to the selling aspects of Uhrenholt. Yet, there can be no doubt that these extra activities were nonetheless an essential part of the business of the Appellants, which was in general, fishing and selling of the catch. One can hardly see how one could have carried on the business of fishing and the selling of the fish as carried on in this case without expending the amounts in issue here.

[24] This Court rejects the argument put forward on behalf of the Respondent that since these expenditures clearly do not relate to the selling of the fish, they must clearly relate to the catching of the fish in Canada. According to this conclusion the Court would have to decide that the Appellants were carrying on two or three different businesses, i.e. catching the fish, selling the fish, preparing the vessels and supplying the vessels. However, what the Appellants were involved in was a fishing operation, which included a number of different and essential parts.

[25] One of these parts required them to pay expenses for supplies and services for the vessels in foreign ports. These expenditures related to carrying on a business in a country other than Canada.

[26] In the end result the Court orders that:

- (1) The portion of the Appellants' total interest expense for the years in question that is subject to withholding tax be calculated in accordance with the formula agreed to by the parties;

- (2) For the purpose of the formula, qualifying expenses incurred outside of Canada, and deemed to have been incurred in the course of carrying on a business in a country other than Canada, consist of packaging expenses, supplies and services for the vessels in foreign ports, and half of the legal expenses for the years in question;
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Signed at Ottawa, Canada this 14th day of November 2003.

"T.E. Margeson"

Margeson, J.

CITATION: 2003TCC842
COURT FILE NO.: 2000-674(IT)G
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STYLE OF CAUSE: Kinguk Trawl Inc. and Farocan Inc.
(Successor to Aqviq Trawl Inc.) and
Her Majesty the Queen

PLACE OF HEARING: Halifax, Nova Scotia

DATE OF HEARING: October 14, 2003

REASONS FOR JUDGMENT BY: The Honourable Justice T.E. Margeson

DATE OF JUDGMENT AND REASONS FOR JUDGMENT: November 14, 2003

APPEARANCES:

Counsel for the Appellant: Edwin C. Harris

Counsel for the Respondent: John P. Bodurtha

COUNSEL OF RECORD:

For the Appellant: Daley Black & Moreira
400 – 1791 Barrington Street
Halifax, Nova Scotia
B3J 2N7

For the Respondent: Morris Rosenberg
Deputy Attorney General of Canada
Ottawa, Canada