Docket: 2006-3799(IT)G

BETWEEN:

STORA ENSO BETEILIGUNGEN GMBH,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on May 4, 2009, at Halifax, Nova Scotia.

Before: The Honourable Justice Patrick Boyle

Appearances:

Counsel for the appellant:	Bruce S. Russell, Q.C.
Counsel for the respondent:	John P. Bodurtha

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* with respect to the appellant's 1999 taxation year is allowed in part and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the reasons herein.

The appellant is entitled to costs.

Signed at Toronto, Ontario, this 26th day of May 2009.

"Patrick Boyle"

Boyle J.

Citation: 2009 TCC 282
Date: 20090526
Docket: 2006-3799(IT)G

BETWEEN:

STORA ENSO BETEILIGUNGEN GMBH,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Boyle J.

[1] Stora Enso Benteiligungen GmbH ("SEB") is a German corporation that has been assessed for failing to withhold 15% on amounts paid to a Swedish company, McKinsey & Company, Inc. ("McKinsey"), in respect of services rendered by McKinsey in Canada for a Canadian corporation in the Stora Enso Group, Stora Enso Port Hawkesbury Limited ("SEPH"). SEPH owned and operated a pulp and paper mill in Nova Scotia.

[2] The assessment of SEB was made pursuant to subsection 227(8.4) of the *Income Tax Act* Canada (the "*Act*") for failure to withhold as required under paragraph 153(1)(*g*) and regulation 105. In addition, SEB was assessed a 10% penalty in respect of its failure to withhold under subsection 227(8), as well as interest pursuant to subsection 227(8.3).

[3] SEB is the successor in title and to the liabilities of a predecessor corporation in the Stora Enso Group, Stora Enso Publication Paper Aktiengesellschaft ("SEPPA") as a result of a foreign reorganisation of SEPPA. At all material times SEPPA was a German corporation, however it has since been reorganised as a limited partnership of some sort. The parties do not dispute that SEB is properly

responsible for any failure by SEPPA to withhold in the years in question and prior to the reorganisation.

[4] SEB, SEPPA and SEPH are all members of the Stora Enso multinational group of companies. They are all related through common ownership. Operationally SEPH reported to SEPPA.

[5] SEPH is a Canadian corporation that owns and operates a pulp and paper mill near Point Tupper, Nova Scotia. In 1998 a new paper-making machine had been installed at the mill at a cost of approximately $800 million. The installation of the line began in 1996 and production began in the middle of April 1998.

[6] The machine's productivity and efficiency was not what was expected nor was the quality of paper as good as expected. For these reasons, the profitability of the mill was low. In the fall of 1998, McKinsey was retained to advise on the profitability of the line and of the mill overall. The terms of this retainer are outlined in a proposal letter from McKinsey to SEPPA.

[7] The taxpayer called two witnesses, the former chief financial officer of SEPH in the years in question as well as a SEPH accountant. Both witnesses gave very clear and credible evidence which was not challenged in any material way in cross-examination. The Crown did not call any witnesses but did read in some questions and undertakings from discovery. Importantly, the parties filed a partial agreed statement of facts in this case, a copy of which is attached hereto.

[8] According to the Partial Agreed Statement of Facts, McKinsey was engaged by SEPPA to do work for SEPH. Further, pursuant to the contract, McKinsey rendered services in Canada for SEPH. Paragraph 16 d) of the Crown's reply provides that the appellant, presumably meaning SEPPA, entered into a contract "on behalf of SEPH with McKinsey". (Emphasis added)

[9] The parties also filed two joint books of documents.

[10] McKinsey issued three invoices to SEPPA for each of the months of October, November and December 1998. The total amount of these three accounts, including out-of-pocket expenses, converted to C$1,539,402. SEPPA paid McKinsey these invoices in full in the ordinary course. The McKinsey invoices were denominated in Swedish Krona. It is not clear whether SEPPA paid in German Marks, Euros or

Swedish Krona. SEPPA did not make any Canadian regulation 105 withholding from the payments.

[11] In January of 1999, SEPPA advised SEPH in writing that SEPH would have to bear the expense of the McKinsey invoices. The Stora Enso Group of companies operate an intercorporate account netting system which ensures that each company's intercorporate payables are paid and receivables are received, on a net basis. Via this netting system, SEPH reimbursed SEPPA the full C$1,539,402 on March 12, 1999 against a final netting message dated March 10, 1999. SEPH's reimbursement to SEPPA for the McKinsey invoices was paid at 100% without any regulation 105 withholding.

[12] Seemingly coincidentally, the Canada Revenue Agency ("CRA") was in the process of conducting a regulation 105 withholding audit of SEPH. The CRA auditor alerted SEPH to the need to withhold under regulation 105 and paragraph 153(1)(*g*) in respect of the McKinsey services. SEPH therefore promptly remitted an amount of $230,910 to the CRA, being 15% of the total of the three McKinsey invoices. On April 9, 1999 SEPH sent an account to SEPPA seeking reimbursement of the $230,910 clearly identified as the 15% non-resident tax on the three McKinsey invoices. Further, SEPH's accounting staff were instructed not to pay any intercorporate accounts to SEPPA until after the $230,910 had been fully set off. SEPH received full cash credit for the $230,910 from SEPPA on December 21, 1999. This is evidenced by the cashbook sheet maintained by SEPH to record its banking transactions that was put into evidence. No reason was given for the delay. A copy of the T4A-NR information slip filed with the CRA is also in evidence and it indicates that SEPH was the payor and SEPPA was the payee.

[13] There was no evidence whether SEPPA claimed the 15% withholding back from McKinsey or tried to.

[14] In summary, there was only one relevant non-resident service provider and that is McKinsey. McKinsey's services were arranged for by SEPPA and SEPPA arranged for payment of McKinsey's invoices, but McKinsey's services were for SEPH. The services provided by SEPPA of arranging for the McKinsey contract and arranging for payment of its accounts were not provided in Canada and the value of those services in any event would have been only a fraction of the fees charged by McKinsey of over C$1.5 million.

[15] It is also clear that there is only one set of three McKinsey invoices for the services rendered in Canada by the non-resident. The amount of those invoices was fully borne by and paid by SEPH by virtue of it having reimbursed SEPPA for 85% of those costs and remitted a further 15% to the CRA as regulation 105 withholding. However, this is complicated somewhat by the fact that SEPPA first paid McKinsey invoices at 100% without any withholding and has only been reimbursed by SEPH for 85% of that amount.

[16] In short,

1) McKinsey provided services in Canada worth $1,539,402 including out-of-pocket expenses,
2) McKinsey has been paid in full for its services, and
3) the CRA has received 15% of the amount paid to McKinsey for its services.

[17] As discussed later, it should be noted that the CRA did not receive 15% withholding in respect of the 15% withholding remitted to it, commonly referred to as a gross-up of the withholding obligation, to reflect the fact that McKinsey received 100% not 85% of the amount otherwise due to it.

[18] In the assessment in question, the Crown seeks to collect from SEB as successor to SEPPA a further 15% in respect of SEPPA's payment to McKinsey for the services rendered in Canada for SEPH. The paragraph 153(1)(*g*) and regulation 105 withholding régime in respect of services rendered in Canada by non-residents does permit of the possibility of cascading withholding obligations. For example, a Canadian may contract with a non-resident for services to be rendered in Canada and that non-resident may in turn subcontract a portion of those services to be provided by a second non-resident. In such a case, the Canadian is subject to regulation 105 withholding on account of the first non-resident's services for which it is paying and the first non-resident may in turn be liable for regulation 105 withholding in respect of its payments to its subcontractor non-resident for the sub-contracted services rendered in Canada. This can have the effect of multiplying the withholding obligations even though the first non-resident is paying the second non-resident out of its net payments from the Canadian. However, this will only create a temporary problem as both non-residents are entitled to claim a full credit for the regulation 105 withholding when they file their Part I Canadian tax return in respect of their services rendered in Canada.

[19] In this case however it is inappropriate for the Crown to seek to impose multiple withholding obligations in respect of the same payment for the same services provided by a single service provider, McKinsey. The CRA cannot expect to receive full regulation 105 withholding in respect of the payment for McKinsey's services more than once. Only McKinsey provided services in Canada. There was no other non-resident providing any of these services. Instead of multiple service providers where cascading withholding obligations may be required, here we have multiple payments to non-residents in respect of McKinsey as single non-resident service provider. The CRA has received 15% withholding from one of the Stora Enso companies paying for McKinsey's services; it cannot also look to collect the regulation 105 withholding again from another Stora Enso company in the chain of payments. SEPH was not paying SEPPA for services rendered in Canada by SEPPA; it was paying SEPPA for the services rendered by McKinsey. Similarly, SEPPA in paying McKinsey was paying for those same services. This is markedly and structurally different from a non-resident service provider subcontracting all or a portion of the services. This case is more analogous to an employer obligated to pay its employees and to withhold under regulation 105 in respect of the salary and wages that uses a payroll company to make the payments to the employees and the remittances to the CRA. When the employer places the payroll company in funds in order to make the net payroll to the employees and to pay the CRA withholding remittances, the employer is also arguably paying the payroll company "in respect of" the services provided by the employees to use the language of the regulation. But query it they are "for" the services as required by the legislation. Such payments by the employer to the payroll company are in effect reimbursements or advances but are not payments for other services. There is a lack of logic in the Crown's position that SEPPA should also be withholding and remitting a further 15% to the CRA since SEPH has already remitted 15% in respect of the very same services provided by McKinsey.

[20] My conclusion that the CRA cannot collect regulation 105 withholding more than once in respect of the same payment to a single non-resident in respect of the same services is consistent with the decision of this Court in *Weyerhaeuser Company Limited v. The Queen*, 2007 TCC 65, 2007 DTC 392. In that case, Bowie J. in completing his textual, contextual and purposive analysis of paragraph 153(1)(*g*) and regulation 105, identified the purpose of the withholding obligations as to ensure that, if a non-resident recipient of a payment is, after all the facts are known (i.e. when its annual Canadian tax returns are filed), liable to pay income tax in Canada, there will be funds available, in the form of the 15% withheld and remitted, to satisfy the obligation. See paragraphs 6 and 7 of the reasons in *Weyerhaeuser*. In that case Bowie J. concluded that while disbursements incurred by a non-resident service

provider in providing its services may arguably be “in respect of” those services, they are not subject to subsection 153(1) regulation 105 withholding since they are not “for” the services and to do so would give the CRA more than 15% of the payments of a revenue or income nature that may be taxed ultimately in Canada.

[21] The respondent seeks to rely on *Ogden Palladium Services (Canada) Inc. et al. v. The Queen*, 2001 DTC 345. However, this is not a case where a Canadian payor to a non-resident for its services argues that there is no need for withholding on account of the non-resident tax because the non-resident will not have an ultimate tax liability. For this reason the *Ogden Palladium* analysis on this aspect is neither relevant nor helpful. To the extent the *Ogden Palladium* analysis equated the word “for” in paragraph 153(1)(*g*) with the words “in respect of” in regulation 105, it must now be read in light of the more detailed analysis in *Weyerhaeuser* with which I concur.

[22] The evidence is that SEPPA paid McKinsey’s invoices in full. I have no evidence before me whether SEPPA sought to reclaim the regulation 105 withholding from McKinsey after SEPH reclaimed it from SEPPA. In any event, subsection 153(1) is clear that the amount remitted to the CRA by SEPH in this case is for the account of McKinsey not for the account of SEPPA. Subsection 153(1) is clear that the payor is to “remit that amount to the Receiver General on account of the payee’s tax for the year”. Reading subsection 153(1), regulation 105 and paragraph 153(1)(*g*) together, it would defy logic to conclude that the payee for whose credit the remitted amount is held by the CRA is an intermediary in the payment chain and not the non-resident service provider.

[23] Subsection 153(1) contemplates regulation 105 withholdings being remitted to the CRA at the prescribed time. They are to be remitted by the 15th of the month following the month in which payment is made. In this case, SEPH paid SEPPA in respect of the McKinsey invoices on March 12, 1999, and the remittance had been made to the Receiver General by April 9, 1999, prior to the time SEPH was obligated to remit in respect of its payment to SEPPA. Paragraph 153(1)(*g*) and regulation 105 do contemplate that SEPPA should have withheld and remitted 15% on its earlier payment to McKinsey for the services. Had SEPPA done so, SEPH could have fully reimbursed SEPPA at 100% for the net payment to McKinsey and the withholding remittance to the CRA without having to withhold any additional amount. Since SEPPA did not withhold, it was at risk that, had SEPH not remitted the required withholding to the CRA, the CRA could come after SEPPA for the missing withholding. However, having received, accepted and retained the withholding

remittance made by SEPH, the CRA cannot also look for the same withholding in respect of the same services from SEPPA.

[24] The respondent is concerned that SEPH, in completing its T4A-NR information slip, identified SEPPA as the payee and not McKinsey. Whether or not an information slip is or is not correctly completed will not determine tax consequences as a general rule. From SEPH's point of view, its payee was SEPPA. From SEPPA's point of view it was the payee of the amounts received from SEPH and it was also the payor of amounts paid by it to McKinsey. SEPH is only a payor, McKinsey is only a payee, but SEPPA is both a payor and a payee given the chain of payments. I am not prepared to conclude that SEPH was wrong in identifying SEPPA as the payee, however nothing turns on that in any event.

[25] There is the residual problem that neither SEPH nor SEPPA remitted the aggregate amount of withholding required. McKinsey billed and was paid $1,539,402. SEPPA remitted 15% of that amount, being $230,910 to the CRA. However, because that withholding remittance is for the account of McKinsey, it is in effect an additional payment to McKinsey for the services which will itself be subject to withholding. The proper calculation for the regulation 105 withholding would be 15% of the quotient obtained when $1,539,402 is divided by 0.85, being $271,659. The difference is $40,749. This amount has not yet been remitted by either SEPH or SEPPA in respect of the services provided by McKinsey. Subsection 153(1) and subsection 227(8) permits the CRA to look to SEPPA for this amount. To the extent of this amount of $40,749, the disputed assessment of SEPPA is valid. There is no double-counting, cascading or multiple imposition of the withholding obligation in respect of this portion of the assessment. It is the CRA's due.

[26] With respect to the 10% penalties assessed for failing to withhold and remit the required amount, there was no evidence of SEPPA's due diligence in trying to avoid the non-payment of the gross-up withholding amount of $40,749. The penalty amount as it relates to this lesser amount of gross-up withholding has been validly assessed by the CRA against SEPPA and is due. It appears that SEPPA either did not turn its mind at all to any withholding when it paid McKinsey or that it chose not to withhold at all much less on a grossed-up basis. Similarly, it does not appear either SEPH or SEPPA ever turned their mind to the issue of grossing up the 15% withholding amount until I raised it in argument. There was no evidence that the 15% withholding remittance was reclaimed by SEPPA from McKinsey or that SEPPA even sought to reclaim it from McKinsey. Obviously, had SEPPA reclaimed it from McKinsey, the additional gross-up withholding obligation would go away.

[27] The remaining issue in this case relates to the fact that SEPH remitted 15% of the entire amount paid in respect of McKinsey's services to the CRA including the amount identified in the McKinsey invoices as being on account of out-of-pocket expenses. It is the taxpayer's position that, in reliance on the *Weyerhaeuser* decision, disbursements and out-of-pocket expenses are not subject to regulation 105 withholding for the reasons summarized above. In this case, if the amount identified as out-of-pocket expenses were backed out, SEPH would have remitted more than 15% but less than the grossed-up withholding required. In *Weyerhaeuser*, it appears that the disbursements and out-of-pocket expenses were, as the name implies, reimbursements by Weyerhaeuser for actual out-of-pocket expenses and disbursements incurred by the non-resident service providers in the course of providing the services in question. That does not appear to be how out-of-pocket expenses were dealt with by McKinsey in this case. In its proposal letter for the services, McKinsey specifies that "additionally, we will bill you for out-of-pocket expenses as they incur which arise from travel, lodging, car rentals, telephone use, etc. While we strive to be as conservative and responsible as possible in incurring these expenses, it typically represents a further 10% in addition to the professional fees". However, it appears clear from the three McKinsey invoices that they have simply added a surcharge described as "out-of-pocket expenses" in an amount equal to exactly 10% of the agreed fee for services each month. This appears to me to be more of a single price all-inclusive bundled contract done in the guise of a surcharge described as out-of-pocket expenses. I have no evidence that these amounts reflected actual out-of-pocket expenses or that McKinsey chose to cap actual the out-of-pocket expenses incurred at 10% based upon their proposal letter and good client relations. I am not satisfied that the *Weyerhaeuser* decision excluding actual reimbursements of disbursements and out-of-pocket expenses should extend to a situation such as this.

[28] In conclusion, I will be allowing the taxpayer's appeal in part and ordering the Minister of National Revenue to reconsider and reassess the appellant in accordance with these reasons for $40,749, being the missing withholding gross-up amount, and reducing the penalty accordingly. The appellant will be entitled to costs in this appeal.

Signed at Toronto, Ontario, this 26th day of May 2009.

"Patrick Boyle"

Boyle J.

APPENDIX

2006-3799(IT)G

TAX COURT OF CANADA

BETWEEN:

STORA ENSO BETEILIGUNGEN GmbH

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Partial Agreed Statement of Facts

1. The Appellant, Stora Enso Beteiligungren GmbH (SEB), is a corporation pursuant to the laws of the Federal Republic of Germany. At all material times SEB, based in Germany, was a non-resident of Canada.

2. At all material times prior to December 31, 2000, SEB was the parent corporation of Stora Enso Publication Paper Aktiengesellschaft (SEPPA). SEPPA was at all material times a corporation pursuant to the laws of Germany, was based in Germany and was a non-resident of Canada.

3. SEB appeals the income tax assessment raised against it on March 26, 2004 by the Respondent's Minister of National Revenue (Minister), totalling $366,738.32. This total is comprised of tax ($230,910), penalty ($23,091) and interest to March 26, 2004 ($112,737).

4. At all material times, Stora Enso Port Hawkesbury Limited (SEPH) was a company incorporated pursuant to the laws of Nova Scotia, and was resident in Canada. SEPH owned and operated a pulp and paper mill located in the area of Point Tupper, Nova Scotia ("Port Hawkesbury Mill").

5. At all material times SEB, SEPH and SEPPA were related through common ownership.

6. In 1998, the Port Hawkesbury Mill was in a time of transition and faced major business challenges. In order to address these challenges, representatives of SEPH (Mr. Jack Hartery), SEPPA (Mr. Horst Thaler) and McKinsey (Mr. J.L. Jonas) met in early September 1998. This meeting is referenced in a letter dated September 14, 1998 from Mr. Jonas of McKinsey to Mr. Horst Thaler of SEPPA, a true copy of which is at tab 9 of the Joint Book of Exhibits.

7. Shortly following the September 1998 meeting, McKinsey was engaged by SEPPA to do work for SEPH, including to perform a business review of SEPH's Port Hawkesbury Mill and to advise on various matters related to SEPH operations, including the efficacy of certain paper-making equipment at SEPH's Port Hawkesbury Mill and the marketing of products produced at SEPH's Port Hawkesbury Mill. The said September 14, 1998 letter from Mr. Jonas, identifies generally the terms of the contract.

8. At all material times McKinsey was not resident in Canada. Pursuant to the aforementioned contract, McKinsey rendered services in Canada for SEPH. Specifically, during some or all of September, October, November and December 1998 McKinsey consultants attended at SEPH's Port Hawkesbury Mill and reviewed and advised on the efficiency of certain paper making equipment.

9. With respect to the work performed at the Port Hawkesbury Mill, McKinsey issued three invoices to SEPPA, which were dated October 31, 1998, November 30, 1998 and December 31, 1998 ("McKinsey Invoices"). The McKinsey Invoices totalled the amount of 8,283,660 Swedish Kroner. True copies of the three McKinsey Invoices are at tab 5 of the Joint Book of Exhibits.

10. In accordance with the McKinsey contract, the McKinsey Invoices included an amount for professional fees and an amount for "out of pocket expenses". The McKinsey Invoices totalled, when converted to Cdn dollars as of March 12, 1999, Cdn $1,539,402 of which $1,399,456 was for professional fees and $139,945 was for "out of pocket expenses".

11. True copies of each of two internal Stora communications, the first being a telefax dated November 13, 1998 from Mr. Horst Thaler of SEPPA to Mr. Ingvar Petersson of the Stora "Group Executive Management", and the second being a telefax dated November 16, 1998 to Mr. Thaler from Mr. Petersson per Karin Hagy, are at tab 10 and 11 of the Joint Book of Exhibits.

12. SEPPA paid the McKinsey Invoices. By telefax dated January 26, 1999, SEPPA per Mr. Thaler forwarded the McKinsey Invoices to Mr. Jack Hartery of SEPH directing SEPH to pay SEPPA for the amounts it had paid on the McKinsey Invoices, absent any internal mark-up. A true copy of the said January 26, 1999 telefax is at tab 3 of the Joint Book of Exhibits.

13. On or about March 10, 1999, Stora Finance AB sent to SEPH a "final netting message" referencing *inter alia* a "CAD" payment to "payee" SEPPA of $1,539,401.90. A true copy of the said message is at tab 4 of the Joint Book of Exhibits.

14. SEPH subsequently remitted to the Receiver General 15 percent of the total amount it had paid to SEPPA, totalling Cdn $230,910. A Canada Revenue Agency auditor advised or instructed SEPH that that remittance be made, pursuant to section 105 of the *Income Tax Regulations* (Canada).

15. On April 9, 1999, SEPH invoiced SEPPA for the said Cdn $230,910 – absent any internal mark-up. A true copy of SEPH's invoice to SEPPA for the Cdn $230,910 is at tab 5 of the Joint Book of Exhibits.

16. On March 26, 2004, the Minister assessed SEB (on behalf of SEPPA, which is not contested by either party) tax of $230,910 pursuant to subsection 227(8.4) of the *Income Tax Act* (Canada) (Act), a penalty of $23,091 pursuant to subsection 227(8) of the Act and interest pursuant to subsection 227(8.3) of the Act which totalled $112,737 to March 26, 2004.

DATED at Halifax, Province of Nova Scotia, this 4th day of May, 2009.

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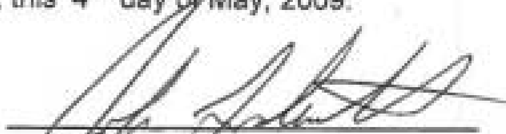
DATED at Halifax, Province of Nova Scotia, this 4th day of May, 2009.



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TO: Registrar
Federal Court

CITATION:	2009 TCC 282
COURT FILE NO.:	2006-3799(IT)G
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PLACE OF HEARING:	Halifax, Nova Scotia
DATE OF HEARING:	May 4, 2009
REASONS FOR JUDGMENT BY:	The Honourable Justice Patrick Boyle
DATE OF JUDGMENT:	May 26, 2009

APPEARANCES:

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Counsel for the respondent:	John P. Bodurtha

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