

BETWEEN:

THE MINISTER OF NATIONAL
REVENUE

APPELLANT;

1961
} May 23
1962
} Nov. 7

AND

PARIS CANADA FILMS LIMITED ... RESPONDENT.

Revenue—Income tax—Income Tax Act, R.S.C. 1952, c. 148, ss. 106(2), 109(1), 123(8)(b)—Canada-United States Tax Convention Act, S. of C. 1943, c. 21 as amended by S. of C. 1950, c. 27, arts. I, II, VIII, XIIC—Canada-France Income Tax Convention Act, S. of C. 1950-51, c. 40, arts. 2, 13—Liability to withhold tax on amounts paid to non-residents for the use of films in Canada—Appeal allowed in part.

Respondent, a Canadian company, in the business of distributing motion picture films, acquired exhibiting rights to a number of foreign films under various arrangements (1) an agreement with a Moroccan film company which gave respondent the right to exploit certain films for a period of 5 years for a 50 per cent share in the profit therefrom (2) an agreement with a French company conferring similar rights but for stated lump sum considerations and (3) with a United States film company which transferred irrevocably to the respondent for a stated lump sum all its rights to 59 films without a time limit

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By s. 106(2) of the *Income Tax Act* a tax is imposed on non-resident persons at the rate of 10 per cent of amounts paid or credited for a right in or to the use of motion picture films . . . that have been or are to be used or reproduced in Canada.

On an appeal from a decision of the Tax Appeal Board the Minister contends that the respondent should have deducted the 10 per cent non-resident tax and having failed to do so was liable for the tax under s. 123(8)(b) of the Act. Respondent contends that payments were capital payments and not subject to the withholding tax or that the payments were exempt from Canadian tax by virtue of the reciprocal tax treaties between Canada and the United States and between Canada and France.

Held: That the payments dependent on profits and the lump sum payments for the Canadian rights for five years were for the "right to the use of motion picture films . . . that are to be reproduced in Canada" within the meaning of s. 106(2) of the Act.

2. That as the territory of Morocco never formed part of metropolitan France within the meaning of the Canada-France Convention, an enterprise of that territory is wholly outside the purview of the said convention.
3. That although the Canada-France Convention applies in the case of payments to the French company, paras. iii and iv of Article 13 of the Convention specifically provide for the taxation of the payments by the debtor state, namely Canada.
4. That the assignment in perpetuity of the exploitation rights by the United States company was equivalent to a transfer of stock-in-trade and so exempt from Canadian tax under Art. I of the Canada-United States convention.

APPEAL from a decision of the Tax Appeal Board.

The appeal was heard before the Honourable Mr. Justice Dumoulin at Montreal.

Philippe Guay and *Roger Tassé* for appellant.

Lazarus Phillips, Q.C. for respondent.

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

DUMOULIN J. now (November 7, 1962) delivered the following judgment:

The Minister of National Revenue has filed this appeal against a decision, dated November 26, 1959, of the Tax Appeal Board¹, affirming respondent's objection to a re-assessment of its income tax for 1953.

At all relevant times, Paris Canada Films Limited, having its Head Office in the City of Montreal, conducted in Canada, its business of distributing motion picture films.

In normal pursuit of its trade the respondent, as more fully illustrated hereunder, concluded several agreements with foreign owners, producers, or initial distributors of picture films, namely: Sigma-Vog-Les Films Marceau of Paris, France; Maroc Films, of Casablanca, Morocco, and Sodak International Films Inc., of New York, U.S.A.

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In connection with these contracts, respondent paid the following amounts, during 1953, to:

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Sigma-Vog-Les Films Marceau	\$ 12,500
Maroc Films	8,500
Sodak International Films Inc.	210,000

The appellant seeks to recover from the respondent the "withholding" tax of 10% stipulated in section 106(2) of the *Income Tax Act* (R.S.C. 1952, ch. 148), amounting to \$23,100, for which the respondent was re-assessed on February 6, 1957, consequent upon its omission of complying with this alleged obligation.

Against this fiscal demand the respondent urges a two-fold exception set out in paragraphs 10 and 12 of its "Reply to the Minister's Notice of Appeal" reading thus:

10. THAT the payments made by the Respondent for the purchase of the above mentioned films were capital payments and not subject to withholding tax.
12. The assessment aforementioned violates the Conventions for the avoidance of double taxation between Canada and the United States of America and between Canada and France.

The first objection is one wherein fact and statutory law merge together, whilst the second deals with the interpretation of two International Agreements.

As will appear, the indispensable approach to the treaties lies in the preliminary analysis of respondent's first argument, the Court must therefore proceed to elucidate this essential factor.

Section 106(2) of the *Income Tax Act* (1952, R.S.C. ch. 148), applicable to the instant case, prescribed that:

106(2) Every non-resident person shall pay an income tax of 10% on every amount that a person resident in Canada pays or credits or is deemed by Part I to pay or credit, to him as, on account or in lieu of payment of, or in satisfaction of payment for a right in or to the use of motion picture films that have been or are to be produced or reproduced in Canada.

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In its Notice of Appeal, at paragraph 2, the Minister declares that:

2. On July 10, 1951, June 18, 1953 and July 10, 1953 there intervened, between Sigma-Vog-Les Films Marceau, having its residence outside Canada, and the Respondent, contracts which granted to the Respondent distribution rights for Canada for a number of films which are enumerated in the said contracts.

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Paragraphs 3 and 4 contain similar allegations, regarding distribution rights for Canada acquired from other non-resident organizations, Maroc Films and Sodak International Films Inc., the contractual dates being the only variant, in exhibits 6, 7, 8, 9, 10 and 11.

The sole question at issue is whether or not Paris Canada Films Ltd., obtained from non-residents "a right in or to the use of motion picture films", to be reproduced in Canada, even though such a right might be derived from an outright "purchase".

The respondent in its qualified denial of appellant's paragraphs 2, 3 and 4 holds "that the contracts referred to therein (i.e. exhibits 6, 7, 8, 9, 10 and 11) speak for themselves". If so, what do these contracts stipulate?

Exhibit 6, the agreement between Maroc Film of Casablanca, Morocco, and Paris Canada Films, Ltd., of Montreal, dated at Paris, April 8, 1951, enacts the following, *inter alia*:

Messieurs, (viz. Paris Canada Films Ltd., the Respondent)

Par la présente, nous vous confirmons, en qualité de propriétaires des droits, l'accord intervenu entre nous:

1°) En qualité de notre mandataire vous exploiterez pour notre compte exclusivement dans les territoires ci-après énumérés.

— C A N A D A —

la version en langue française, du film intitulé «LA PASSANTE» . . .

2°) Cette exploitation (underlinings are mine throughout these notes) aura lieu pour une durée de CINQ ANS (5) années, à dater du jour de l'acceptation du film par la censure canadienne. . . .

Vous vous engagez à mettre en exploitation le film au plus tard le-- après l'obtention du visa de censure.

3°) Vous vous engagez à nous fournir le 20 de chaque mois:

a) Un bordereau récapitulatif des contrats signés, mentionnant, pour chaque établissement, le pourcentage de location ou le forfait, le minimum garanti, la date limite d'exécution;

b) Un bordereau détaillé par salle, des encaissements, mentionnant: le nom de la ville, la date de passage, la recette nette, le pourcentage de location appliqué, le montant de la facturation . . .

c) Un relevé du compte mensuel tenu séparément pour le film. Les produits d'exploitation du film nous seront versés jusqu'à concurrence de 50/50 (cinquante-cinquante) étant entendu que Vous Nous verserez, à valoir et à titre de MINIMUM GARANTI, une somme de 1,500,000,—(Un million Cinq Cent-Mille Francs) . . . de la recette brute d'exploitation que vous nous ferez parvenir avant le 20 de chaque mois suivant le début de l'exploitation de la première copie.

Le surplus des recettes brutes vous restera acquis, tant à titre de rémunération forfaitaire de mandataire que pour vous couvrir des frais d'exploitation visés au paragraphe 6 ci-après . . .

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Exhibit 7, between the same parties, bearing date of December 5, 1951, to all practical intents is similar, providing also for a five-year exploitation of certain films.

Exhibit 8 links together for identical purposes of exploitation and a five-year term, Sigma-Vog-Les Films Marceau of Paris (July 10, 1951) and respondent.

Exhibit 9, dated at Paris, June 18, 1953, grants to Paris Canada Films, during five years, at a price of \$3,500, "les droits exclusifs de représentation cinématographique . . .". The party of the first part, or stipulator, here, is Les Films Marceau.

Exhibit 10, again between the above, is precisely to the same effect as the preceding indenture, bestowing for a consideration of \$5,000, "les droits exclusifs de représentation cinématographique", in Canada. Date: July 10, 1953; duration: five years.

It seems a waste of time to underscore that each of those five contracts possessed all the elements attaching to a "right to the use of motion picture films . . . that are to be reproduced in Canada", and none of the essential components of a "purchase".

Exhibit 11, a contract with Sodak International Films Inc., of New York City, bears date of July 6, 1953. Couched in brief terms, and for a large lump sum of \$210,000, it assigns the transferor's rights, which are qualified as follows:

En notre qualité de propriétaires des droits d'exploitations cinématographiques . . . nous vous cédon*s* irrévocablement . . . les droits que nous détenons pour les 59 films cités ci-dessous nommés . . .

The rights conceded here are similar to those transferred by the preceding contracts: commercial exploitation of motion picture films, but with an irrevocable surrender unrestricted as to time. Despite this particular feature,

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about which more will be said further on, the respondent company, obligated by section 109(1) to “deduct or withhold . . . the amount of the tax and forthwith remit that amount to the Receiver General of Canada on behalf of the non-resident person . . .”, and having omitted to do so, would incur the sanction decreed by section 123(8)(b) of the Act, “. . . to pay to Her Majesty . . . the whole amount that should have been deducted or withheld”, unless, and we now reach the respondent’s second objection, the relevant International Conventions, in avoidance of double taxation, should operate as relieving measures.

Since the contract between the respondent and the New York firm of Sodak International Films (ex. 11) comprises practically the 9/10 of the amount at stake, it is apropos to review, firstly, the *Canada-United States Tax Convention Act*, 1943 (7-8 Geo. VI, chap. 21), as amended in 1950 (14 Geo. VI, chap. 27).

Article I of the Convention in the 1943 treaty enacts that:

An enterprise (defined in the Protocol, sec. 3(b)) of one of the contracting States is not subject to taxation by the other contracting State in respect of its industrial and commercial profits except in respect of such profits allocable in accordance with the Articles of this Convention to its permanent establishment (defined in the Protocol, sec. 3(f)) in the latter State . . . Sodak Films has no “permanent establishment in Canada”.

Article II proceeds to narrow down the expression “industrial and commercial profits”, thus:

For the purposes of this Convention, the term “industrial and commercial profits” shall not include income in the form of rentals and royalties, interest, dividends, management charges, or gains derived from the sale or exchange of capital assets . . .

Next in the line of appropriate texts comes the initial paragraph of Article XIII C in Schedule A of the 1950 amending Act (14 Geo. VI, chap. 27) which I quote:

Royalties for the rights to use copyrights or in respect of the right to produce or reproduce any literary, dramatic, musical, or artistic work (but not inclusive of rents or royalties in respect of motion picture films) derived from sources within one of the contracting States by a resident or corporation or other entity of the other contracting State not engaged in trade or business in the former State through a permanent establishment shall be exempt from tax imposed by such former State.

It now remains for me to determine the legal nature of the transaction evidenced in exhibit 11, whereby the rights of cinematographic exploitation (droits d’exploitation cinématographique) for Canada are assigned irrevocably

by Sodak Films of New York to Paris Canada Films of Montreal, against a monetary consideration of \$210,000, payable in twelve months and three instalments.

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Proceeding by elimination, I incline to believe that a lump payment for rights irrevocably ceded, tantamount to an assignment in perpetuity, as in exhibit 11, can hardly be reconciled with the customarily accepted notions attaching to "rents or royalties", *id est*: limit of time, retention of a *jus in re* by the lessor, and periodical rentals by the lessee, either for fixed sums or an apportionment of receipts.

Neither can this deal, or more exactly its subject-matter be considered as instancing a "sale or exchange of capital assets", that, in the present set of facts, would also be exempt from taxation in Canada, by virtue of Article VIII of the 1943 Tax Convention, hereunder recited:

Gains derived in one of the contracting States from the sale or exchange of capital assets by a resident or a corporation or other entity of the other contracting State shall be exempt from taxation in the former State, provided such resident or corporation or other entity has no permanent establishment in the former State.

The only commercially profitable use to which motion picture films can be put consists in their reproduction on the theatrical screens of the land. Then, an assignment in perpetuity of all exploitation rights to those 59 films, listed in exhibit 11, by a non-resident company, whose regular business it is to transact such deals, seems equivalent to a disposal, or sale, of so many "inventory or stock in trade goods", productive of corresponding "industrial and commercial profits".

We have seen that receipts of this kind benefit from the tax exemption decreed by Article I of the Canada-United States Convention. On this most important part of the case, the respondent's objections appear fully substantiated, and the appellant's claim to a \$21,000 withholding tax is unfounded.

Coming now to the second series of motion picture contracts, exhibits 6 to 10 inclusive, concerning which the Canada-France Income Tax Convention (1950-1951, S.C. 15 Geo. VI, chap. 40) was invoked by respondent, attention is at once attracted to Article 2:

For the purposes of this agreement: I.—The term "France" when it is used in the geographical sense, will mean only "Metropolitan" France excluding Algeria, the overseas departments and other territories of the French Union.

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Two contracts filed as exhibits 6 and 7, though dated at Paris, France, have, as a party thereto, "Maroc Film, 38, rue Galliéni, Casablanca (Maroc)".

Although this point was not argued at trial nor raised in the written pleadings, I do not think I should, on that account, ignore the jurisdictional extent of the Treaty. To all appearances, "Maroc Film", with its place of business at Casablanca, Morocco, which never formed part of "Metropolitan" France, is an enterprise wholly outside this convention's purview, and the \$8,500, admittedly paid to it by the respondent, offers proper ground for the applicability of the 10% tax imposed by section 106(2).

The latter international Covenant also governs the third and last group of undertakings, comprised in exhibits 8, 9 and 10, between Sigma-Vog-Les Films Marceau, a Parisian producing and distributing concern, and the respondent.

Each of these three contracts, with a duration restricted to five years, sufficiently responds to the taxing requirements set out in Article 13, paragraphs III and IV of the Canada France Convention providing that:

III. The proceeds of royalties (redevances) derived from the sale or licensing of the use of patents, trademarks, secret processes or formulae, are taxable in the State of the debtor.

IV. The word "royalties" as used in paragraph III of this Article should be understood to include the income from the lease of motion picture films.

Notwithstanding the mention, in exhibits 9 and 10, of the term "cession", currently associated with notions of sale, the purport of the transaction, a grant of cinematographic reproduction rights for a five-year period at global prices of, respectively, \$3,500 and \$5,000, undoubtedly fall in the classification of "income from the lease of motion picture films". No ambiguity whatever subsists as to exhibit 8, and its fifty per cent apportionment of profits between the parties thereto, affording a clear application of the "royalty" payment, assessable in the debtor State. The respondent should account for a withholding tax of ten per cent on this last sum of \$12,500.

For the reasons outlined the appeal is allowed as regards the amounts paid to Maroc Films, exhibits 6 and 7 and to Sigma-Vog-Les Films Marceau, exhibits 8, 9 and 10; it is dismissed in the matter of Sodak International Films Inc., exhibit 11.

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The record will be referred back to the appellant to adjust the assessments accordingly.

Since respondent has succeeded for nine-tenths of the amount involved it should be entitled to the entire costs after taxation.

Judgment accordingly.