THE POPE APPLIANCES CORPORATION LIMITED .... APPELLANT;

1926
Nov. 4.
Nov. 16.

AND

THE MINISTER OF CUSTOMS AND EXCISE .... RESPONDENT.

Revenue—Income Tax Act, 1917, and Amendments—Non-resident person —Royalties from licensees under patent—Return of capital—"Income."

The appellant was a foreign corporation with its head office in the United States of America, having no office or place of business in Canada. It was the owner of certain inventions for paper machines for which letters patent had been issued by the Dominion of Canada. It did not manufacture or sell the patented machines, but granted licenses to persons in Canada to use the inventions aforesaid, for which it received royalties.

Held that the use of these patents in Canada under the licenses was a use of a "thing" in Canada as contemplated by section 3 of chapter 46, 14-15 Geo. V (1924).

2. That, as there was a "thing" sold or used in Canada for which a royalty was paid, the appellant was carrying on a business in Canada, within the meaning of the Income War Tax Act, 1917, and amendments thereto, and the payment made under the licenses was not the return of capital, but "income" within the meaning of the statutes and was properly assessed as such.

APPEAL from the decision of the Minister of Customs and Excise assessing the appellant for income tax.

The appeal was heard at Ottawa before the Honourable Mr. Justice Maclean, the President of the Court.

Harold Fisher, K.C., and *R. S. Smart, K.C.*, for the appellant.

P. D. Wilson for the respondent.

The facts are stated in the reasons for judgment.

THE PRESIDENT, on the 16th day of November, 1926, delivered judgment.

This is an appeal from an assessment made against the appellant, under the Income War Tax Act, 1917, and the appellant asks that the said assessment be set aside.

The appellant is a corporation, incorporated under the laws of the State of Maine, U.S.A., having its head office and principal place of business in the United States, and having no office or place of business within Canada. The

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corporation is the owner of certain inventions relating to improvements on machines used for the manufacture of paper, and letters patent have been issued by the Dominion of Canada in respect to such inventions. The appellant has by several licenses, granted to certain persons and corporations in Canada the right to use inventions covered by such letters patent, and such persons or corporations have been operating in Canada, machines embodying such inventions and have paid to the appellant royalties in respect of the licenses granted to them. The appellant does not manufacture or sell the patented machines, but grants to licensees the right to use the inventions, which implies the right to make them.

The principal paragraph in the usual form of license is as follows:—

> The licensor hereby grants to the licensee the right to usê the inventions described and claimed in said letters patent on the aforesaid machines of the licensee, located as aforesaid including any improvements on said inventions which the licensor may acquire upon the following terms and conditions.

The licenses are not assignable, and no license passes with the sale of any machine sold by the licensee, but the licensor agrees not unreasonably to refuse to grant a license in the case of a sale of a machine by the licensee. The royalty paid by the licensee, is fixed on the basis of so much per ton of paper produced on machines equipped with the appellant's inventions; for instance, the royalty is 10 cents per ton for machines running less than 600 feet per minute, and 25 cents per ton for machines running 800 feet and over per minute. Royalties are payable quarterly and are remitted directly to the appellant at its place of business in the United States. The licensor reserves the right to inspect all the licensed machines in the mills of the licensee, and all production records for the purpose of investigating any claims for royalty, and also the right of placing plates on each machine containing patent dates, etc. The licensor may cancel the license upon failure to pay the royalties, or for any non-performance of the licensing agreement.

By the Statutes of Canada, 1924, chap. 46, sec. 3, there was added to subsection 3 of the Income War Tax Act, 1917, the following paragraph:—

> Any non-resident person soliciting orders or offering anything for sale in Canada through an agent or employee, and whether or not any con-

tract or transaction may result therefrom is contemplated within Canada or without Canada, or partly within and partly without Canada, or any non-resident persons who lets or leases anything used in Canada, or who receives a royalty or other similar payment for anything used or sold in Canada, shall be deemed to be carrying on business in Canada, and to earn a proportionate part of the income derived therefrom in Canada. The Minister shall have full discretion as to the manner of determining such proportionate part.

The appellant claims that it does not receive royalty for "anything used or sold in Canada," and that the transactions of the appellant in Canada in connection with the licensing of patents, is not a carrying on of business in Canada within the contemplation of the statute, and that the payments made to the appellant by the licensees are not taxable. The appellant also contends that the licensing in Canada of its patents is virtually a sale of their patents with payments deferred, and that the payment of royalties therefor periodically, is but a receipt of payments on account of such sale, and are capital sums and not income.

The amendment to the Income War Tax Act, to which I have referred, clearly discloses I think the object of the amendment, and it is equally clear I think that the amending sections fully accomplish that object. The licenses granted by the appellant permit the use in Canada of machines made under its patents, and if it were not for such licenses, the machines could not be made or used in Canada, unless the appellant failed in some way to meet the public demand or requirements for such patents, in which circumstances the Patent Act makes due provision for such default. To say that the provisions of the statute do not apply here because the appellant does not sell a tangible or physical thing, such as one of the machines made under its patents, but merely licenses somebody else to make and use them, is altogether too narrow a construction of the statute, and such a contention is not I think tenable. There can be no doubt that here there is a "thing used in Canada," within the meaning of the statute. Mr. Wilson for the respondent referred to Holland on Jurisprudence, at page 101, wherein the author describes a "thing" as the "object of a right," i.e., is whatever is treated by the law as the object over which one person exercises a right, and with reference to which another person lies under a duty. This text writer proceeds

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to state that "things are of two kinds: (1) material objects or physical things, and (2) intellectual objects or artificial things; and he mentions patents, copyright, trademarks, etc., as illustrative of the second group, and he states that the fiction by which patents, etc., are regarded as "things" is not only harmless but indispensable. It seems to me that the view thus expressed by this writer is well founded, and is quite pertinent here. I am of the opinion that the use of the appellant's patents in Canada under license, is clearly a use of a thing in Canada as contemplated by the statute.

If I am right in this view, then it follows that there is a "thing" sold or used in Canada, for which a "royalty" is paid. If the statute covers the licensing and use here in question, and I think it does, then the appellant is carrying on business in Canada, because the statute explicitly states that the receipt of royalty or other similar payments for anything used in Canada, shall be deemed to be a carrying on of business in Canada.

The contention that the payments made under the licenses is a capital sum, and not income, cannot I think be maintained. The royalty received by the appellant is for the use of its inventions. The payment or royalty is in respect of the user of the inventions measured by the quantity of production of paper which may vary according to the machine to which the invention is attached, the speed, etc. That is the substance of the arrangement. The bargain is that the licensee pay, not a capital sum, but a sum dependent on the volume of paper produced, and which would vary according to market demands and other factors. What the appellant receives is income from the earnings or use of the inventions. These payments have none of the characteristics of a capital sum. I think they are clearly income within the statute, and that the assessment in question was properly made. See *Jones* v. *Commissioners of Inland Revenue* (1); *Constantinesco* v. *Rex* (2).

I would therefore dismiss the appeal with costs to the respondent.

Judgment accordingly.

(1) [1920] L.R. 1 K.B. 711.

(2) [1926] 42 T.L.R. 383 and 685.