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INTERPROVINCIAL PIPE LINE COMPANY ..... APPELLANT;

AND

THE MINISTER OF NATIONAL REVENUE ..... RESPONDENT.

ON APPEAL FROM THE EXCHEQUER COURT OF CANADA

Taxation—Income tax—Calculation of foreign tax credit—Sources of income—Effect of 1960 amendments to Income Tax Act—Canada-U.S. Tax Convention, Article XV—Income Tax Act, R.S.C. 1952, c. 148, ss. 11(1)(c), 41, 139(1a), (1b).

The facts in this case are substantially the same as those in *Interprovincial Pipe Line Co. v. M.N.R.*, [1959] S.C.R. 763, which dealt with the appellant's taxation years 1950 to 1954. The question again is how the calculation of the foreign tax deduction under s. 41 of the *Income Tax Act* is to be made and the result depends upon the effect to be given to the amendment to the *Income Tax Act* enacted in the year 1960. The appellant company's pipelines were connected by a pipe running through the United States which was owned and operated by a wholly-owned U.S. subsidiary company. The appellant carried on no business there. All the capital needed for the construction of the pipeline was raised by the appellant largely through the issue

* PRESENT: Cartwright C.J. and Abbott, Martland, Judson and Ritchie JJ.

of bonds and debentures in Canada. The appellant also financed the construction of the U.S. section of the line and took from its subsidiary interest bearing demand notes and bonds. In the years 1960 and 1961, the appellant received substantial amounts of interests on the bonds of its U.S. subsidiary, on which it paid a withholding tax of 15 per cent to the U.S. government. In computing its income, the appellant deducted the total amount of the tax paid to the United States. The Minister granted the appellant a much smaller foreign tax credit, ruling that the appellant's income from U.S. sources for the purposes of s. 41, was the net interest from the bonds of the U.S. subsidiary, *i.e.*, the bond interest received less the interest paid on the money borrowed to acquire the bonds. The Exchequer Court upheld the Minister's assessment, and the company appealed to this Court.

Held: The appeal should be dismissed.

As decided by the Exchequer Court, the method followed by the Minister in computing the appellant's foreign tax credit was the correct one. The effect of s. 139(1a) and (1b) was to require that the total interest on borrowed money claimed by the appellant and allowed to it under s. 11(1)(*c*) of the Act as a deduction had to be broken up and related to the appellant's various sources of income.

The effect of Article XV of the Canada-U.S. Convention was to establish a mutual covenant to apply as between each country whatever foreign tax credit provision the respective domestic laws of each country may from time to time adopt. This covenant did not require any alteration in the appellant's rights as determined by the interaction of ss. 41 and 139(1a) and (1b) of the *Income Tax Act*.

Revenu—Impôt sur le revenu—Calcul du dégrèvement pour impôt étranger —Sources du revenu—Effet des amendements de 1960 à la Loi de l'impôt sur le revenu—Convention entre le Canada et les États-Unis, Article XV—Loi de l'impôt sur le revenu, S.R.C. 1952, c. 148, arts. 11(1)(c), 41, 139(1a), (1b).

Les faits dans cette cause sont substantiellement les mêmes que dans la cause *Interprovincial Pipe Line Co. v. M.N.R.*, [1959] R.C.S. 763, qui a considéré les années d'imposition 1950 à 1954 de la compagnie appelante. La question est de savoir comment doit se faire le dégrèvement pour impôt étranger sous l'art. 41 de la *Loi de l'impôt sur le revenu* et le résultat dépend de l'effet que l'on doit donner à un amendement de 1960 à la *Loi de l'impôt sur le revenu*. Les pipelines de la compagnie appelante sont reliés par un pipe-line traversant les États-Unis et qui est possédé et exploité par une corporation filiale américaine entièrement possédée par l'appelante. Cette dernière ne fait pas affaires aux États-Unis. La compagnie appelante s'est procuré le capital nécessaire pour la construction du pipe-line en grande partie au moyen d'obligations et de débentures émises au Canada. Elle a aussi fourni les fonds nécessaires à la construction de la section américaine et en retour a reçu de sa filiale des billets promissoires et des obligations portant intérêt. En 1960 et en 1961, la compagnie appelante a reçu des montants substantiels d'intérêts sur les obligations de sa filiale américaine, et a payé sur ce montant une taxe de 15 pour-cent au gouvernement américain. Dans le calcul de son revenu, l'appelante a déduit le montant total des taxes payées

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aux États-Unis. Le Ministre a permis un dégrèvement pour impôt étranger beaucoup moindre, statuant que le revenu de l'appelante provenant des sources américaines pour les fins de l'art. 41 était l'intérêt net provenant des obligations de la filiale américaine, *i.e.*, l'intérêt provenant des obligations moins l'intérêt encouru dans le prêt d'argent pour l'acquisition des obligations. La Cour de l'Échiquier a maintenu la cotisation du Ministre, et la compagnie en a appelé à cette Cour.

Arrêt: L'appel doit être rejeté.

Tel que décidé par la Cour de l'Échiquier, le Ministre a employé la bonne méthode pour calculer le dégrèvement pour impôt étranger de l'appelante. L'article 139(1a) et (1b) a pour effet d'exiger que le montant total de l'intérêt sur l'argent emprunté, dont la déduction a été réclamée par l'appelante et qui lui fut permise en vertu de l'art. 11(1)(*c*), doit être fractionné et attribué aux différentes sources de revenu de l'appelante.

L'article XV de la Convention entre le Canada et les États-Unis a pour effet d'établir une entente mutuelle entre chaque pays pour appliquer les dispositions relatives au dégrèvement pour impôt étranger que les lois domestiques de chaque pays peuvent adopter de temps à autre. Cette entente ne requiert aucune modification des droits de l'appelante, tels que déterminés par l'action réciproque des arts. 41 et 139(1a) et (1b) de la *Loi de l'impôt sur le revenu.*

APPEL d'un jugement du Président Jackett de la Cour de l'Échiquier du Canada[1] en matière d'impôt sur le revenu. Appel rejeté.

APPEAL from a judgment of Jackett P. of the Exchequer Court of Canada[1] in an income tax matter. Appeal dismissed.

Lazarus Phillips, Q.C., and *Philip F. Vineberg, Q.C.,* for the appellant.

G. W. Ainslie, for the respondent.

The judgment of the Court was delivered by

JUDSON J.:—We are concerned here with appeals of Interprovincial Pipe Line Company from reassessments made for its 1960 and 1961 taxation years. The Exchequer Court has affirmed these reassessments. The facts are substantially the same as those in *Interprovincial Pipe Line Company v. The Minister of National Revenue*[2]. The sole question again is how the calculation of the foreign tax

[1] [1967] C.T.C. 180, 67 D.T.C. 5125.

[2] [1959] S.C.R. 763, [1959] C.T.C. 339, 59 D.T.C. 1229, 20 D.L.R. (2d) 97.

deduction under s. 41 of the *Income Tax Act* is to be made and the result depends upon the effect to be given to the amendment to the *Income Tax Act* enacted in the year 1960 following the former decision.

The amendment is to be found in 8-9 Eliz. II, Statutes of Canada 1960, c. 43, s. 33. It repeals s. 139(1)(*az*) of the Act as it stood when the 1959 litigation was decided and substitutes for it a new section 139(1a) and 139(1b). I will put the old legislation and the new legislation in two parallel columns for the purpose of comparison. I am not reproducing the new legislation in full but only those parts that are relevant to this appeal:

Old Legislation
Section 139(1) (az)

139. (1) In this Act,

(*az*) a taxpayer's income from a business, employment, property or other source of income or from sources in a particular place means the taxpayer's income computed in accordance with this Act on the assumption that he had during the taxation year no income except from that source or those sources of income and was entitled to no deductions except those related to that source or those sources.

New Legislation 1960
Section 139(1a) and (1b)

(1a) For the purposes of this Act

(*a*) a taxpayer's income for a taxation year from a business, employment, property or other source of income or from sources in a particular place means the taxpayer's income computed in accordance with this Act on the assumption that he had during the taxation year no income except from that source or those sources, and was allowed no deductions in computing his income for the taxation year except such deductions as may reasonably be regarded as wholly applicable to that source or those sources and except such part of any other deductions as may reasonably be regarded as applicable to that source or those sources; and

(*b*) In applying subsection (*1a*) for the purposes of sections 31 and 41, all deductions allowed in computing the income of a taxpayer for a taxation year for the purposes of Part I... shall be deemed to be applicable either wholly or in part to a particular source or to sources in a particular place.

There is no substantial difference between s. 41(1) and (5) of the *Income Tax Act* applicable to this appeal and

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the section as it read when the 1959 appeal was decided. This section deals with foreign tax deduction. The other sections of the Act are the same in both cases—s. 3 (world income); s. 4 (income from business or property); s. 6(1)(*b*) (interest), and s. 11(1)(*b*) (deduction allowed for interest paid on borrowed money for the purpose of computing income).

Interprovincial's method of financing is set out in the 1959 Report. Interprovincial owns and operates a pipe line in Canada with a connecting link in the United States. The connecting link is owned and operated by Lakehead Pipe Line Company Inc., a wholly owned subsidiary. Interprovincial raised all the money to construct these lines. It lent the necessary money to Lakehead and took bonds in return. In the year 1960 Interprovincial received interest on these bonds but it itself had to pay interest on its own bonds which it had issued to acquire the Lakehead bonds. These are the figures:

Interest received from Lakehead Bonds	$2,421,165.80
Cost of borrowed money used to acquire Lakehead Bonds	2,363,966.79
	$ 57,199.01

These figures can be broken down by taking the Lakehead bonds series by series and making the same calculation. The result is the same and there is no dispute about the figures.

During the 1960 taxation year, the item of $2,421,165.80 above shown was not an actual receipt in that the sum of $363,174.87 was remitted by Lakehead to the Government of the United States pursuant to the provisions of the Internal Revenue Code of that country. This was a 15 per cent withholding tax. But Interprovincial, in computing its income as required by s. 6 of the Act, included the full sum of $2,421,165.80. Lakehead, in computing its income, deducted as an expense the said sum of $2,421,165.80.

Interprovincial claimed and was allowed as a deduction for interest on borrowed money pursuant to s. 11(1)(*c*) of the *Income Tax Act* the sum of $4,549,355. This sum includes the sum of $2,363,966.79 referred to above under the heading "Cost of borrowed money used to acquire Lakehead Bonds".

The question is what is to be done about the $363,174.87 withholding tax paid to the United States? The 1959 decision held

(1) that this was available as a tax credit in respect of foreign tax paid on a gross basis on receipts of an income nature whether or not those receipts, after deduction of expenses incurred to earn them, resulted in a net profit when brought into the computation of the taxpayer's overall taxable income;

(2) that there was no authority for splitting up the income of the business of the taxpayer; and

(3) that the income of the business to be determined in order to ascertain what was taxable income was the entire income of the appellant and not that income split up into parts according to the situs of the source of that income.

Interprovincial still submits that it is entitled to deduct under s. 41 of the Act the full amount of the United States withholding tax, $363,174.87. The Minister submits that subs. (1b) of s. 139 of the Act contains a mandatory direction that in computing income from various sources for the purpose of s. 41 of the Act, the deduction of $4,549,355, *i.e.*, the total interest on borrowed money claimed by Interprovincial and allowed to it pursuant to s. 11(1)(*c*) of the Act, is to be broken up and related to Interprovincial's various sources of income. If this is done, as I have shown above, Interprovincial's income for the year 1960 from United States sources was $57,199.01. In my opinion the Minister is right and the effect of the 1960 amendment (the new s. 139(1a) and (1b) above quoted) is to require this to be done. This is the conclusion also reached by the Exchequer Court and I would affirm it.

We now must start by segregating the income from United States sources. That income is not a gross amount of $2,421,165.80, but a net amount of $57,199.01 after deducting the cost of borrowed money used to acquire the Lakehead bonds. Interprovincial's submission that its income from sources in the United States for the purpose of computing the amount deductible under s. 41 was still

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the gross amount of interest received from the United States without being reduced by its interest expense in Canada, is in error.

I cannot see that there is any substantial difference between s. 41(1) and (5) dealing with the foreign tax deduction as it stood when the 1959 case was decided and as it now stands. Briefly, it enables the taxpayer to deduct from the tax payable an amount equal to the lesser of two sums,

(a) any income or profits taxes paid to the government of a country other than Canada for the year, or

(b) that proportion of the tax that (i) the taxpayer's income from sources in that country is of (ii) the taxpayer's income for the year.

The lesser of these two sums is now the sum calculated in accordance with the provisions of s. 41(1)(*b*) and this is all that is allowable as a foreign tax credit when the provisions of the new s. 139(1a) and (1b) are applied.

Interprovincial also put forward an alternative argument that the provisions of the Canada-U.S. Reciprocal Tax Convention prevented the application of the *Income Tax Act* in the way above outlined and that the Minister could not deny the taxpayer the full deduction of foreign taxes paid.

Article XV of the Convention provides:

1. As far as may be in accordance with the provisions of the Income Tax Act, Canada agrees to allow as a deduction from the Dominion income and excess profits taxes on any income which was derived from sources within the United States of America and was there taxed, the appropriate amount of such taxes paid to the United States of America.

2. As far as may be in accordance with the provisions of the United States Internal Revenue Code, the United States of America agrees to allow as a deduction from the income and excess profits taxes imposed by the United States of America the appropriate amount of such taxes paid to Canada.

I agree with the judgment of the Exchequer Court that the effect of this Article was to establish a mutual covenant to apply as between each country whatever foreign tax credit provision the respective domestic laws of each country might from time to time adopt and that this

covenant does not require any alteration in the appellant's rights as determined by the interaction of s. 41 of the *Income Tax Act* and section 139(1a) and (1b).

I therefore agree with the judgment of the Exchequer Court on both grounds and I would affirm it.

The appeal should be dismissed with costs.

Appeal dismissed with costs.

Solicitors for the appellant: Phillips, Vineberg, Goodman, Phillips & Rothman, Montreal.

Solicitor for the respondent: D. S. Maxwell, Ottawa.