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 SUBJECT IFA 2012 - Beneficial Ownership

Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA. Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES: Determination of beneficial ownership of Canadian-source income for the purposes of Canada's income tax treaties.
 POSITION: Where income is received by a recipient in the capacity as agent or nominee, the recipient is not the beneficial owner. Where income is not received in the capacity as agent or nominee, the recipient is the beneficial owner if the payment is received for the recipient's own use and enjoyment and the recipient assumes risk and control over the payment.
 REASONS: In conformance with applicable jurisprudence.

International Fiscal Association (IFA) Conference
 Canada Revenue Agency Roundtable
 May 17, 2012

Beneficial Ownership

Question

On two occasions, Canadian courts have considered the question of whether a recipient of an income payment was the beneficial owner of the income for treaty purposes. In both instances, the courts allowed the appeals of the taxpayers and held that the recipients in question were the beneficial owners of the respective payments, with the result that treaty benefits were found to apply to the income amounts at issue.

In the recent judgment of the Tax Court of Canada in *Velcro Canada Inc. v. The Queen*, (footnote 1) it was held that Canadian-source royalty income paid to a Netherlands resident was beneficially owned by that resident under the Canada-Netherlands Tax Convention, despite the fact that the recipient had a corresponding obligation to pay a royalty to another person, who was not entitled to benefits under that treaty, based, to a large extent, on the amount of the Canadian-source royalty received. The Tax Court of Canada followed the earlier decision of the Federal Court of Appeal in *Prévost Car Inc. v. The Queen*. (footnote 2) In *Prévost Car*, dividends paid to a Netherlands-resident corporation were found to be beneficially owned by the corporation, despite the fact that its shareholders, neither of whom was entitled to benefits under that treaty, had an agreement specifying that the corporation would pay dividends to the shareholders out of the Canadian-source dividend income received by the corporation.

In addition, it is noted that a discussion draft proposed changes to the commentary in Articles 10, 11 and 12 of the OECD Model Tax Convention concerning beneficial ownership was published on April 29, 2011. (footnote 3) As well, disputes concerning the interpretation of beneficial ownership continue to arise between tax authorities and taxpayers in a number of other countries.

Having regard to the *Prévost Car* and *Velcro Canada* decisions, is CRA continuing to challenge beneficial ownership? If so, would CRA comment on what factors it will take into account in determining beneficial ownership in light of these cases?

Response

Canada's income tax conventions generally limit Canada's right to tax Canadian-source dividend, royalty and interest payments, but only if the recipient of the payment is the beneficial owner of the income. Therefore, treaty benefits will only apply to such payments in a particular set of circumstances if the recipient is the beneficial owner of the income. Where a payment is received by a person or an entity in the capacity as an agent or nominee for another person, that recipient will not be considered the beneficial owner of that income for treaty purposes.

Where a recipient of income does not receive the payment as agent or nominee for another party, the CRA will consider the recipient to be the beneficial owner of the income if the payment is received for the recipient's own use and enjoyment and the recipient assumes risk and control over the payment. In light of *Prévost Car* and *Velcro Canada*, the CRA will generally accept that a payment will be for the recipient's use and enjoyment, and that the recipient assumes risk and control over the payment, if the recipient holds a sufficient degree of discretion with respect to the use or application of the payment.

Although a resident of a treaty country may be considered the beneficial owner of a payment of income, entitlement to treaty benefits is always subject to the application of the general anti-avoidance rule (the

"GAAR"). Where a transaction or a series of transactions is carried out so that income is paid to a treaty resident in order to obtain the benefits of the particular treaty, and those benefits would not have applied in the absence of the transaction or the series of transactions, the CRA will give consideration to the application of the GAAR to disallow those treaty benefits.

Nothing in the foregoing comments should be construed as a departure from the attribution of beneficial ownership of income that persons resident in the United States are considered to derive under Article IV(6) of the Canada-United States Tax Convention. The approach described in the commentary to Article IV(7) of the United States Treasury Department's Technical Explanation to the Fifth Protocol under the heading "Interaction of paragraphs 6 and 7 with the determination of 'beneficial ownership'" will continue to be applied.

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FOOTNOTES

Note to reader: Because of our system requirements, the footnotes contained in the original document are shown below instead:

- 1 2007-1806(IT)G [hereinafter Velcro Canada].
- 2 2009 DTC 5053 (FCA); [2009] 3 CTC 160, 2008 DTC 3080 (TCC); [2008] 5 CTC 2306 [hereinafter Prévost Car].
- 3 OECD Working Party 1 on Tax Conventions and Related Questions (OECD Committee on Fiscal Affairs) Clarification of the Meaning of "Beneficial Owner" interpretation of this term in treaties.