

## **Tax Window Files**

**Date:** January 27, 2016

### **2014-0525501E5 Royalty payments & the US or UK Treaties**

LANGIND E

DOCNUM 2014-0525501E5

REFDATE 150615

SUBJECT Royalty payments & the US or UK Treaties

SECTION 212(1)(d) of the Act; Article XII of the US Treaty; Article 12 of UK Treaty

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: 1) Is the fee paid from Canco to OwnerCo considered to be a "royalty" as provided under paragraph 4 of Article XII of the US Treaty and paragraph 4 of Article 12 of the UK Treaty? 2) If so, does paragraph 3(c) of Article XII of the US Treaty and paragraph 3(b) of Article 12 of the UK Treaty provide any relief?

POSITION: 1) Yes 2) Yes.

REASONS: 1) The payment was for "the use or the right to use,...any information concerning industrial, commercial or scientific experience" as included in the definition of "royalties" in the US Treaty and the UK Treaty. 2) Paragraph 3 of Article XII of the US Treaty (and paragraph 3 of Article 12 of the UK Treaty) generally provides an exemption from Part XIII taxation to a US resident (or UK resident, as applicable) in respect of payments arising in Canada for the use of, or the right to use, inter

alia, any information concerning industrial, commercial, or scientific experience.

XXXXXXXXXX

2014-052550

Keely Storr

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June 15, 2015

Dear XXXXXXXXXXXX:

Re: Article XII of the Canada/US Treaty and Article 12 of the Canada/UK Treaty

This letter is in response to your letter of March 25, 2014 wherein you requested our views concerning the following hypothetical scenario.

1. The taxpayer is a Canadian corporation ("CanCo") that carries on business in Canada which consists of providing confidential lists of customer names and addresses ("Lists") to unrelated Canadian corporations ("UserCos").
2. UserCos use the Lists for commercial purposes such as mailing information about their products and/or services to persons on the Lists.
3. CanCo sources the information for the Lists from various corporations ("OwnerCo" or "OwnerCos") that are resident in either the United States ("US") or the United Kingdom ("UK").

4. The OwnerCos'' income is derived from the fees they collect for the right to use their Lists, and this income constitutes business profits.

5. None of the OwnerCos has a permanent establishment in Canada as defined under Article V of the Canada-US Tax Convention (the "US Treaty") or Article 5 of the Canada - UK Tax Convention (the "UK Treaty").

6. CanCo is a resident of Canada and does not have a permanent establishment outside of Canada for the purposes of the US Treaty or the UK Treaty.

Each time UserCos wish to obtain the use of a List, a List Exchange and a List Security Agreement ("Agreement") between a particular OwnerCo and a particular UserCo is signed which specifies terms of the particular Agreement, including limitations and restrictions on the use of the particular List, and the number of times that the List may be used before all information contained on the List is to be removed from the UserCo''s database. While the List remains on UserCo''s database, it is to be treated as a trade secret and confidential information proprietary to OwnerCo. Any use by UserCos outside the terms of the Agreement would be actionable as a breach of contract.

7. OwnerCo provides the List directly to UserCo.

8. UserCo pays CanCo a fee ("Fee #1") for the use of a List and CanCo pays OwnerCo (Fee #2") on behalf of UserCo. Fee #1 in each case will be based upon UserCo''s use of the List and at no time would UserCo acquire ownership of the information contained in the List. OwnerCo is the beneficial owner of Fee #2.

In respect of the above hypothetical circumstances, assuming that Fee #2 from CanCo to OwnerCo is taxable under Part XIII at a rate of 25% by application of paragraph 212(1)(d) of the Act, you inquire whether Fee #2 can be considered to be a "royalty" as defined in paragraph 4 of Article XII of the US Treaty and paragraph 4 of Article 12 of the UK Treaty.

In addition, where Fee #2 meets the definition of "royalty" in paragraph 4 of Article XII of the US Treaty and paragraph 4 of Article 12 of the UK Treaty, you then request our view whether paragraph 3(c) of Article XII of the US Treaty or paragraph 3(b) of Article 12 of the UK Treaty provide any relief.

Our Comments

This technical interpretation provides general comments about the provisions of the Income Tax Act (the "Act") and related legislation (where referenced). It does not confirm the income tax treatment of a particular situation involving a specific taxpayer but is intended to assist you in making that determination. The income tax treatment of particular transactions proposed by a specific taxpayer will only be confirmed by this Directorate in the context of an advance income tax ruling request submitted in the manner set out in Information Circular IC 70-6R6, Advance Income Tax Rulings and Technical Interpretations however, we offer the following general comments, which may be of assistance to you.

Unless otherwise stated, references in this letter to a Part, section, subsection, paragraph or subparagraph refer to the provisions of the Act.

For the purposes of our response below, we assume that the Lists are made up of names and addresses of persons who are known to have purchased

certain types of products or services from other businesses in the past and that the Lists are in existence such that the payments made are not for the service of compiling Lists.

US Treaty

The term "royalties" is defined in paragraph 4 of Article XII of the US Treaty and includes payments of any kind received as a consideration for, inter alia, the use of or **the right to use information concerning industrial, commercial or scientific experience.**

Paragraph 3 of Article XII of the US Treaty identifies four types of royalty payments arising in Canada and beneficially owned by a resident of the US that are exempt from Canadian Part XIII withholding tax. Specifically, **paragraph 3(c) of Article XII includes an exemption for "payments for the use of, or the right to use,... any information concerning industrial, commercial or scientific experience..."** arising in Canada and beneficially owned by a resident of the US and states that these payments shall be taxable only in the US.

In ascertaining the purpose and intentions of the provisions of Canada's tax treaties, Canada's **courts have found the OECD Model Convention and the Commentary (footnote 1) ("Commentary") thereon to be of high persuasive value.** (footnote 2)

First, one must consider whether the payment is for "the use of, or the right to use,...". Paragraph 8.2 of the Commentary on Article 12 indicates that in order for the payment to be considered "payments for the use of, or the right to use,..." there **cannot be a transfer of ownership** of the information on the Lists (or the Lists themselves) and paragraph 10.2 of

the Commentary on Article 12 indicates that the Lists must already be in existence. As indicated in point #9 above, at no time did UserCo acquire ownership of the information on the Lists and we have previously stated that we have assumed that the Lists were already in existence. UserCo agrees that they will return the particular List to the OwnerCo upon completion of the approved usage of the List pursuant to the Agreement. UserCo will also abide by the requirement to destroy all information from UserCo's servers after the approved use, so as to ensure the information cannot be used again without payment. These types of stipulations indicate that there has not been a transfer of ownership of the information, but simply **permission has been granted to use the information on the Lists** for an approved purpose. Given these types of stipulations and limitations, it is our view that the payment can be said to be "for the use of or the right to use..." the information on the Lists.

Next, one must determine if the payments were made in relation to **"information concerning industrial, commercial, or scientific experience"**. According to **paragraph 11 of the Commentary on Article 12,** "royalties payments received as consideration for information concerning industrial, commercial or scientific experience" (footnote 3) is **referring to the concept of "know-how"**. (footnote 4) This paragraph of the Commentary further indicates that this phrase is "used in the context of the transfer of certain information that **has not been patented and does not generally fall within other categories of intellectual property rights.** It generally corresponds to undivulged information of an industrial, commercial or scientific nature arising from previous experience, which has **practical application in the operation of an enterprise and from the disclosure of which an economic benefit can be derived.**" (footnote 5) Paragraph 11.1 of the Commentary on Article 12 continues on to say that "In the know-how contract, one of the parties agrees to impart to the other, so that he can use them for his own account, his special knowledge and experience which

remain unrevealed to the public." (footnote 6)

In the hypothetical situation above, the OwnerCos have information in their possession due to their special knowledge and experience and there is little that needs to be done to meet the request by CanCo to provide the Lists. The information on the Lists is considered confidential as it is not generally available to the public and CanCo can derive an economic benefit from the disclosure of the List by OwnerCo. Therefore, it is our view, that the Lists constitute "information concerning industrial, commercial or scientific experience" for the purposes of paragraph 4 of Article XII of the US Treaty.

Given the above analysis, it is our view that Fee #2 is a "royalty" as it qualifies as "payments ... for the use of, or the right to use, any ... information concerning industrial, commercial or scientific experience..." as defined under paragraph 4 of Article XII of the US Treaty.

The final determination to be made is where the payment arose. Paragraph 6 of Article XII of the US Treaty generally deems the payment to arise where the payer is resident. In this particular hypothetical scenario, CanCo (the payer) is a resident of Canada and therefore, it is our view that the payment arose in Canada.

As discussed above, we have concluded that Fee #2 paid by CanCo to OwnerCo is for "the use of, or the right to use, ... any information concerning industrial, commercial, or scientific experience...". As those same words are used to describe payments that qualify for the exemption under subparagraph 3(c) of Article XII of the US Treaty, it is our view that Fee #2 would be exempt from Part XIII withholding tax in Canada.

UK treaty

Similar wording is present in the UK Treaty under Article 12 and following the same analysis as above regarding the operation of the US Treaty, it is our view that if Fee #2 were paid to an OwnerCo resident in the UK, it would fall into the definition of "royalties" in paragraph 4 of Article 12 of the UK Treaty. However, it would meet the exemption under paragraph 3(b) of Article 12 and would be exempt from Part XIII withholding taxes in Canada.

We trust these comments are of assistance.

Olli Laurikainen, CPA, CA  
Section Manager  
for Division Director  
International Division  
Income Tax Rulings Directorate  
Legislative Policy and Regulatory Affairs Branch

#### FOOTNOTES

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

1 OECD (2014), Model Tax Convention on Income and on Capital: Condensed Version 2014, OECD Publishing.

2 **The Queen v Crowne Forest Industries Ltd et al [95 DTC 5389]**

3 OECD (2014), Model Tax Convention on Income and on Capital: Condensed Version 2014, OECD Publishing.

4 The Technical Explanation [1995 Protocol] to paragraph 3 of Article 12 of the US Treaty also indicates that the negotiators of the US Treaty intended "information concerning industrial, commercial or scientific experience" to refer to the concept of "know-how" as defined in the OECD Model Commentary to Article 12.

5 OECD (2014), Model Tax Convention on Income and on Capital: Condensed Version 2014, OECD Publishing.

6 Ibid.