

**2009 IFA TRAVELLING LECTURESHIP ON ROYALTIES BY NATHAN BOIDMAN
APPENDICES TO LECTURE OUTLINE**

**ADDITIONAL MATERIALS
TO BE INTEGRATED INTO FINAL VERSION OF PAPER AND APPENDICES**

Material:

Nathan Boidman, “Royalties: A Curious Relationship Between Two FCA Decisions Six Months Apart”, Note dated January 26, 2009

OECD, Transfer Pricing Guidelines, Chapter 1, Section C, Guidelines Applying Arm’s Length Principle, Paragraph ii) Recognition of the actual transactions undertaken; July 1995 at page I-15

Richard Dooley, “Fiddler MacIsaac aims to sell future earnings; Asking Price: \$1.5M; Winning online bidder will get 50% of all annual profits”, *National Post*, July 2, 2008

“E-Commerce & Computer Software”. December 2008 Release, Windows on Canadian Tax Commentary, Document No. 2002-0135765, May 16, 2002, *CCH Canadian Limited**

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2009 IFA – TRAVELLING LECTURESHIP

ROYALTIES – NATHAN BOIDMAN

**A CURIOUS RELATIONSHIP BETWEEN TWO FCA DECISIONS
SIX MONTHS APART**

1. The decision of the Federal Court of Appeal in *Farmpart* (80 DTC 6157) was handed on February 28, 1980; Judge Heald with Ryan and Kerr concurring.
2. The decision of the Federal Court of Appeal in *Saint John Shipbuilding* (80 DTC 6272) was handed down on July 8, 1980; Judge Thurlow, again, with Ryan and Kerr concurring.
3. FCA in *Farmparts* in Feb/80 decided that subparagraph 212(1)(d)(i) could apply independent of the pre-ambule.
4. FCA in *Saint-John Shipbuilding* (with two of the three judges as in *Farmparts*) said six months later that, because of the US Treaty it did not have to decide the very point (see #3) that it (FCA) had, in fact, decided in *Farmparts* six months earlier and in so doing did not refer back to *Farmparts*
5. Very strange indeed – how did this come about?

NB:ehf

January 26, 2009

OECD TRANSFER PRICING GUIDELINES

CHAPTER 1, SECTION C

GUIDELINES APPLYING ARM'S-LENGTH PRINCIPLE

ii) *Recognition of the actual transactions undertaken*

1.36 A tax administration's examination of a controlled transaction ordinarily should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them, using the methods applied by the taxpayer insofar as these are consistent with the methods described in Chapters II and III. In other than exceptional cases, the tax administration should not disregard the actual transactions or substitute other transactions for them. Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured.

1.37 However, there are two particular circumstances in which it may, exceptionally, be both appropriate and legitimate for a tax administration to consider disregarding the structure adopted by a taxpayer in entering into a controlled transaction. The first circumstance arises where the economic substance of a transaction differs from its form. In such a case the tax administration may disregard the parties' characterization of the transaction and re-characterise it in accordance with its substance. An example of this circumstance would be an investment in an associated enterprise in the form of interest-bearing debt when, at arm's length, having regard to the economic circumstances of the borrowing company, the investment would not be expected to be structured in this way. In this case it might be appropriate for a tax administration to characterise the investment in accordance with its economic substance with the result that the loan may be treated as a subscription of capital. The second circumstance arises where, while the form and substance of the transaction are the same, the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price. An example of this circumstance would be a sale under a long-term contract, for a lump sum payment, of unlimited entitlement to the intellectual property rights arising as a result of future research for the term of the contract (as previously indicated in paragraph 1.10). While in this case it may be proper to respect the transaction as a transfer of commercial property, it would nevertheless be appropriate for a tax administration to conform the terms of that transfer in their entirety (and not simply by reference to pricing) to those that might reasonably have been expected had the transfer of property been the subject of a transaction involving independent enterprises. Thus, in the case described above it might be appropriate for the tax administration, for example, to adjust the conditions of the agreement in a commercially rational manner as a continuing research agreement.

National Post

Fiddler MacIsaac aims to sell future earnings; Asking Price: \$1.5M; Winning online bidder will get 50% of all annual profits

Wednesday, July 2, 2008
Page: A2
Section: News
Byline: Richard Dooley
Dateline: HALIFAX
Source: Canwest News Service

HALIFAX - For sale: Half the future earnings -- for about the next 40 to 50 years -- of a famed Cape Breton fiddler known as much for his antics as his music.

Asking price: \$1.5-million.

Ashley MacIsaac, 33, has put his future for sale on eBay.

The edgy musician -- who scored big in the 1990s with his breakout hit album *Hi! How Are You Today?* -- is offering his future earning potential to bidders on the online auction site.

It has been a week now and Mr. MacIsaac has not had any serious bidders. But the firebrand fiddler says he is serious and is hoping to find a wealthy patron of the arts interested in providing him with a healthy advance against his earnings.

"I see this as no different than what they did in Mozart's day," Mr. MacIsaac said in an interview from his home in Toronto.

Mr. MacIsaac is offering 50% of profits from all "albums, concerts, publishing, movies, DVDs and entertainment-related income" to the successful bidder.

As a bonus, Mr. MacIsaac will agree to 10 years of performing annual concerts for the cause of the patron's choice.

The winning bidder will get 50% of all annual profits until the bid has been paid off and will continue to get 50% until the day of Mr. MacIsaac's death.

"And unless I get hit by a car tomorrow, I guarantee I am going to lead a good, long life," he said.

Mr. MacIsaac is as much known for his unique musical style as he is for his on and offstage behaviour.

He made headlines in 2006 by announcing he was making a bid for the leadership of the Liberal Party of Canada. He dropped out of the race a few months later citing concerns about his lack of command of French. But he said he is not ruling out a future career in politics.

The kilt-wearing performer raised eyebrows when he appeared on *Late Night with Conan O'Brien* in 1997 and did a high kick that revealed more than his fiddle

style. Mr. MacIsaac, who was not wearing underwear, later apologized, saying the incident was unintentional.

Mr. MacIsaac once told a reporter he wished to be weirder than Michael Jackson and has discussed his sexual preferences in public.

He has also fought with his record companies after making onstage remarks he maintains were misconstrued as racist; has declared bankruptcy; and openly discussed his crack cocaine addiction.

Last year, Mr. MacIsaac married violinist Andrew Stokes during a performance at the East Coast Music Awards.

Mr. MacIsaac said he is not playing a prank or seeking publicity, although that has been a beneficial side-effect of his eBay bid as he heads to the studio later this month to record his 11th album.

"I don't play games when it comes to business," he said. "I have a lot of earning potential."

Despite the bumps in his career, Mr. MacIsaac sees himself as a successful touring musician who plays numerous shows every year at between \$5,000 and \$15,000 per show.

He realizes that some people see him as outrageous, but says all he hopes to do is continue working.

"Besides, this is an opportunity for someone wealthy to get to say they own Ashley MacIsaac's music," he said.

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E-Commerce & Computer Software

May 16, 2002

Window On Canadian Tax Commentary

Document number: 2002-0135765

Income Tax Act: 212(1)(d)

Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CCRA.

Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ADRC.

PRINCIPAL ISSUES: request for IFA conference to provide status of e commerce papers (Position Paper Internet Commerce and Characterization Issues Arising From Electronic Commerce) and announcements regarding related issues

POSITION: e commerce paper at Department of Finance for their consultation and CCRA no longer views payment for computer software as payment for secret formula

REASONS: Department of Finance removed Canada's observation in OECD Model Convention that Canada viewed a payment for "computer software" as a payment for a "secret formula"

2002-013576
Memo to Close File

DATE: May 16, 2002

SUBJECT: May 2002 Ifa Conference Question Regarding Status of E Commerce Papers and Change in Ccra View Regarding Payments For Computer Software

For the May 2002 IFA Conference in Toronto, we were asked whether we had any internal papers regarding the taxation of E commerce and whether we had any significant related announcements to make. Our response is as follows:

Question 3. Electronic Commerce

There have been various electronic commerce initiatives at the CCRA and OECD recently. Has the Income Tax Rulings Directorate prepared any publications or

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papers regarding the taxation of electronic commerce as a result? If yes, will the publications be made available to the public? Are there any significant announcements that the Income Tax Rulings Directorate can make now with respect to this study?

CCRA's Response

The Income Tax Rulings Directorate is currently working on two papers with respect to electronic commerce.

1. Position Paper Internet Commerce, which evolved from 2 sources:
 - a 1998 CCRA Technical Advisory Group (TAG) on Interpretation & International Cooperation; and
 - The "Taxation Framework Conditions", agreed upon in Ottawa in 1998 by member countries of the OECD.

2. Characterization Issues Arising From Electronic Commerce, which evolved from the OECD TAG on Treaty Characterization of Electronic Commerce Payments.

The above two papers have not been completed, but preliminary drafts have been forwarded to the Department of Finance for consultation purposes. Once the consultation process is completed with the Department of Finance, and once the OECD has finalized its positions on electronic commerce, the CCRA will make a decision as to how to communicate to the public the content of these two papers or, at least, how to communicate any significant discrepancies between the views of the OECD and the CCRA on this subject.

Computer Software

An issue that did come to the forefront as a consequence of the work done so far on the above two papers dealt with computer software. In the Commentary on Article 12 of the OECD Model Tax Convention on Income and Capital (April 29, 2000 condensed version) concerning the taxation of royalties, at paragraph 27, Canada has an observation that states:

Canada does not adhere to paragraphs 14 through 14.3. In Canada, payments by a user of computer software pursuant to a contract that requires that the source code or program be kept confidential, are payments for the use of a secret formula or process and thus are royalties within the meaning of paragraph 2 of the article.

After consultations with the Department of Finance, the Department of Finance wrote to the OECD on March 28, 2002 to inform them that Canada is removing its observation on Article 12 of the Commentary. Accordingly, as of March 28, 2002, for the purposes of Canada's Income Tax Conventions, subject to the

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exceptional cases described in paragraph 14.3 of the commentary on Article 12, the CCRA will no longer view such a payment as a payment for a "secret formula" and the CCRA will apply this interpretation for the Conventions in force as of March 28, 2002 and subsequent Conventions that come into force after that date.

However, for the purposes of Canada's Income Tax Conventions, the CCRA does view such a payment as a payment for "other intangible property", where the definition of a "royalty" in the royalty article in the particular Convention refers to "other intangible property". Also, the CCRA continues to view that Part XIII tax applies to such a payment pursuant to paragraph 212(1)(d) of Canada's Income Tax Act, unless the payment is in respect of what the CCRA refers to as "shrinkwrap" or the exception in subparagraph 212(1)(d)(vi) applies, because the payment is a "rent, royalty or similar payment, including, ..., any payment (i) for the use of or for the right to use in Canada any property ... or other thing whatever".

The CCRA intends to make an announcement regarding computer software payments in our next Technical News publication.

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Division: Income Tax Rulings Directorate

The file is being closed since there are no other issues to address.

Gilles Gosselin
May 15, 2002