

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

APPENDIX 23 (CRA ON SCOPE OF SUBPARAGRAPH 212(1)(d)(iii))

Material:

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Window On Canadian Tax Commentary

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Income Tax Act: 212(1)(d), 212(1)(d)(iii), 212(1)(d)(ii)

Interpretation Bulletins: IT-303, Know-how and similar payments to non-residents

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

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

XXXXXXXXXX
922179
D. Patrick
(613) 957-2125

Attention: XXXXXXXXXXXX

March 16, 1993

Dear Sirs:

Re: Technical Interpretation of subparagraph 212(1)(d)(i), (ii) and (iii)

This is further to your letter requesting a technical interpretation as to whether, Paragraph 212(1)(d) would be applicable in three hypothetical situations.

Without the benefit of the actual contracts in question we are unable to respond particularly to your queries. The nature of the obligations under the contract can only be determined after a careful review of the actual agreements in question, the surrounding circumstances, and relationship between the parties. This information is necessary in order to determine what was the real intent of the parties, and to determine what in fact is the nature of their undertakings in the contract. We therefore are only able to respond in a general way to the questions and sub-questions raised.

HYPOTHETICAL SITUATIONS:

Case #1:

- A Canadian resident company wants to solve a specific engineering problem in Canada.

- Since the Canadian company does not have the required expertise to solve the said problem, it retains the services of a non-resident engineer having the required expertise.
- The services of the engineer are rendered outside of Canada.
- The engineer comes up with a solution.
- The fees charged for the engineering work are at an hourly rate of \$125.00 (the \$125 can be split as follows: engineer's salary \$75; mark-up \$50).

Case #2

- A Canadian company entered into a service contract with a non-resident engineering company.
- The contract provides for technical assistance which will be rendered outside Canada.
- The information derived from the technical assistance is used in Canada.
- A portion of the costs is allocated to technical assistance services.

Case #3

- A non-resident engineering company has an extensive research program.
- The conclusion of its research are put together in a training course offered to engineers resident in Canada.
- The training course is given outside Canada.
- The registration fees are of a specific amount.
- The technical information derived from the training courses will be used in Canada.

General Comments on all questions raised

Paragraph 212(1)(d) of the Canadian Income Tax Act (Act) imposes a withholding tax on "rent royalties or similar payment". Revenue Canada considers the quoted words are used in a broad sense and represent any payment, whether periodic or lump sum, made to the owner of property for the right to use such property.

In our opinion the underlined words in subparagraph 212(1)(d)(i) of the Act are broad enough to include payments for "know-how" and for the use of any confidential or Technical information. Interpretation Bulletin 303 (IT-303) outlines Revenue Canada's position on the withholding provisions of paragraph 212(1)(d) of the Act. Paragraph 3 of IT-303 discusses the concept of "know how" and paragraphs 10 to 13 discusses the scope of subparagraph 212(1)(d)(i).

To determine whether withholding tax would be applicable in any particular factual scenario it is necessary to determine whether in fact the contract was a contract for the "use of...a secret formula, process or other thing whatever", or was the contract in fact for "information" covered by (ii). or

was it for "services". In making this determination it would be necessary to consider whether the payments relate in part to services, and in part for the right to use property, or information. A reasonable allocation of what in fact the payment is for, must be determined in situations where the payment is for a combination of the right to use property, or for services, or for information.

Comments on Case 1

The facts supplied suggest that the contract in question would be a contract for services with a set fee based on an hourly rate. Normally, where services are performed entirely outside of Canada, a Canadian tax liability with respect to the payment therefor would occur if the provisions of subparagraph 212(1)(d)(iii) of the Act apply, and then only to the extent that a reciprocal income tax treaty does not override this provision. Assuming that the payment is one of professional services conducted in the U.S., there would be no section 212 withholding tax and no withholding under subsection 105(1) of the Income Tax Regulations.

A payment for the type of services in question would not be subject to Part XIII tax under subparagraph 212(1)(d)(iii) of the Act provided the payment in question is not dependent in whole or part upon

- (i) the use to be made thereof or the benefit to be derived therefrom,
- (ii) production or sales of goods or services, or
- (iii) profits,

Thus, if the payments in question satisfy the proviso referred to above (which is impossible to discern from the facts provided), they will be subject to withholding tax pursuant to subparagraph 212(1)(d)(iii) of the Act.

As stated in paragraph 22 of IT-303 "Where fees are charged for services on a per hour, per diem or similar basis, it is a question of fact whether the amount depends upon the use to be made or the benefit to be derived from such services. In our opinion, the payment in your query which is calculated on an hourly basis for services do not appear to be dependent upon the "use to be made of" or the "benefit to be derived from" such services, however this will be a question of fact to be determined on a case by case basis.

Reciprocal Income Tax Treaties

Notwithstanding that a particular payment might be caught under subparagraph 212(1)(d)(iii), a provision of a reciprocal income tax treaty may override this provisions of the Act. For example, where a payment for services is otherwise exigitible to Part XIII tax is made to a U.S. resident but does not fall within Article XII of the Convention, the recipient can look to either Article VII or Article XIV of the Canada-U.S. Income Tax Convention (1980) for relief.

Comments on Case 2

From the facts provided, this also appears to be a contract for services with the only major distinction being that "a portion of the costs is allocated to technical assistance services". Without additional details on what the quotation means, it is impossible to comment on this query. We note in the recent decision of **Grand Toys Ltd. v. M.N.R. 90 DTC 1063** the court looked at the nature of the payment, and it determined that to be considered a royalty or similar payment, it was necessary to consider whether the fee was

related to profits, and whether there was an element of contingency in the amount of the payment.

Comments on Case 3

In the third case outlined in your query, the substance of the arrangements appear to be a set fee paid for a training course which will be given outside of Canada. The payment does not appear to be in any way dependent on the use to be made of the training course, or for the information contained in the course. The activity appears to all take place outside of Canada, and the information learned by participants in the course will be used in Canada. There does not appear to be any exclusivity of the course (i.e. there is no suggestions as to secrecy of the information or limits placed on the course participants as to what they can do with this information when they return to Canada).

There also is not any suggestion that the fee is in any way related to the use that the Canadian payer can put this information to. For the above reasons this payment would not appear to be subject to withholding pursuant to subparagraph 212(1)(d)(ii). For a fuller understanding the scope of subparagraph 212(1)(d)(ii) refer to paragraphs 14 to 19 of IT-303.

In summary, the above comments are of a general nature and a specific response to the situations outlined in your letter could only be given after receiving all the facts of the particular situation, including a copy of the relevant contracts between the parties.

Yours truly,

for Director
Reorganizations and Foreign Division
Rulings Directorate
Legislative and Intergovernmental
Affairs Branch