

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

APPENDIX 27 (HASBRO CANADA INC. v. HER MAJESTY THE QUEEN)

Material:

Hasbro Canada Inc. v. Her Majesty the Queen, 98 DTC 2129

Hasbro Canada Inc. (Appellant) v. Her Majesty the Queen (Respondent)

GENERAL PROCEDURE

Tax Court of Canada, October 23, 1998. (Court File Nos. 96-19(IT)G and 97-2698(IT)G.)

Part XIII non-resident withholding tax — Rents, royalties, or similar payments — Corporate taxpayer a manufacturer and distributor of toys — Taxpayer employing purchasing agents in the Far East and paying them commissions — Whether such commissions subject to Part XIII tax (a) as a rent, royalty or similar payment (paragraph 212(1)(d) of the Act), or (b) as having been specifically paid for commercial information or commercial services (subparagraphs 212(1)(d)(ii) or (iii) of the Act) — Income Tax Act, R.S.C. 1985 (5th Supp.), c. 1, as amended, ss. 212(1)(d)(ii), (iii)(A), (iii)(B), (iii)(C), 215(6) and 227(8).

The corporate taxpayer was a manufacturer and distributor of toys. It employed purchasing agents in the Far East and paid them commissions. Such commissions were calculated as a percentage of the total amount invoiced by the manufacturer as the price of the toys and games purchased. The Minister issued assessments (covering the taxpayer's 1988 to 1994 taxation years) imposing non-resident withholding tax on such commissions. The Minister's position was that such commissions constituted amounts paid as a rent, royalty or similar payment (paragraph 212(1)(d) of the Act), and that they had been specifically paid for commercial information or commercial services (subparagraphs 212(1)(d)(ii) or (iii) of the Act). The taxpayer appealed to the Tax Court of Canada.

Held: The taxpayer's appeal was allowed. As a matter of statutory interpretation, payments coming within the ambit of one of the subparagraphs of paragraph 212(1)(d) need not also come within the ambit of the phrase "rent, royalty or similar payment" in paragraph 212(1)(d) in order to be subject to Part XIII tax. Unquestionably, the commissions paid by the

taxpayer to its purchasing agents were not for the use of any real or personal property, and hence were not rent or a similar payment. Nor were such commissions in the nature of a royalty or similar payment, since they were not contingent on the use, profit or sales by the taxpayer of the toys purchased by its agents. And they had not been paid for the use of property, but for services rendered. Nor did the information concerning the negotiations with manufacturers price quotations, delivery schedules, etc. provided to the taxpayer by its agents, constitute "know-how" imparted to the taxpayer. Hence it was not "information concerning industrial commercial or scientific experience" within the meaning of subparagraph 212(1)(d)(ii), since that subparagraph is intended to apply only to know-how. Subparagraph 212(1)(d)(iii) covers payment for services of an industrial, commercial, or scientific character performed by a non-resident person. The taxpayer's commission payments to its purchasing agents constitute payments for "services . . . of a . . . commercial character". However, it was unclear as to whether such commission payments also met the other criteria in clauses 212(1)(d)(iii)(A) to (C) of the Act. This was because the arguments presented by both the taxpayer and the Minister on this point were not unreasonable. But, notwithstanding the foregoing, the said commission payments were made for services performed "in connection with the sale of property" within the meaning of the postamble to subparagraph 212(1)(d)(iii) of the Act. Hence they were no subject to the subparagraph, and thus not subject to the withholding tax imposed thereon by the Minister. For all of the foregoing reasons, the Minister's assessments were vacated.

Counsel: R.W. Pound, Q.C. for the appellant; P. Plourde for the respondent.

Before: Dussault, T.C.C.J.

DUSSAULT, T.C.C.J.: [1] The first set of appeals (#96-19(IT)G) relates to assessments issued by the Minister of National Revenue (the "Minister") under Part XIII of the *Income Tax Act* (the "Act") in respect of the 1988, 1989, 1990 and 1991 taxation years of Tonka Canada Inc. The appellant, Hasbro Canada Inc. ("Hasbro") manufactures and distributes toys and games in Canada and is a successor company to Hasbro Canada Inc. and Tonka Canada Inc. which were amalgamated into the appellant with effect as of December 30, 1991.

[2] The second set of appeals (#97-2698(IT)G) relates to assessments issued by the Minister under Part XIII of the Act concerning the 1991, 1992, 1993 and 1994 taxation years of the appellant.

[3] During the taxation years 1988 through 1994, Hasbro or its predecessors employed related companies in Hong Kong including Tonka Kenner Parker Toys (Hong Kong) Limited ("TKPT"), Tonka Manufacturing Inc. ("TMI") and Hasbro Far East Ltd. ("HFE") to act as its buying or purchasing agents in the Far East, particularly with regards to purchases from manufacturers in the People's Republic of China. The Part XIII tax was assessed with respect to commissions paid to the purchasing agents. Relying, *inter alia*, on subsections 215(6) and 227(8) of the Act, the Minister issued the assessments on the basis that the appellant had failed to deduct or withhold the Part XIII tax from amounts paid or credited to non-residents as a rent, royalty or similar payment within the meaning of para-

graph 212(1)(d) of the Act and specifically from amounts paid or credited for commercial information or commercial services within the meaning of subparagraphs 212(1)(d)(ii) or (iii) of the Act.

[4] The parties have filed a Partial Agreed Statement of Facts along with a joint book of documents (exhibit AR-1) containing all the pertinent agreements. The Partial Agreed Statement of Facts reads as follows:

The Parties hereby admit the following facts for the purposes of these Appeals only and subject to any reservations as to the relevance thereof.

1. Hasbro Canada Inc. (the "Appellant") is a Canadian corporation having its registered office and principal place of business at 2350 de la Province Longueuil, Québec, J4G 1G2.
2. The Appellant is the successor company to Hasbro Canada Inc. and Tonka Canada Inc. ("Tonka Canada") which were amalgamated into the Appellant, the successor corporation, with effect from December 30, 1991, by Articles of Amalgamation dated December 20, 1991.
3. The Appellant carries on, and its predecessor Tonka Canada carried on, the business of manufacturing and distributing toys, games and similar items.
4. During the taxation years under appeal, the Appellant (and its predecessor company Tonka Canada) purchased and imported into Canada a variety of products from manufacturers, vendors and suppliers based outside of Canada, principally in the Far East and the United States.
5. During the taxation years under appeal, both Tonka Canada and the Appellant utilized the services of buying agents in Hong Kong. In each case

the buying agents were companies related to Tonka Canada or the Appellant.

6. The matters referred to in the Appeal bearing Court File No. 96-19(IT)G relate to matters which occurred prior to the amalgamation of Tonka Canada into the Appellant and pertain to Tonka Canada and its related companies, Tonka Kenner Parker Toys (Hong Kong) Limited ("TKPT") and Tonka Manufacturing Inc. ("TMI"). These matters were referred to in two contracts [Exhibit 24 and Exhibit 25].
7. The matters referred to in the Appeal bearing Court File No. 97-2698(IT)G relate to matters referred to in two contracts [Exhibit 22 and Exhibit 23] with its related company, Hasbro Far East, Limited ("HFE") pursuant to which HFE performed a variety of services described in the agreement.
8. The Minister has assessed Part XIII tax against the Appellant, in its own right and as successor to Tonka Canada Inc., in respect of the "buying commissions" paid to TKPI [IKPT] and TMI and to HFE on the basis that they were payments subject to tax under subparagraph 212(1)(d)(ii) or (iii) of the *Income Tax Act* (the "Act"), which tax was not withheld and remitted by the Appellant, with the result that the Appellant has been assessed under subsection 215(6) of the Act in respect thereof, including interest and penalties.
9. There is no effect on the income or taxable income of the Appellant arising from the assessments under appeal. No issue has been raised as to the reasonableness or deductibility of the buying commissions in computing the Appellant's income for tax purposes under Part I of the Act in respect of the payments of buying commissions to TKPI [IKPT], TMI or HFE. The amount of Part XIII tax assessed in:
 - (a) Appeal No. 96-19(IT)G aggregates \$260,874.75, to which penalties and interest have been added and
 - (b) Appeal No. 97-2698(IT)G aggregates \$949,970.00, to which penalties and interest have been added.

The parties agree that if the Appellant is successful in this appeal, the assessments in respect of tax, penalties and interest should be vacated.

10. The services performed by the buying agents included, but were not limited to, locating various vendors and manufacturers of the products specified by the Appellant, negotiating the prices for such products, the quantities of product and the delivery schedules and advising the Appellant of such prices and delivery schedules. The Appellant would then decide whether the prices and delivery schedules were satisfactory and might, or might not, place an order for the product. The buying agents had no authority to commit on behalf of the Appellant unless the Appellant decided to place a purchase order for the products.

11. If the Appellant placed a purchase order with the buying agents, the buying agents would, in turn, contact the selected manufacturer or vendor and place a purchase order with that manufacturer or vendor. The buying agents would then supervise the manufacture of the product, ensure that the design specifications were followed, ensure that the applicable health and safety standards were observed, that delivery schedules were maintained, that proper labelling and packaging was provided and any other matters relating to the manufacture and delivery of the products. They also invoiced the Appellant for the price of the products which the manufacturer or vendor had invoiced them.
12. The buying agents were remunerated for their services by way of a fixed commission expressed as a percentage of the purchase price of the products purchased by the Appellant from the Far East suppliers, which was billed to the Appellant when the goods were delivered f.o.b. the Far East. The commissions paid to the buying agents did not vary in relation to the success or lack of success of the products in the marketplace.
13. The buying agents received no compensation for any services if the Appellant decided not to purchase a particular product.
14. Exhibit 26 provides a typical example of the process by which the buying agents acted on behalf of the Appellant.

[5] An agreement signed July 28, 1985¹ and referred to as a typical agreement between the appellant and its agents reads as follows:

WHEREAS Hasbro Canada purchases a substantial volume of goods and merchandise in the Far East.

WHEREAS it is of great importance to Hasbro Canada that its purchases of goods and merchandise be adequately coordinated and that quality controls be implemented and maintained in respect thereof.

WHEREAS HBFE [HFE] has considerable expertise in such activities and can perform such activities on behalf of Hasbro Canada at rates lower than those available to Hasbro Canada from competitive sources.

WHEREAS HBFE [HFE] is willing to undertake such activities for Hasbro Canada upon the terms and conditions hereinafter set forth.

NOW THEREFORE THIS AGREEMENT WITNESSETH AS FOLLOWS:

1. *Appointment of Purchasing Agent*

Hasbro Canada hereby appoints HBFE [HFE] as its exclusive purchasing agent for the Far East area (including Hong Kong, the Peoples Republic of China, Korea and Taiwan) effective July 28, 1985.

The scope and nature of the activities which HBFE [HFE] shall perform are set forth in Article 2 of this Agreement.

¹ Book of documents filed as exhibit AR-1, tab 22.

2. *Description of Activities of Purchasing Agent*

HBFE [HFE] will assist Hasbro Canada in the matters described below and will provide such other information or perform such other activities as Hasbro Canada may reasonably request from time to time, namely:

- (a) provide and maintain up-to-date market research and information with respect to vendors, products and prices in the Far East;
- (b) negotiate purchase prices and payment or credit terms with vendors on behalf of Hasbro Canada;
- (c) place orders with the appropriate vendors based upon the purchasing needs of Hasbro Canada;
- (d) provide quality control and inspection services so as to ensure that products are manufactured to the proper specifications and quality standards required by Hasbro Canada;
- (e) arrange for and supervise shipments and consolidations thereof in order to reduce shipping costs incurred by Hasbro Canada;
- (f) coordinate shipping activities to ensure that products are received by Hasbro Canada or its customers, as directed by Hasbro Canada on a timely basis;
- (g) provide regular advice and information on shipment date, including date of shipments, specifics of vessel, bills of lading, insurance and related matters;
- (h) ensure regular liaison with Hasbro Canada concerning its needs for products to be manufactured in or shipped from the Far East;
- (i) maintain a sufficient staff to ensure that its duties hereunder can be adequately performed;
- (j) enter into such banking and letter of credit arrangements as may be necessary to enable the prompt and regular handling of orders placed on behalf of Hasbro Canada;
- (k) investigate and report to Hasbro Canada on activities in the Far East which relate to Hasbro Canada or which might provide additional business opportunities for Hasbro Canada, including new product ideas, technological innovations, new sources of supply and activities within the market which may affect Hasbro Canada or its business, and
- (l) maintain accounting and related systems which are compatible with those used by Hasbro Canada.

3. *Compensation of Purchasing Agent*

As compensation for the activities undertaken by HBFE [HFE], HBFE [HFE] shall be entitled to receive a 7 percent commission based on the amount and in the currency invoiced by the manufacturer to Hasbro Canada.

4. *Term of Agreement*

This Agreement shall be effective as of July 28, 1985 and shall continue in force indefinitely, subject to termination by either party as of the end of any calendar year upon written notice given not later than September 30th of the year in respect of which termination is sought.

No such termination as aforesaid shall affect the right of HBFE [HFE] to receive compensation in respect of activities contemplated herein carried out prior to the effective date of termination.

5. *Assignment*

This Agreement shall not be assignable by HBFE [HFE] without the prior written consent of Hasbro Canada. Notwithstanding any such permitted assignment, HBFE [HFE] shall remain fully liable for all obligations contained herein.

6. *Entire Agreement*

This Agreement constitutes the entire agreement between the parties with reference to the subject matter hereof and may not be changed or modified except in writing signed by both parties.

7. *Applicable Law*

This Agreement shall be construed in accordance with and be governed by the laws of the Province of Quebec and the Civil courts in Montreal, Quebec shall be the forum for any action taken in relation to this Agreement.

[6] Mr. A. Stark, financial manager for the appellant, testified on the activities of HFE as a purchasing agent for the appellant mainly by referring to a letter and supporting documents sent on May 12, 1995 by the appellant's Controller to a Mr. Daniel Anctil of Revenue Canada who was then conducting a Customs Valuation Review. The letter reads:

The following is a brief description of the procedures and activities performed by Hasbro Far East Ltd. (HFE), acting as a Purchasing Agent on behalf of Hasbro Canada Inc. (HC).

1. HC sends "Canadian Specification" forms (Exhibit 1) to HFE which itemized the product numbers and assortments that HC is interested in purchasing and specifying all the Canadian requirements e.g., bilingual packaging artwork, films and negatives, bilingual instructions, Canadian promotion inserts, master carton specification.
2. HFE uses the "Canadian Specification" to negotiate purchase prices and payment terms with the potential vendors on behalf of HC. The selected vendor submits the price quotation to HFE (Exhibit 2). HFE sends HC a "Price Confirmation Report" (Exhibit 3) which shows the F.O.B. cost from the vendor plus tooling costs as well as buying commission, country or origin, pieces per carton, cubic size and approximate pieces per container.
3. HC places an "Order Enquiry" (Exhibit 4) to HFE showing the item number and description, the quantities required and the date of shipment. HFE then communicates with the selected vendor to determine whether it can comply with HC requirements. If there are any discrepancies HFE will use the same order enquiry form to advise HC of any changes.
4. If HC accepts the conditions then, HC sends "Purchase Order" (Exhibit 5) to HFE and HFE in turn places order (Exhibit 6) with the appropriate vendors based upon the purchasing needs of HC.

5. Before orders are shipped, HFE provides quality control and inspection services so as to ensure that products are manufactured to Canadian specifications and quality standards i.e., lead content, drop tests, decibel levels and child safety standards required by HC.
6. HFE coordinates with the vendors to ensure that first-production samples are sent to HC.
7. HFE arranges for and supervises shipments and consolidations thereof in order to reduce shipping costs incurred. HFE also coordinates shipping activities to ensure that products are received by HC on a timely basis.
8. Vendor provides a shipment advice to HFE when merchandise is loaded on specified shipping line warehouse as per shipping schedule (Exhibit 7). HFE in turn provides HC "Vessel Status Reports" (Exhibit 8) for each shipment which specifies the vessel, bills of lading, product shipped and quantity.
9. HFE coordinates with the vendors to ensure that proper documents i.e., Canada Customs Invoice (Exhibit 9) and Certificate of Origin (Exhibit 10) are provided to HC for Canadian Customs clearance. On the Canada Customs Invoice, HFE instructs the vendor to declare its selling price plus applicable tooling charges at the time of shipment.
10. After the shipment was made, the vendor provides an invoice (Exhibit 11) to HFE for payment. Then HFE prepares an Invoice and Packing List (Exhibit 12) and forwards to HC. Before any payment is made to the vendor HFE send HC a weekly accounts payable statement (Exhibit 13) for payment. Once HFE receives payment from HC it in turn settles the account with the vendor(s) (Exhibit 14).

[7] According to Mr. Stark, HFE has approximately 100 employees and performs the services described to some 30 companies of the Hasbro group around the world. In a typical year it would deal as purchasing agent with approximately 40 different manufacturers. Some 1,500 shipments in 500 containers would be sent annually to the appellant.

[8] In his testimony, Mr. Stark described the typical activities of HFE as routine and clerical in responding to specific requests from the appellant for toys and games to be sold on the Canadian market. According to him, HFE does not supply general business advice or any report or information on conditions or businesses in the Far East, its response being confined to addressing specific requests from the appellant and nothing else.

[9] In cross-examination, Mr. Stark stated that similar services are currently available from a number of companies based in Hong Kong and that the appellant had chosen to deal with HFE because of its expertise.

[10] In his extensive Notes of Argument, counsel for the appellant made submissions which I will summarize as follows:

— Parliament enacted subparagraphs 212(1)(d)(ii) and (iii) in 1968 to extend withholding tax liability to information and services analogous to intellectual property. "[I]nformation concerning industrial, commercial or scientific experience", as found in subparagraph 212(1)(d)(ii), was intended to apply to know-how while "services of an industrial, commercial or scientific character", as found in subparagraph 212(1)(d)(iii), to apply to technical services. Neither provision was intended to apply to services such as those performed by a purchasing agent.

— Part XIII is generally directed towards passive receipts earned by non-residents. Buying agents do not derive passive income but perform active services. The payments do not possess those essential characteristics of rent or royalty which would bring them within the ambit of Part XIII in general and paragraph 212(1)(d) in particular.

— The structure of paragraph 212(1)(d) and its context within the Act indicate that subparagraphs (ii) and (iii) were intended to apply to information and services analogous to intellectual property rights.

— Subparagraph 212(1)(d)(ii) is not applicable because the payments were for the rendering of services, rather than for transferring information gained from experience. Counsel for the appellant cites the O.E.C.D. Commentary on Article 12 of the Model Convention and "Klaus Vogel on Double Taxation Conventions"² as support for the proposition that buying agents provide services but do not sell or otherwise impart knowledge gained from experience or know-how.

— The criteria listed in clauses 212(1)(d)(iii)(A) to (C) were intended to limit the application of subparagraph 212(1)(d)(iii) to payments computed in a manner substantially similar to royalty pay-

² Prof. Dr. Klaus Vogel, "Klaus Vogel on Double Taxation Conventions, A Commentary to the OECD-, UN- and US Model Conventions for the Avoidance of Double Taxation on Income and Capital *With Particular Reference to German Treaty Practice*", Third Edition, Kluwer Law International, London — The Hague — Boston.

ments. The payments in question do not possess those characteristics which would make them analogous to royalty payments.

— The phrase “in connection with”, as found in the postamble of subparagraph 212(1)(d)(iii), should be interpreted broadly in a manner consistent with the purpose and general wording of the provision. Thus, it should be read as broader than the phrases “engaged in”, “involved in” or “participating in” and analogous to the phrase “having to do with”.

— The payments in question were for “services performed in connection with the sale of property or negotiation of a contract” and are therefore excluded from liability by virtue of the postamble of subparagraph 212(1)(d)(iii).

— A “sale of property”, as found in the postamble of subparagraph 212(1)(d)(iii) is not limited to a sale by the payer but can include a sale by a third party to the payer. There is no reason to read in a phrase like “by the payer” into the phrase “sale of property”. Alternatively, even if such a phrase were read in, the buying agent’s activities in this case were still performed in connection with the sale of property by Hasbro to its customers in Canada.

— The Minister’s position on withholding tax liability conflicts with his position that the commissions were non-dutiable under the *Customs Act*. Revenue Canada carried out an analysis of the appellant’s payments to HFE to determine duties due on imported goods. In a letter dated March 26, 1996 from Mr. Daniel Anctil, Senior Program Officer, Valuation Division of Revenue Canada Customs, Excise & Taxation, to the appellant, found at page 5 of tab 27 of the joint book of documents, Revenue Canada agreed that payments from the appellant to HFE were “for the services of representing Hasbro Canada abroad in respect of sales”.

[11] Counsel for the respondent first submitted that the words “or a similar payment” in paragraph 212(1)(d) have been held not to have the strict legal characteristics of rent or royalty and were of sufficiently wide import as to include the payments made by the appellant to its purchasing agents. Referring to the preamble of the agreement reproduced under paragraph [5] herewith, counsel concludes that the appellant is using the information provided by the agents and is paying for their expertise when it purchases from the foreign manufacturers.

[12] In support of this argument, counsel referred to the following cases:

— *United Geophysical Co. of Canada v. M.N.R.*, 61 DTC 1099 (Ex. Ct.)

— *Warsh and Co. Ltd. v. M.N.R.*, 62 DTC 247 (T.A.B.)

— *C.I. Burland Properties Ltd. v. M.N.R.*, 67 DTC 5289 (Ex. Ct.), reversed 68 DTC 5220 (S.C.C.)

— *Western Electric Company Inc. v. M.N.R.*, 69 DTC 5204 (Ex. Ct.), affirmed 71 DTC 5068 (S.C.C.)

— *Technical Tape Corp. v. M.N.R.*, 64 DTC 428 (T.A.B.)

[13] Then, referring to paragraphs 10, 11 and 12 of the Partial Agreed Statement of Facts, reproduced under paragraph [4] herewith, counsel for the respondent argued that the payments made by the appellant to the purchasing agents were all for information and services of a commercial character and were dependent on the use to be made or the benefit to be derived therefrom by the appellant.

[14] Counsel for the respondent submitted that all the services performed by the purchasing agents were of a commercial character. According to him, they are not excluded by the postamble of subparagraph 212(1)(d)(iii) because negotiation is only an incidental element of those services and because they are in connection with purchases and not sales of property. He added that the words “in connection with the sale of property or negotiation of a contract” should be read as referring to services provided in relation or assistance to exporting goods and not importing them. Had Parliament wished to include “purchases” it would have done so by simply using the word or adding it to the word “sale”.

[15] Paragraph 212(1)(d) of the Act partly reads as follows:

212. (1) Every non-resident person shall pay an income tax of 25% on every amount that a person resident in Canada pays or credits, or is deemed by Part I to pay or credit, to the non-resident person as, on account or in lieu of payment of, or in satisfaction of,

...
 (d) rents, royalties, etc. — rent, royalty or similar payment, including, but not so as to restrict the generality of the foregoing, any payment

...
 (ii) for information concerning industrial, commercial or scientific experience where the total amount payable as consideration for that information is dependent in whole or in part on

- (A) the use to be made of, or the benefit to be derived from, that information,
- (B) production or sales of goods or services, or
- (C) profits,

(iii) for services of an industrial, commercial or scientific character performed by a non-resident person where the total amount payable as consideration for those services is dependent in whole or in part on

- (A) the use to be made of, or the benefit to be derived from, those services,
- (B) production or sales of goods or services, or
- (C) profits,

but not including a payment made for services performed in connection with the sale of property or the negotiation of a contract.

[16] Counsel for the appellant argued that a payment which comes within the ambit of one of the subparagraphs of paragraph 212(1)(d) but is not a "rent, royalty or similar payment", as per the preamble of paragraph 212(1)(d) should not be subject to tax under subsection 212(1). I disagree with this submission. On this point, it might be useful to refer to paragraph 106(1)(d), the predecessor of paragraph 212(1)(d), as it read prior to its amendment in 1968. It then read:

- (d) rent, royalty or a similar payment, including, but not so as to restrict the generality of the foregoing, any such a payment
 - (i) for the use in Canada of property,
 - (ii) in respect of an invention used in Canada, or
 - (iii) for any property, trade name, design or other thing whatsoever used or sold in Canada.

[17] In *The Queen v. Farmparts Distributing Ltd.*, 80 DTC 6157 (F.C.A.) at page 6160, a decision referred to by counsel for the respondent, Heald, J. wrote on the interaction between the preamble and subparagraphs of paragraph 212(1)(d) and also on the significance of the change in the wording of the new provision in the following terms:

[T]he appellant submits that the intent of Parliament to widen the scope of section 212(1)(d) is evidenced by the fact that section 106(1)(d), the predecessor to section 212(1)(d) was amended in 1968 by deleting the words "any such a payment" and substituting therefor the words "any payment". The appellant further submits that the word "including" is used in its extensory sense for the purpose of enlarging the meaning of the preceding words . . .

I have concluded that this submission by the appellant's counsel is well founded. I agree with him that the combination of the 1968 amendment and the use of the word "including" is a clear indication that Parliament intended that the payments described in subparagraphs (i) to (v) be subject to the charge of the section whether or not those payments can be said to be *ejusdem generis* with "rent, royalty, or a similar payment".³

[18] I agree with this conclusion. A payment which comes within the ambit of one of these subparagraphs need not also come within the ambit of the phrase "rent, royalty or similar payment" to be subject to Part XIII tax. The subparagraphs should be applied as extensory inclusions to, rather than examples of, what is "rent, royalty or similar payment".

[19] It seems unquestionable to me that the payments made by the appellant to its purchasing agents, not being for the use of any real or personal property, cannot be said to represent rent or a similar payment. Thus, in order to decide whether the payments made by Hasbro to its purchasing agents are subject to withholding tax under paragraph 212(1)(d) it is necessary to consider first if the payments are in the nature of a royalty or a similar payment. If not, it will then be necessary to determine whether these payments come within the ambit of subparagraph 212(1)(d)(ii) or (iii) of the Act. Finally, if the payments do come within the ambit of subparagraph 212(1)(d)(iii) it will have to be decided if they are excluded by the effect of the postamble of that subparagraph.

[20] As to the meaning of the term "royalty", in *Vauban Productions v. The Queen*, 75 DTC 5371 at page 5372, Addy, J. of the Federal Court — Trial Division said the following:

The term "royalties" normally refers to a share in the profits or a share or percentage of a profit based on user or on the number of units, copies or articles sold, rented or used. When referring to a right, the amount of the royalty is related in some way to the degree of use of that right. . . . Royalties, which are akin to rental payments, have invariably been considered as income since they are either based on the degree of use of the right or on the duration of the use, while a lump sum payment for the absolute transfer of a right, without regard to the use to be made of it, is of its nature considered a capital payment, although it may of course be taxable as income in the hands of the recipient if it is part of that taxpayer's regular business.

[21] More recently, in *Grand Toys Ltd. v. M.N.R.*, 90 DTC 1059 at page 1063, Lamarre Proulx, J. of this Court wrote:

³ Further support for this proposition can be found in the dicta of Thurlow, C.J. in *The Queen v. Saint John Shipbuilding & Dry Dock Co. Ltd.*, 80 DTC 6272 (F.C.A.) at page 6274.

In the case at bar, the payments were the payee's profits and were in no way related to the Appellant's profits nor were they related to the Appellant's gross sales of the units. Whether the Appellant sold all the units or none of them, whether it made profits or not, did not influence the amount of money paid. There was no element of contingency in the payments in question and an element of contingency is the essence of a royalty payment.

[22] A royalty or similar payment is therefore one made for the use of property, rights or information whereby the payments for such use are contingent upon the extent or duration of use, profits or sales by the user.

[23] In my opinion, the payments made by Hasbro to its purchasing agents cannot be said to be in the nature of a royalty or similar payment. The payments rightly described as "commissions" were in the form of a lump sum expressed as a simple percentage (7%) of the total amount invoiced by the manufacturer as the price of the toys and games purchased with a given order. They were not contingent upon the use, profit or sales of those items by Hasbro. Furthermore, the payments were not made for the use of property, right, or information but were essentially for services rendered. In my view, the payments did not possess those characteristics that would bring them within the contemplation of the preamble phrase "rent, royalty or similar payment" as found in paragraph 212(1)(d).

[24] To come within the ambit of subparagraph 212(1)(d)(ii), a payment must be for information concerning industrial, commercial or scientific experience where the total amount payable must be dependent, in whole or in part, either on the use to be made of, or the benefit to be derived from the information, on production or sales of goods or services, or on profits. It is not immediately apparent what sort of information is contemplated by that provision. The term "information" is not defined in the Act. Counsel for the appellant argued there is ample evidence available to support the claim that the phrase "information concerning industrial, commercial or scientific experience" was intended to apply to know-how.

[25] Evidence in this regard can be found in the 1968 budget statement of The Honourable E.J. Benson, then Minister of Finance, who said:

The *Income Tax Act* will be amended to provide that the present non-resident withholding tax on royalties paid by a resident of Canada to a non-resident shall apply to a somewhat wider range of payments. The proposed amendment will be based on the definition of royalties suggested by the O.E.C.D. fiscal committee and used as a model by Canada in several of its international tax agreements.⁴

[26] In paragraph 2 of Article 12 of the "Draft Double Taxation Convention on Income and Capital", Report of the O.E.C.D. Fiscal Committee 1963, Organisation for Economic Co-operation and Development, "royalties" are defined in the following manner at page 49:

The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematographic films, any patent, trade mark, design or model, a secret formula or process, or for the use of, or the right to use, industrial, commercial, or scientific experience.

[27] In the Commentary to that provision, it is said at page 118:

Paragraph 2 contains a definition of the term "royalties". These relate, in general, to rights or property constituting the different forms of literary and artistic property, the elements of industrial and commercial property specified in the text and information concerning industrial, commercial or scientific experience.

[28] In subsequent commentaries, the O.E.C.D. Committee on Fiscal Affairs has elaborated its explanation of Article 12.⁵ Paragraph 11 of the 1997 Commentary⁶ reads in part:

In classifying as royalties payments received a consideration for information concerning industrial, commercial or scientific experience, paragraph alludes to the concept of "know-how". Various specialist bodies and authors have formulated definitions of know-how which do not differ intrinsically. One such definition, given by the "Association des Bureaux pour la protection de la Propriété Industrielle" (ANBPI) states that "know-how" is all the undivulged technical information, whether capable of being patented or not that is necessary for the industrial reproduction of a product or process, directly and under the same conditions: inasmuch as it is derived from experience, know-how represents what a manufacturer cannot now [sic] from mere examination of the product and mere knowledge of the progress of technique. 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. It is recognised that th

⁴ Canada, House of Commons Debates, October 22, 1968 at page 1989.

⁵ See Model Double Taxation Convention on Income and on Capital, Report of the OECD Committee on Fiscal Affairs, 1997, Organisation for Economic Co-operation and Development, Paris.

⁶ Model Tax Convention on Income and on Capital, OECD Committee on Fiscal Affairs, Organisation for Economic Co-operation and Development, Paris, Volume 1 (Updated as of 1st November 1997), pages C(12)-3 and -4.

grantor is not required to play any part himself in the application of the formulas granted to the licensee and that he does not guarantee the result thereof. *This type of contract thus differs from contracts for the provision of services, in which one of the parties undertakes to use the customary skills of his calling to executive work himself for the other party.*

(emphasis added)

[29] Counsel for the appellant argued that, given the extensive consultation that accompanied the revisions of the Model Convention and the right to register any misgivings about the terms or the Commentary attached, one can assume that Canada is also of the view that the phrase "industrial, commercial or scientific experience" is intended to bring know-how within the ambit of withholding taxes.

[30] Counsel for the appellant also made reference to several articles describing subparagraph 212(1)(d)(ii) as a provision dealing with know-how.⁷

[31] I agree with counsel for the appellant that there is sufficient evidence that the phrase "information concerning industrial, commercial or scientific experience" in subparagraph 212(1)(d)(ii) was intended to apply to payments for know-how.

[32] As one can readily appreciate, providing know-how implies imparting knowledge or experience to someone else, which knowledge or experience remains unrevealed to the public.

[33] Comments by Professor Klaus Vogel also suggest that central to the idea of providing know-how in relation to industrial, commercial or scientific experience is the notion of imparting knowledge derived from experience that is more than "general specialist knowledge" or mere knowledge of the state of the art.⁸ In the context of the present case, it does not seem to me that skills in trade practices in a particular area of the world or general business acumen in handling day-to-day commercial transactions for others can be the subject matter of know-how.

[34] More to the point, in my view, the information provided to the appellant by its purchasing agents concerning negotiations with manufacturers, price quotations, delivery schedules, shipment arrangements, etc. does not constitute

know-how imparted to the appellant. This is specific information concerning the details of commercial transactions between parties situated in different countries, effected through an intermediary, nothing more. Moreover, while the agreement does say that HFE would provide "up-to-date market research and information ..." and would "investigate ... activities in the Far East which relate to Hasbro Canada or which might provide additional business opportunities for Hasbro Canada ...", it is doubtful whether such information could ever be considered know-how. Finally, I must point out that the evidence presented at trial indicates that no such information was actually transferred to Hasbro. The May 12, 1995 letter from Hasbro to Mr. Daniel Anctil of Revenue Canada and the testimony given by Mr. Stark both make it clear that the purchasing agents provided services almost exclusively in the nature of arranging and supervising purchasing orders. If, indeed, the purchasing agents had a certain level of expertise and experience it would seem that they used their knowledge themselves in providing the various services to Hasbro. In my opinion, subparagraph 212(1)(d)(ii) simply has no application in the present case.

[35] Subparagraph 212(1)(d)(iii) covers a payment for services of an industrial, commercial or scientific character performed by a non-resident person where the total amount payable as consideration is dependent in whole or in part either on the use to be made of, or the benefit to be derived from, those services, on production or on sales of goods or services, or on profits. The postamble of subparagraph 212(1)(d)(iii) contains an exclusive clause which states that the provision does not apply to "a payment made for services performed in connection with the sale of property or the negotiation of a contract".

[36] While Finance Minister Benson indicated that amendments to the Act would be based on the definition of royalties suggested by the O.E.C.D. Fiscal Committee, that definition does not refer to services of an industrial, commercial or scientific character. Because the O.E.C.D. Draft or Model Convention has never specifically dealt with that category of services, subparagraph 212(1)(d)(iii) cannot be interpreted in

⁷ Counsel for the appellant referred to M.A. Régnier, "Know How" (1968) 21 C.T.F. Conference Report 402 and S.C. Smith and G. McGregor, "Tax Treatment of Know-How" (1971) 19 Can Tax J. 154 (G.T.F.). On this point, one can also refer to P. Crawford, "Management Fees and Know-How Payment" (1969) 17 Can Tax J. 409 (G.T.F.), S.L. Scheuermann "Income and Commodity Tax Aspects of Acquiring and Exploiting Technology" 1991 C.T.F. Conference Report 45:1 and M.I. Atlas, "Canadian Taxation of Non-Residents" (1995, CCH Canadian Limited) Chap. 8 "Other Rentals, Royalties and Similar Payments".

⁸ See footnote 2 at page 790, 60.

light of the O.E.C.D. Commentary as can subparagraph 212(1)(d)(ii). On a plain reading, the types of industrial, commercial or scientific services covered are not restricted in any manner.

[37] Some authors have attempted to explain the intended scope of subparagraph 212(1)(d)(iii) by referring to payments of services in relation to know-how. For example, Scott Scheuermann in "Income and Commodity Tax Aspects of Acquiring and Exploiting Technology"⁹ describes subparagraph 212(1)(d)(ii) as covering payments for "know-how" and subparagraph 212(1)(d)(iii) as covering payments for "show-how", although he says nothing else which would explain the ambit of the latter provision.

[38] Mr. P. Crawford was somewhat more enlightening when he stated in "Management Fees and Know-How Payments"¹⁰ that he believed subparagraphs 212(1)(d)(ii) through (iv) were:

[O]bviously drafted with what might be regarded as a standard type of know-how agreement in mind, whereby payments are allocated between amounts paid for know-how, amounts paid for services of a technical nature relating to the effective transfer of the know-how and amounts paid for "keep-out" covenants.

[39] In Mr. M.I. Atlas' book "Canadian Taxation of Non-Residents"¹¹, the author writes of subparagraph 212(1)(d)(iii):

In general terms, the application of subparagraph 212(1)(d)(iii) is quite similar to that of subparagraph 212(1)(d)(ii) . . . , except this provision applies to payments for services performed, rather than to information provided.

However, it is important to note that this provision will not apply to a payment rendered in connection with the sale of property or the negotiation of a contract. Accordingly, sales commissions will generally not be subject to this provision. Neither will buying commissions or finders fees be subject to this provision, provided the recipient was actually involved in the negotiation of the purchase contract.

(emphasis added)

[40] Counsel for the appellant submitted that subparagraph 212(1)(d)(iii) was intended to apply only to "technical services". He argued that the context of subparagraph 212(1)(d)(iii), immediately following subparagraphs 212(1)(d)(i) and (ii), indicates that Parliament intended subparagraph 212(1)(d)(iii) to apply only to technical services which are analogous to know-how.

[41] In paragraph 23 of Interpretation Bulletin No. IT-303, "Know-how and similar payments to non-residents", April 8, 1976, Revenue Canada says by way of examples that "fees for technical or production services where the amount of such fees depends in any way upon performance or productivity" and "charges for product development and marketing know-how or research which vary in accordance with production or sales" come within the ambit of subparagraph 212(1)(d)(iii). At paragraph 24, Revenue Canada uses the example of a hotel business to support an argument that subparagraph 212(1)(d)(iii) applies to various services related to income producing activities. Therefore, Revenue Canada's position is that the ambit of subparagraph 212(1)(d)(iii) is wider than "technical services" alone, as counsel for the appellant argued.

[42] Although I would tend to agree with counsel for the appellant as to the intended scope of subparagraph 212(1)(d)(iii), in my view, it is difficult to interpret that provision as applying only to payments for a particular category of services when the words used have definitely a wide import and are not qualified in any manner. Applying a plain meaning approach to the interpretation of that subparagraph, it is clear that the payments made by Hasbro to its purchasing agents were payments for "services . . . of [a] . . . commercial . . . character". The purchasing agents negotiated and supervised the business transactions between Hasbro and the manufacturers and therefore their services can be described as being of a commercial character.

[43] However, it is less clear whether the payments from Hasbro to its purchasing agents satisfy any of the criteria enumerated in clauses 212(1)(d)(iii)(A) through (C). These clauses require that the total amount payable to the non-resident provider of the services be dependent to some extent on the "use to be made of or the benefit to be derived from, those services" on "production or sales of goods or services" or on "profits". One interpretation of that condition is that the use or benefit, production or sales or profits referred to in these clauses should only cover those of the payer and not those of any other party. If I adhere to this interpretation of clauses 212(1)(d)(iii)(A) through (C), then the appeals must succeed because the payments from Hasbro to its purchasing agents were not dependent in whole or in part on the use, benefit, pro-

⁹ *Id.* note 7, at pages 45:36 and 45:37.

¹⁰ *Id.* note 7, at page 412.

¹¹ *Id.* note 7, at pages 182 and 183.

duction, sales or profits of Hasbro. However, one problem is that this interpretation requires that I effectively read the phrase "by the payer" into these clauses. In his arguments on the phrase "in connection with the sale of property", as found in the postamble of subparagraph 212(1)(d)(iii), counsel for the appellant referred to the rule of statutory interpretation which mitigates against reading in extra words or phrases where a reasonable interpretation could be had without them (See *Friesen v. The Queen*, 95 DTC 5551 at page 5556 (S.C.C.); *The Queen v. Pongrantz*, 82 DTC 6200 at page 6203 (F.C.A.)). The same should also hold true here. However, I do not think it is necessary to reach a definite conclusion on that question because even if I assume that the terms of clauses 212(1)(d)(iii)(A) through (C) apply to third parties that would not change the final outcome of this case because of the exclusion in the postamble of subparagraph 212(1)(d)(iii). While I am of the opinion that the use, benefit, production, sales and profits referred to in clauses 212(1)(d)(iii)(A) through (C) were intended to refer primarily to those of the payer, I recognize that it is not an unreasonable interpretation that they can sometimes refer to the use, benefit, production, sales or profits of third parties. In the present case, the phrase "dependent . . . on . . . sales of goods" could thus, as argued by counsel for the respondent, include payments which are dependent on the sales of goods by third parties, like the sales by the manufacturers to Hasbro. Assuming this is so, it must be decided whether or not these payments are excluded by the postamble of subparagraph 212(1)(d)(iii).

[44] Counsel for the appellant submitted that the phrase "in connection with" as found in the postamble of subparagraph 212(1)(d)(iii) should be interpreted broadly and similar in scope to a phrase like "having to do with". According to a decision of the British Columbia Supreme Court referred to by the appellant, *Re Nanaimo Community Hotel Ltd.*, [1944] 4 D.L.R. 638 at page 639, "the words would include matters occurring prior to as well as subsequent to or consequent upon, so long as they are related to the principal thing". To the same effect one can also refer to *Hutchinson et al. v. Berridge et al.*, [1921-22] 18 Alta. L.R. 121, 66 D.L.R. 753 (Alta. S.C. App. Div.); *I.G.T.C. Ltd. v. M.N.R.*, 82 DTC 1581, [1982] C.T.C. 2570, (T.R.B.).

[45] Given the breadth of the phrase "in connection with", it seems clear to me that the whole of the payments from Hasbro to its purchasing agents can be said to have been made "in connection with the sale of property . . .". The locating of manufacturers, the negotiating of purchase

orders and the supervising of production and delivery were all undertaken in connection with the sale of toys and games from the Far East manufacturers to Hasbro. As remarked by counsel for the appellant, it is also worthy to note in this regard that Revenue Canada in its Customs Valuation Review had described the payments from Hasbro to its purchasing agents as services "in respect of sales".

[46] Counsel for the respondent argued that the "sale of property" referred to in the postamble of subparagraph 212(1)(d)(iii) did not refer to sales by third parties but only to sales by the payer. I find this position untenable given that counsel for the respondent also argued that the phrase "dependent . . . on . . . sales of goods" as found in clause 212(1)(d)(iii)(B) should include sales by third parties. If I assume that the phrase "dependent . . . on . . . sales of goods" includes sales by third parties, then surely I must also find that the phrase "in connection with the sale of property" as found in the postamble to subparagraph 212(1)(d)(iii) also includes sales by third parties. While counsel for the respondent argued that a dualistic reading of these two provisions accords with a purported legislative intent to encourage Canadian exports, no evidence was tendered which would support such a position. It is worth noting that the phrase "in connection with" is clearly broader in its scope than the phrase "dependent on". Likewise, the phrase "sale of property", given the broad definition of the term "property" in subsection 245(1) of the Act, is broader than the phrase "sale of goods". These observations add further support to the conclusion that, if I accept that the payments were "dependent . . . on . . . sales of goods", then I must accept that they were also made "in connection with the sale of property" and allow the appeals to succeed. The commissions paid by the appellant to its purchasing agents were expressed as a percentage of the purchase price of the goods sold by the manufacturers to the appellant. The word "sale" and not "purchase" is the generic term used in article 1708 of the *Civil Code of Québec* to describe the contract "by which a person, the seller, transfers ownership of property to another person, the buyer, for a price in money which the latter obligates himself to pay". One can also appreciate that, in other provinces, Sales of Goods acts need not be entitled "Sales and Purchases of Goods" acts. A sale requires two parties and a reference to a sale implies, in my opinion, a reference to a single contract between the two whereby one sells and the other buys the same property. There is no necessity of adding the word "purchase" when

referring to something "in connection with" such a contract.

[47] I must admit that it is puzzling that the inclusion of the phrase "in connection with the sale of property" in the postamble of subparagraph 212(1)(d)(iii) appears to nullify the effect of the phrase "sale of goods" in clause 212(1)(d)(iii)(B) insofar as any payment which is "dependent . . . on . . . sales of goods" would necessarily also be made "in connection with the sale of property". However, such an effect is less absurd and unreasonable than reading one of those phrases but not the other to apply to sales by third parties without some indication that this is what Parliament intended. One must also realize that in a situation where payments for services to a non-resident person would be dependent on sales by the payer, the same result would also occur. Such a situation has certainly been contemplated by Parliament.

[48] Moreover, even if I were convinced that the phrase "sale of goods", as found in clause 212(1)(d)(iii)(B), contemplates sales involving third parties, while the phrase "sale of property", as found in the postamble of subparagraph 212(1)(d)(iii), does not, I would still find in favour of the appellant because at least some portion of the payments made by Hasbro to its purchasing agents was for services rendered in connection with the negotiation of a contract. In paragraph 10 of their Partial Agreed Statement of Facts, the parties agreed that the services provided by the purchasing agents to Hasbro consisted in part of "negotiating the prices for such products, the quantities of product and the delivery schedules". It is clear then that an important part of the services performed by these purchasing agents was "performed in connection

with . . . the negotiation of a contract", as per the postamble of subparagraph 212(1)(d)(iii). Give the breadth of the expression "in connection with" accepted earlier it could also cover services rendered subsequent to or consequent upon the negotiation itself. As at least a portion of the payments in question would have been non-taxable because they were performed in connection with the negotiation of a contract, there was an onus on the Minister to specify which portion of the payment was taxable under that provision. The Minister has not in this case specified which portion of the payments from Hasbro to its purchasing agents he believes is subject to taxation and which portion would have been non-taxable as related to services performed in connection with the negotiation of a contract. In *The Queen v. Farmparts Distributing Ltd.*, 80 DT 6157 (F.C.A.), *Quality Cheked Dairy Products Assn. (Co-op.) v. M.N.R.*, 67 DTC 5303 (Ex. Ct) and *Brad-Lea Meadows Limited v. M.N.R.*, 9 DTC 1269 (T.C.C.), it has been decided that where a payment can reasonably be considered to be in part for something taxable and in part for something non-taxable, there is an onus on the Minister to specify which portion of the payment is subject to the taxing provision relied upon. If the Minister fails to make this allocation, the taxpayer will not be subject to tax under that particular provision.

[49] For all the foregoing reasons, I hold that the payments from Hasbro to its purchasing agents in the Far East are not subject to withholding tax under paragraph 212(1)(d) of the Act.

[50] The appeals are allowed and the assessments are vacated. The appellant is entitled to one set of costs.