

Case Name

Velcro Canada Inc. v. The Queen, 2012 TCC 57

Countries

Country of decision

Canada

Other countries

Netherlands

Netherlands Antilles

Court

Tax Court of Canada

Case Number

2007-1806(IT)G

Parties

Name

Velcro Canada Inc.

Role

Appellant

Name

Her Majesty the Queen

Role

Respondent

Date of Decision (format yyyy-mm-dd)

2012-02-24

Treaty Article(s) and Paragraph(s)

Canada-Netherlands Income Tax Convention, Article 3(2) and Article 12

Country of decisions

Canada

Other country

Netherlands

Subject

Royalties and beneficial ownership

Sign year

1986

Last amending protocols (sign date yyyy-mm-dd)

1997-08-25 and 1993-03-04

Taxable years

1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2003 and 2004 taxation years

Keywords

Beneficial ownership; royalties; license agreement; assignment agreement; holding companies; *Canada-Netherlands Income Tax Convention, article 12*

Summary of Facts

Prior to 1996, Velcro Canada Inc. (“VCI”), a Canadian resident company, paid royalties to Velcro Industries BV (“VIBV”), a Netherlands resident, under a License Agreement for the use of Velcro Brand Technology to manufacture and sell fastening products. The amount of royalties owed was calculated as a percentage of net sales.

In 1995, VIBV became a resident of the Netherlands Antilles, and assigned the License Agreement to Velcro Holdings BV, a VIBV subsidiary resident in the Netherlands. From 1996 to 2004, Velcro Canada paid royalties to VHBV. Under the Assignment Agreement, VHBV was then required to pay an arm’s length percentage of the royalties received to VIBV within 30 days of their receipt. The arm’s length percentage was subject to the

approval of the Dutch tax authorities and was ultimately determined to be 90% of the royalty payments received.

There is no tax treaty between Canada and the Netherland Antilles. If the royalty payments were paid directly by VCI to VIBV, or if VIBV was found to be the beneficial owner of the royalty payments made to VHBV, the payments would be subject to a withholding rate of 25%.

There is a tax treaty between Canada and the Netherlands. If VHBV was found to be the beneficial owner of the royalty payments from VCI, the applicable withholding rate under the *Canada-Netherlands Income Tax Convention* (the “*Convention*”) would be 10% from 1996 to 1998 and 0% beginning in 1999.

The Canada Revenue Agency argued that VIBV was the beneficial owner of the payments and therefore reduced withholding rates for royalties under the *Convention* did not apply. VCI countered that VHBV was the beneficial owner of the royalty payments as required under Article 12 of the *Convention* and entitled to the reduced withholding rate.

Penalties were also assessed, with counsel agreeing that the decision regarding penalties should follow the result of the beneficial ownership determination. At issue was a total of \$8,583,938 in reassessed tax and \$855,694 in penalties.

Issue

Was Velcro Holdings BV, a Netherlands corporation, the beneficial owner of the royalties received from Velcro Canada and therefore entitled to the reduced withholding rate under the *Convention*?

Court Decision

The appeal was allowed, with the Tax Court of Canada finding that VIBV was the beneficial owner of the royalties. The Court applied the beneficial ownership test outlined in *Prévost Car Inc. v. R.*, 2008 TCC 231, and affirmed by the Federal Court of Appeal (2009 FCA 57). Despite the contractual obligation to pay 90% percent of the royalties received from VCI to VIBV within 30 days, the Court found that VIBV enjoyed the attributes of ownership over the royalties through its possession, use, risk and control over the funds.

The Court reviewed a number of factors demonstrating that VHBV had the necessary attributes of ownership, including VHBV’s legal right to the payments; the fact that the payments were deposited in VHBV’s own account, converted into other currencies, and earned interest; and the commingling of the royalty amounts with other VHBV funds which were then used for various VHBV purposes including bill payments. The Court emphasized that VHBV had the sole discretion to use the funds as it saw fit. If VHBV failed to make payments under the Assignment Agreement, the recourses available to VIBV were

the same as those available to any other creditor. When VHBV did make the payments owed to VIBV, the funds used were not the exact funds that had been paid by VCI and in fact were less than the amount received. The Court determined that there was no automatic flow of funds between VHBV and VIBV.

The Court also rejected the Minister's argument that VHBV was acting as a mere conduit, agent, or nominee of VIBV. Citing *Prévost Car Inc. v. R.* and referring to OECD commentary and the OECD's Conduit Companies Report, the Court noted that a corporation will not be considered a conduit unless it has absolutely no discretion. The Court emphasized that VHBV had sufficient discretion over the funds. Because VHBV could not affect the legal position of VIBV, the Court determined that there was no agency relationship, and that VHBV could not be characterised as a nominee since it acted on its own account throughout the taxation years in question.

Decision in Favour of

Velcro Canada Inc.

Other Relevant Cases

Prévost Car Inc. v. R., 2008 TCC 231, aff'd 2009 FCA 57 [*Prévost Car*].

Editor's Notes

This was the first case to consider beneficial ownership in a treaty context since the Federal Court of Appeal's decision in *Prévost Car*. Unlike *Prévost Car*, which considered the beneficial ownership of dividends, this case addressed the beneficial ownership of royalties.

Language of Decision

English and French

Full Text of Decision

In English: [Judgments of the Tax Court of Canada](#) or [CanLII](#)

In French: [Judgments of the Tax Court of Canada](#) or [CanLII](#)