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DOCNUM 2013-0475161I7

REFDATE 140225

SUBJECT Whether USCo has a PE in Canada

SECTION Article V of the Canada-US Treaty

PRINCIPAL ISSUES: 1. Whether services have to be rendered at the construction site to be subject to Article V(3)? 2. Does Article V(3) apply to planning and supervision by a subcontractor? 3. Does the position in 2. apply, given that Article V(3) was drafted before the change to paragraph 17 of the OECD Commentary on Article 5? 4. Are paragraphs 17 and 19 of the OECD Commentary on Article 5 contradictory? 5. Does USCo have XXXXXXXXXX separate functions? 6. Are the various operations the "same or connected" projects?

POSITION: 1. Yes. 2. Yes. 3. Yes. 4. No. 5. Likely not. 6. Unable to conclude.

REASONS: 1. Article V(9) applies to services that are not covered by Article V(3). 2. Paragraph 17 of the OECD Commentary on Article 5. 3. Both Canada and the US take this view. 4. Paragraph 19 deals only with duration. 5. Based on guidance from the FCA in Du Pont. 6. We have provided some guidance on how to make the determination.

February 25, 2014

XXXXXXXXXX TSO

HEADQUARTERS

Income Tax Rulings

Directorate

S.E. Thomson

(613) 957-2122

2013-047516

XXXXXXXXXX ("USCo") - Permanent Establishment ("PE")

Dear XXXXXXXXXX:

This letter is in response to your email of January 14, 2013 in which you ask for our opinion on whether or not USCo would have a permanent establishment in Canada under Article V of the Canada-U.S. Tax Convention (the "Treaty").

Facts

USCo is a corporation resident in the U.S., and is a subsidiary of XXXXXXXXXX (USParent), also a corporation resident in the U.S. USCo provides services to the world-wide affiliated group in planning and executing XXXXXXXXXX projects.

The Canadian affiliates of USParent have several multi-year operations in XXXXXXXXXX. The operations comprise the development of XXXXXXXXXX. The major operations, such as the XXXXXXXXXX and the XXXXXXXXXX, are further sub-divided into separate phases, with each phase lasting more than 12 months.

The XXXXXXXXXX is owned by XXXXXXXXXX and XXXXXXXXXX, indirect Canadian subsidiaries of USParent. We understand that the XXXXXXXXXX is XXXXXXXXXX. You suggest that the XXXXXXXXXX is one project. The taxpayer maintains that the XXXXXXXXXX comprises XXXXXXXXXX projects as listed below. XXXXXXXXXX.

XXXXXXXXXX

The XXXXXXXXXX is a joint venture. XXXXXXXXXX owns and operates the assets as agent for the participants in the joint venture. One of the participants, XXXXXXXXXX, XXXXXXXXXX limited partnership, owns approximately XXXXXXXXXX% of XXXXXXXXXX. The partnership interests in XXXXXXXXXX are owned by XXXXXXXXXX and XXXXXXXXXX, indirect Canadian

subsidiaries of USParent.

XXXXXXXXXX. You suggest that the XXXXXXXXXX is one project. However, the taxpayer considers that there are several distinct projects, as follows:

XXXXXXXXXX

The taxpayer lists the following reasons for considering the various XXXXXXXXXX and XXXXXXXXXX projects as distinct and unconnected:

* Each project is run separately.
* The projects are not integrated.
* Each project was managed by a separate team.
* Each project had a separate capital budget.
* Each project had a different scope.
* Each project was executed by a different team.
* Separate project codes were set up.
* USCo may be heavily involved in one project, but may not provide services again in a subsequent project. (footnote 2)

USCo has signed a Master Services Agreement with XXXXXXXXXX under which USCo provides services to XXXXXXXXXX and its affiliates in connection with the XXXXXXXXXX operations. You understand that there is only one agreement, and that it governs the services provided to other Canadian affiliates besides the XXXXXXXXXX operations, even though it is not signed by the other affiliates.

USCo sends employees to Canada to render the services. Most of the services are provided in XXXXXXXXXX at the Canadian affiliates' offices, or at the third party contractors' offices or other project participants' offices, or in hotels. Occasionally, USCo's employees will travel to the XXXXXXXXXX. We understand that the employees' presence in Canada would total 183 days or more in any 12-month period, but their presence at the XXXXXXXXXX would total less than 183 days in any 12-month period.

Similarly, we understand that USCo sends employees to XXXXXXXXXX and the XXXXXXXXXX sites XXXXXXXXXX. You have not asked for our views with regards to these services.

The services provided by USCo under the Master Services Agreement are what you refer to as "intellectual, planning and supervisory" type services performed by engineers, advisors and coordinators, and are not physical construction activities. For example, USCo provides the following services with respect to the projects:

- technological assistance
- general advice on strategy development
- advice on business controls, XXXXXXXXXX programs, XXXXXXXXXX development planning, engineering, design and project execution

USCo has identified XXXXXXXXXX functional enterprises, each carrying out distinct and different activities. The functions are:

XXXXXXXXXX

Issues

For the year under audit, you would like to ascertain if USCo had a permanent establishment in Canada under Article V of the Treaty. In this respect, you request our view:

a) Can paragraph 3 of Article V apply when the services are not rendered at the building site or construction or installation project?

b) Does paragraph 3 of Article V of the Treaty apply to "intellectual" services?

c) Does paragraph 17 of the Commentary on Article 5 of the OECD Model (footnote 3) apply, given that paragraph 3 of Article V of the Treaty has not been amended?

d) Are paragraphs 17 and 19 of the OECD Commentary on Article 5 contradictory?

e) Do USCo's XXXXXXXXXX separate functions constitute XXXXXXXXXX separate "enterprises" for purposes of paragraph 9 of Article V of the

Treaty?

f) Are the various projects identified by the taxpayer the "same or connected" projects for purposes of paragraph 9 of Article V of the Treaty?

Analysis

Before we address the specific questions posed, we would like to provide some general comments with regard to USCo's services rendered in Canada.

* Subject to paragraph 3 of Article V, paragraph 9 of Article V applies when the enterprise does not have a PE under the rest of Article V. We assume that you have already determined that USCo does not have a PE under paragraph 1 of Article V, the fixed base article. We note that in a recent similar case, the court said, in obiter,

"Based upon the extensive evidence before this Court, it appears that I would have been bound to follow and apply the Federal Court of Appeal's decision in Dudney v. The Queen, 2000 DTC 6169 (FCA), [2000] 2 C.T.C. 56 (FCA)." (footnote 4)

We also assume that the exclusions in paragraph 6 of Article V do not apply.

We assume that the employees are employees of USCo; that is, they have not been seconded to the Canadian affiliates. A finding that USCo has a PE in Canada is relevant under Article XV of the Treaty, and section 102 of the Income Tax Regulations with respect to the employees. If USCo has a PE in Canada, USCo's employees are not eligible for a treaty-based waiver under Regulation 102.

Note that paragraphs XXXXXXXXXX and XXXXXXXXXX of the letter from XXXXXXXXXX to you on XXXXXXXXXX mentions that some of USCo's employees are seconded to the Canadian affiliate. If USCo's employees are in fact under the supervision of the Canadian affiliates, then the services provided by those employees would not be counted in determining whether USCo has a PE in Canada. For more discussion on this point, see paragraphs 8 to 8.28 of the OECD Commentary on Article 15, and document

XXXXXXXXXX (question 19 from the 2009 Canadian Tax Foundation annual conference CRA round table).

* We note that the Canadian affiliates are paying USCo for the services at cost. If we are to find that USCo has a PE in Canada, only the profits attributable to the PE can be taxed in Canada. If there are no profits, having a PE is a moot point. However, the US may insist on an arm's length transfer price, in which case the Canadian affiliates may ask for a corresponding adjustment. Also, as noted above, it is still necessary to determine whether USCo has a PE in Canada for the purposes of Article XV.

* You indicate that USCo provides only intellectual-type services. XXXXXXXXXX. It is not clear if USCo actually performs any of the physical work as well.

* Finally, we note that your questions do not address subcontractors. The facts indicate that USCo may be sending subcontractors to Canada as well as employees. We have previously said that in computing the number of days in which services are provided in Canada under subparagraph 9(b) of Article V, the days on which services are provided by subcontractors that are not resident in Canada would be included. See documents 2010-0391541E5 and 2011-042659.

a) Offsite Services

Paragraph 3 of Article V of the Treaty reads as follows:

A building site or construction or installation project constitutes a permanent establishment if, but only if, it lasts more than 12 months.

XXXXXXXXXX.

There is nothing in the words of paragraph 3 of Article V to indicate whether services rendered in respect of the construction site have to be rendered at the site, and we found no case law on this point. However, in the book, The Taxation of Permanents Establishments (footnote 5), Dr. Arvid Skaar says, "Only work performed at the building site may be part

of a particular construction project".

In addition, in his paper (footnote 6), The New Services PE Rule in the Canada-U.S. Treaty Protocol, Brian Arnold says,

"It is the location where the services are performed that is important. Any services performed at a construction site (assuming that they have some connection to that site) is governed by the construction site provision."

In our view, in determining whether a permanent establishment exists under paragraph 3 of Article V, only the services rendered at the construction site can be considered. Services rendered offsite will not be taken into account.

Paragraph 3 of Article V overrides paragraph 9. Therefore, if the construction site lasts more than 12 months, USCo will have a PE under paragraph 3, but only with respect to services rendered at the construction site. Services rendered in Canada but away from the construction site are covered by paragraph 9.

However, if USCo does not have a PE under paragraph 3 of Article V, then all of the services rendered in Canada, including those rendered at the construction site, can be considered when making a determination under paragraph 9. The TE to paragraph 9 implies that days of services on-site would be counted for purposes of paragraph 9. It says,

Another example would be that of an architect who is hired to design blueprints for the construction of a building in the other State. As part of completing the project, the architect must make site visits to that other State, and his days of presence there would be counted for purposes of determining whether the 183-day threshold is satisfied.

In the facts given, the employees of USCo provide most of the services in the offices in XXXXXXXXXX, and very few of the services are rendered at the construction sites.

b) Intellectual Services

The taxpayer argues that the services rendered by USCo cannot be taken into account in determining whether USCo has a PE under paragraph 3 of Article V of the Treaty because they are intellectual, planning and supervisory type services.

In our view, on-site planning and supervising activities are included when making a determination under paragraph 3, even where they constitute the sole activities of the enterprise.

The following was added to paragraph 17 of the OECD Commentary on Article 5 in 2003:

On-site planning and supervision of the erection of a building are covered by paragraph 3. States wishing to modify the text of the paragraph to provide expressly for that result are free to do so in their bilateral conventions.

Neither Canada nor the U.S. registered an observation to the new wording. In The Taxation of Permanent Establishments (footnote 7), Dr. Skaar says,

"The OECD Commentary, however, expressly states that on-site planning and supervision meet the business activity test of the construction clause and may, therefore, constitute a PE (subject to other conditions). To avoid PE taxation, the subcontractor's work must be restricted to planning and supervision outside the building site."

c) Subsequent Commentaries

The taxpayer says that even if planning and supervision are included when making a determination under paragraph 3 of Article V, this represents a change in position with respect to a treaty negotiated prior to the change.

Paragraph 17 of the OECD Commentary on Article 5 was modified when the OECD Model was updated in 2003. Prior to that it said,

Planning and supervision of the erection of a building are covered by this term, if carried out by the building contractor. However, planning

and supervision is not included if carried out by another enterprise whose activities in connection with the construction concerned are restricted to planning and supervising the work. If that other enterprise has an office which it uses only for planning or supervision activities relating to a site or project which does not constitute a permanent establishment, such office does not constitute a fixed place of business within the meaning of paragraph 1, because its existence has not a certain degree of permanence.

According to the taxpayer, even though the Treaty was renegotiated and amended in 2007 by the Fifth Protocol, the wording of paragraph 3 of the Treaty was not modified. Therefore, the new commentary in paragraph 17 of the OECD Commentary should not apply to paragraph 3, and the pre-2003 commentary in paragraph 17 should apply.

We do not agree with the taxpayer on this point. In our view, paragraph 17 of the OECD Commentary on Article 5 as it reads now is applicable. Also, the 2006 U.S. Model Convention Technical Explanation on paragraph 3 of Article 5, which was written after paragraph 17 of the OECD Commentary on Article 5 was amended in 2003, says,

These interpretations of the Article are based on the Commentary to paragraph 3 of Article 5 of the OECD Model, which contains language that is substantially the same as that in the Convention. These interpretations are consistent with the generally accepted international interpretation of the relevant language in paragraph 3 of Article 5 of the Convention.

Are paragraphs 17 and 19 of the OECD Commentary to Article 5 contradictory?

The taxpayer understands that the activities have to be conducted at the construction site in order for paragraph 3 of Article V to apply. We agree with this. Therefore, the activities that take place off-site would not be included in determining whether USCo has a PE under paragraph 3. But you note that paragraph 19 of the OECD Commentary implies that planning and supervisory services should be included in determining whether USCo has a PE under paragraph 3, and there is no mention in paragraph 19 of whether the services must take place on-site

or off-site.

In our view, paragraph 19 deals with the computation of the duration of the construction site. If the services are provided off-site, paragraph 3 would not apply to them, and they would not be considered in determining the duration of the construction site.

d) Separate Enterprises

The new services PE, paragraph 9 of Article V, was added to the Treaty in 2007 by the Fifth Protocol. Paragraph 9 reads as follows,

Subject to paragraph 3, where an enterprise of a Contracting State provides services in the other Contracting State, if that enterprise is found not to have a permanent establishment in that other State by virtue of the preceding paragraphs of this Article, that enterprise shall be deemed to provide those services through a permanent establishment in that other State if and only if:

(a) Those services are performed in that other State by an individual who is present in that other State for a period or periods aggregating 183 days or more in any twelve-month period, and, during that period or periods, more than 50 percent of the gross active business revenues of the enterprise consists of income derived from the services performed in that other State by that individual; or

(b) The services are provided in that other State for an aggregate of 183 days or more in any twelve-month period with respect to the same or connected project for customers who are either residents of that other State or who maintain a permanent establishment in that other State and the services are provided in respect of that permanent establishment.

(Underline added)

In the taxpayer's view, each of the XXXXXXXXXX different functions should be treated as a separate enterprise because each function:

1. constitutes a separate division in USCo,

2. is led by a separate vice president and managers;

3. has distinct and separate staff;

4. has separate financial and accounting results; and

has separate budgets.

In the taxpayer's view, since none of the XXXXXXXXXX different functional enterprises provided services in Canada for an aggregate of 183 days or more in any twelve-month period, USCo did not have a PE in Canada under paragraph 9.

The term "enterprise" is not defined in the Treaty. In document 2008-0300941C6 (the December 2008 Tax Executives Institute round table), we said,

"Our view is that the term "enterprise" refers to a resident of a contracting state but only in reference to a particular line of business carried on by such resident. Therefore, where a resident of a contracting state carries on two lines of business, that resident may have a permanent establishment in the other contracting state by reference to one of such lines of business, but not the other."

Based on this definition, each of USCo's XXXXXXXXXX functions would constitute separate enterprises if they can be considered as separate "lines of business". The term "line of business" is not defined in the Treaty or the TE. It is used in the U.S. Model Tax Treaty in the Limitation on Benefits article, but again, is not defined there.

In our view, the determination of whether USCo has one or more "lines of business" should be done using the same analysis as is used for determining whether the company carries on a separate business. Interpretation Bulletin IT-206R, Separate Businesses, sets out the CRA's views on this point (footnote 8). Paragraph 2 of IT-206R says:

"Whether the carrying on of two or more simultaneous business operations by a taxpayer is the same business is dependent upon the degree of interconnection, interlacing or interdependence and the extent of the unity embracing the business operations."

You note that the separate functions have a high degree of interlacing

and interdependence. We defer to your knowledge of USCo's operations to decide whether the XXXXXXXXXX functions constitute one or more separate businesses. Using the factors in paragraph 3 of IT-206R, you may want to consider the following:

1. processes - We understand that USCo provides only intellectual services, i.e. it does not manufacture or sell products, or perform physical construction.
2. products - The entire company supplies only intellectual products - project planning and consultation services.
3. customers - USCo provides its services only to its worldwide affiliates.
4. services - All of the services are related to planning and executing the same XXXXXXXXXX development projects.
5. inventories - We are not aware that USCo has any inventory.
employees - We understand that USCo's employees across the XXXXXXXXXX functions may work on the same projects.
6. machinery and equipment - We are not aware that USCo has any machinery or equipment.
7. premises - We have no facts on this point.
8. whether one operation supplies another - We suspect that some of the functions must be done in sequence, or support one another.
9. fiscal year ends - We have no facts on this point.
10. accounting system - USCo has separate job codes for each activity.

The CRA's approach in IT-206R was confirmed by the Federal Court of Appeal in Du Pont Canada Inc. v The Queen (footnote 9). In Du Pont, the taxpayer sold its explosives division to an arm's length buyer. The taxpayer made the argument that the explosives division was not a separate business from its other divisions, so that it could avoid recapture on the disposition of depreciable assets. The Federal Court of Appeal agreed with the taxpayer, even though there were a number of facts that indicated that the explosives division was separate and distinct, such as:

1. The explosives division was in a separate physical location.
2. The employees at that location worked only for that division.
3. The products produced by the explosives division were distinct from

the company's other products.

4. The explosives division did not rely on other divisions for its key manufacturing material.

5. Inventory was stored at the explosives division's site.

6. It had its own dedicated sales and marketing staff.

7. It had its own research facilities for limited research.

8. It had its own software designed for its operations.

9. It had its own fleet of trucks and heavy equipment.

10. It had its own budget.

11. It had its own accounting, but not a complete set of financial statements.

12. Centralized services were billed to the explosives division.

13. The purchaser became the successor employer to the collective agreement.

14. The sale agreement contained goodwill.

On the other hand, the following factors indicated that there was only one business:

1. the company's annual reports indicated that it presents itself as a manufacturer of a number of different chemical products whose operations are integrated;

2. common services to several divisions throughout the company such as system and computer services, freight forwarding, engineering, advertising, payroll, public relations and legal services;

3. centralized financing and credit management;

4. centralized human resources and industrial relations;

5. common suppliers and centralized purchasing;

6. centralized marketing;

common customers;

7. cross-selling (e.g. sales staff of the explosives division sold a product manufactured by another division);

8. the explosives division did not have its own bank account;

9. product integration (e.g. plastic products used in the explosive products, etc.);

10. common research facilities for more complex research;

11. lack of complete autonomy given to the explosives branch;

12. centralized accounting, except for cost-accounting purposes;

13. no senior management dedicated solely to the explosives division;

14. pay levels were not dependent upon the profitability of the explosives division; and

15. retention of the Du Pont trade name and trademarks by the vendor when the division was sold.

The Federal Court of Appeal said that the question that had to be addressed was whether the aspects of the company's operations that are characteristic of a single integrated business are more substantial than the aspects that are characteristic of separate businesses.

It appears that the factors that would indicate that USCo has a single integrated business are more substantial than the factors that would indicate that the XXXXXXXXXX functions are separate businesses. Therefore, in our view, USCo likely is carrying on only one line of business, which is the business of planning and executing XXXXXXXXXX projects. However, you may wish to consider how the factors in Du Pont would apply from USCo's point of view to make the final determination (footnote 10).

e) Same or Connected Projects

Subparagraph 9(b) of Article V requires that the services be provided in Canada for 183 days or more in any 12-month period with respect to the same or connected project. It is given as a fact that each phase of the XXXXXXXXXX and XXXXXXXXXX operations lasts more than 12 months. Assuming that USCo has one line of business, and therefore constitutes one enterprise, the next question to be determined is whether the various operations in Canada constitute one project, several connected projects, or several unconnected projects.

We assume that as a whole, USCo has employees rendering services in Canada for 183 days or more in any 12-month period. If all of the days of service can be added together, then USCo will have a PE in Canada. The TE specifies that for subparagraph 9(b), only days on which services are provided are to be included; non-working days do not count.

One Project in Canada

We must first identify the "projects". The term "project" is not defined in the Treaty, the TE, the OECD Model or the OECD Commentary. XXXXXXXXXX.

USCo has one contract with one related group to provide one type of product (intellectual services) in one industry (XXXXXXXXXX) in one country (Canada) on a continuous basis. Therefore, an argument can be made that all of those services constitute one project in Canada.

If there is only one project, there is no need to determine whether the services are provided at the same geographic point. The requirement for "geographic coherence" (discussed below) is relevant only when determining whether different projects represent a coherent whole. However, as noted above, services provided at a construction site that constitutes a PE under paragraph 3 of Article V would not be counted in the computation under paragraph 9 of Article V.

Two Projects in Canada

If the services provided in Canada by USCo constitute more than one project, we must again identify the projects. As noted above, USCo's main operations appear to be the permanent and continuous business of providing XXXXXXXXXX expertise to related companies in Canada. An argument can be made that USCo has two main projects: one related to XXXXXXXXXX, and the other related to XXXXXXXXXX. Since the two projects would not be connected geographically (see below), they would not be a coherent whole for the purposes of paragraph 9 of Article V.

The XXXXXXXXXX as Separate Projects

The Canadian affiliates have two main XXXXXXXXXX operations in XXXXXXXXXX. The XXXXXXXXXX is owned by two Canadian affiliates. The XXXXXXXXXX are owned by a joint venture, with another Canadian affiliate as one of the joint venturers. In your view, the two XXXXXXXXXX operations, XXXXXXXXXX and XXXXXXXXXX, would each be a separate project.

If this is correct, then the days of service should be computed separately for each of these projects, keeping in mind that days at the construction site, if it is itself a PE under paragraph 3 of Article V,

are not included. If the days for any particular project compute to less than 183 days, then we will examine whether the projects are connected so that they can be combined for purposes of paragraph 9 of Article V. As noted in the TE, the determination of whether projects are connected should be determined from the point of view of the enterprise (i.e. USCo), not that of the customer (i.e. the Canadian affiliates). The fact that the XXXXXXXXXX may be separate projects to the Canadian affiliates is not relevant.

The term "connected project" is not defined in the Treaty. In her paper, Marsha Reid says, "The term "connected project" is capable of being interpreted quite broadly" (footnote 11).

The TE to paragraph 9 of Article V says:

For purposes of determining whether the time threshold has been met, subparagraph 9(b) permits the aggregation of services that are provided with respect to connected projects. Paragraph 2 of the General Note provides that for purposes of subparagraph 9(b), projects shall be considered to be connected if they constitute a coherent whole, commercially and geographically. The determination of whether projects are connected should be determined from the point of view of the enterprise (not that of the customer), and will depend on the facts and circumstances of each case. In determining the existence of commercial coherence, factors that would be relevant include: 1) whether the projects would, in the absence of tax planning considerations, have been concluded pursuant to a single contract; 2) whether the nature of the work involved under different projects is the same; and 3) whether the same individuals are providing the services under the different projects. Whether the work provided is covered by one or multiple contracts may be relevant, but not determinative, in finding that projects are commercially coherent.

(Underline added)

Paragraph 42.41 of the OECD Commentary on Article 5 lists similar factors.

The TE specifically states that the determination will depend on the facts of each case. There may be factors that are relevant besides the three factors listed in the TE, and the weight to be given to any one factor may differ in each case. In his 2008 paper on PE's (footnote 12), Brian Arnold says the following additional factors may be relevant in determining whether projects are the same or connected:

- whether the services are provided for the same or related enterprises;
- whether the services are provided at the same or different locations; and
- whether the services are provided continuously or at different times (i.e. gaps).

We suggest that a grid could be used to examine the various factors that are relevant to each of the projects. For example, in your case, you could apply the facts to the following grid:

	Project 1	Project 2
Contract		
Nature of work		
Time period		
Employees		
Customer		
Location		

You would then add up the factors and determine, on a balance of probabilities, whether the projects are connected.

Coherent whole commercially

As noted, the fact that the projects may be distinct to the Canadian affiliates is not relevant. Examining the factors from USCo's point of view, we see:

	XXXXXXXXXX	XXXXXXXXXX
Contract	One contract	Same contract
Nature of work	Intellectual services in the XXXXXXXXXX industry	Same

Time period	Continuous	Same
Employees	We do not have enough information to comment	
Customer	Related Canadian affiliates	Same
Location	XXXXXXXXXX in XXXXXXXXXX	Same

While the single contract is not determinative, it is still relevant. For example, Dr. Skaar says,

"Usually, a decisive factor for treating different operations as one project in terms of the construction clause is when only one contract has been concluded." (footnote 13)

If USCo were to break up the contract, we would consider whether the projects are still connected. The TE says,

The aggregation rule addresses, for example, potentially abusive situations in which work has been artificially divided into separate components in order to avoid meeting the 183-day threshold.

The time factor may be relevant, but the amount of weight to afford to it may differ in any particular case. For example, a taxpayer may have a contract for a project, and a separate contract for a project that immediately follows and is dependent upon the completion of the first. Or, there may be long gaps between periods in which the services are provided. In our view, the fact that services are rendered simultaneously to different projects would not be a deciding factor on its own. However, continuous presence may be relevant. Dr. Skaar says,

The TE to paragraph 9 of Article V provides two examples where projects would not be connected. In the first, a technology firm is hired to install a computer system for a company. Under a separate contract, technology firm is hired by the same company to train its staff on the use of software that is unrelated to the first system.

Examining the factors,

	Project 1	Project 2
Contract	Separate	Separate
Nature of work	Install computer software	Train staff on unrelated
Time period	Not enough information	
Employees	Not enough information	
Customer	One	Same
Location	enough information	

In the second example, a company hires a law firm to provide tax advice by one group of its staff. Under a separate project, the same company hires the same law firm to provide trade advice by another group of its staff.

Examining the factors,

	Project 1	Project 2
Contract	Presume a separate contract	
Nature of work	Tax advice	Trade advice
Time period	Not enough information	
Employees	Different	Different
Customer	Same	Same
Location	Not enough information	

XXXXXXXXXX

In USCo's case, there are some factors that are common to both the XXXXXXXXXX operations and the XXXXXXXXXX operations, however, we would need more information to come to a conclusion on whether they are a coherent whole commercially.

Coherent whole geographically

The July 2008 amendments to the OECD Commentary on Article 5 added new sections 42.11 to 42.48 on the taxation of services. Paragraph 42.23 of the Commentary provides what is referred to as an "alternative provision" that countries can include in their treaties if they wish to extend

source taxation to services provided in their state. The alternative provision is similar, but not identical, to paragraph 9 of Article V of the Treaty.

Paragraph 42.41 of the OECD Commentary explains that the reference to "connected projects" is intended to apply where separate projects have a "commercial coherence". Under the OECD alternative provision, there is no requirement that connected projects must also have geographic coherence. However, geographic coherence is required under the Treaty. The TE states,

Additionally, projects, in order to be considered connected, must also constitute a geographic whole. An example of projects that lack geographic coherence would be a case in which a consultant is hired to execute separate auditing projects at different branches of a bank located in different cities pursuant to a single contract. In such an example, while the consultant's projects are commercially coherent, they are not geographically coherent and accordingly the services provided in the various branches shall not be aggregated for purposes of applying subparagraph 9(b). The services provided in each branch should be considered separately for purposes of subparagraph 9(b).

Note that the TE specifically states that the projects in the preceding example are commercially coherent.

Paragraph 5.4 of the OECD Commentary on Article 5 provides a similar example. It says,

For example, where a consultant works at different branches in separate locations pursuant to a single project for training the employees of a bank, each branch should be considered separately.

Paragraph 5.4 does not specifically address whether the branches have to be in the same city to be connected. It merely refers to "separate locations", and could be construed to consider all branches to be separate, even if they are in the same city. However, paragraph 5.4 is commentary on the fixed base PE article, paragraph 1 of Article 5. Paragraph 9 of Article V applies where paragraph 1 of Article V does not

apply. The purpose of paragraph 9 of Article V is to allow a contracting state to tax services provided in the source state when certain thresholds are met, and necessarily applies even when the non-resident does not have a fixed place of business. We believe that the purpose of paragraph 9 would not be met by applying a restrictive interpretation.

"Geographical diversification does not necessarily create two (or more) sites or projects. As long as two or more building lots in one country, form a coherent whole, that is, are operated at one place or for one and the same ordering party, for related parties or for parties who act jointly and in coordination, these places should be aggregated and treated as one single unit for the determination of the minimum period (footnote omitted)." (footnote 16)

(Underline added.)

A large area could represent a geographic whole, depending on the nature of the business. Our expectation is that an area would have to have some relevant defining physical characteristics in order to be found a geographic whole. In our view, XXXXXXXXXX would constitute one geographic area, and the XXXXXXXXXX area would constitute another area. If the projects in XXXXXXXXXX and in XXXXXXXXXX area constitute a coherent whole commercially, then in our view, they would also constitute a coherent whole geographically, since each of the connected projects require services to be provided at the same two geographic areas. Accordingly, all the days of service can be added together for determining whether the thresholds in paragraph 9 of Article V have been met.

XXXXXXXXXX (or More) Projects

The taxpayer has sub-divided the XXXXXXXXXX and XXXXXXXXXX projects into several different sub-projects, arguing that each sub-project is commercially distinct. If you think that this argument has any merit, we recommend that the analysis above be done to determine whether any of the sub-projects are a commercial and geographic whole to see if it makes a difference for purposes of paragraph 9 of Article V.

Conclusion

In answer to your questions, our view is the following:

a) If a PE exists under paragraph 3 of Article V, services provided at a building site or construction or installation project would be subject to paragraph 3, and only the services provided offsite would be considered in determining whether a PE exists under paragraph 9. If no PE exists under paragraph 3, then all of the services in Canada can be considered in the determination of whether a PE exists under paragraph 9.

b) Providing purely "intellectual" (i.e. planning and supervisory) services could give rise to a PE under paragraph 3 of Article V.

c) Paragraph 17 of the Commentary on Article 5 of the OECD Model applies to the Treaty.

d) Paragraphs 17 and 19 of the OECD Commentary on Article 5 are not contradictory. Paragraph 19 deals only with the duration of the site.

e) USCo likely is carrying on only one line of business, which is the business of planning and executing XXXXXXXXXX projects. However, the analysis should be done using the approach in IT-206R, Separate Businesses.

We do not have enough information to determine if the various sites are a coherent whole commercially. We have recommended a methodology for you to use to make the determination, based on your knowledge of the taxpayer. If the projects in the XXXXXXXXXX area and XXXXXXXXXX area in XXXXXXXXXX are a coherent whole commercially, then they would also be a coherent whole geographically.

We trust that we have been of some assistance. If you have any questions, please contact Sherry Thomson at (613) 957-2122.

Yours truly,

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For Director

International Division

Income Tax Rulings Directorate

Legislative Policy & Regulatory Affairs Branch

FOOTNOTES

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

1 There may be more XXXXXXXXXX that we don't know about, but the analysis should be the same.

2 We note that some of these reasons appear to be repetitive.

3 Model Tax Convention on Income and on Capital

4 Bruce Elliott, Larry Dysert, and Todd Pickett v The Queen, 2013 DTC 1070 (TCC).

5 IBFD - 2005 (loose leaf), at par 3.4. Dr. Skaar wrote the chapter entitled, "Commentary on Article 5 of the OECD Model Treaty: The Concept of Permanent Establishment".

6 Tax Notes International, Special Reports, July 14, 2008, p. 189 - 200.

7 Supra, note 4, at paragraph 3.4.2.

8 IT-206R is based, in part, on the Supreme Court of Canada cases, Frankel Corporation Limited v MNR, (59 DTC 1161) and H.A. Roberts Ltd v MNR, (69 DTC 5249) and on the English case, Scales v Georges Thompson & Company Limited , (1927), 13 T.C. 83 (K.B.).

9 2001 DTC 5269 (FCA), overturning 99 DTC 1132 (TCC)

10 For an interesting discussion on this issue, see The New Services PE Provision, by Marsha Reid in the 2010 Canadian Tax Journal, Issue 4, pp. 865-870.

11 Supra, footnote 10.

12 Supra, footnote 6.

13 Supra, footnote 5, at par 3.2.3.

14 Permanent Establishment: Erosion of a Tax Treaty Principle, 1991 Kluwer Law and Taxation Publishers, p. 371.

15 The term "constructional entity" is used by Dr. Skaar in his book, Permanent Establishment: Erosion of a Tax Treaty Principle, supra, footnote 14. See in particular pp. 354 to 378, in which he discusses the

aggregation of construction projects.

16 Edited by Ekkehart Reimer, Nathalie Urban and Stefan Schmid, Chapter 2, Is There a Permanent Establishment?, 2010/2011, Wolters Kluwer / PricewaterhouseCoopers, at par 212.