

Dear Mr. Owens:

I am responding to the proposed Commentary changes relating to the tax treaty treatment of services as set out in the public discussion draft of December 8, 2006.

My comments are noted with a reference to the paragraph numbers of the draft Commentary on Article 5.

Paragraph 42.23

There are a number of issues that I have seen in respect of this suggested new provision to be included in tax treaties. The first is the unequal treatment of an enterprise carried on by a single person where it is likely that under subparagraph a), if the day count is met, the revenue earned will also allow for permanent establishment taxation whereas an enterprise in which more than one individual works, even though one of the individuals is present in the source state for more 183 days would be unlikely to meet the gross revenue test. Therefore, it would be unlikely to have a permanent establishment unless the individual was working on the same project or connected projects. This suggested treaty provision also introduces a concept that services are performed "through" an individual or "through" one or more individuals. If the services are performed in part in the residence state (such as engineering, research, preparation of documents, etc.) and the result of the services performed in the residence state is delivered by an individual present in and also providing services in the source state, are all the services rendered "through" that individual? The ambiguity would be removed if the word "through" was changed to "by" which perhaps is what is intended.

Paragraph 42.37

This draft paragraph of the Commentary introduces the concept of an amount that an enterprise "should charge" for its active business activities. In the services area, in many cases the amount that an enterprise in fact can charge for services and therefore "should charge" is often prescribed under law or by agreement with the client by such things as holdback requirements, certificates of completion, premiums for success, etc. Before the job is complete real questions can arise as to how much the enterprise "should charge" for its uncompleted activities for the client. The question is whether this concept is precise enough to provide clarification or whether it is so indefinite that it really confuses the concept of what are "gross revenues" of a business, which under normal accounting practices is what is recorded in the books of account.

Paragraph 42.40

The term "connected projects" is not a precise term nor a term of art. I would suggest it should be avoided. Presumably, the Working Group had a more precise concept in mind. My suggestion would be that that wording should be better expressed in the draft treaty Article and better explained in the Commentary. Paragraphs 5.3 and 5.4 use the expression "commercial coherence" which may be a better expression to describe a relationship between two or more projects, the services in respect of which could lead to a permanent establishment finding under subparagraph b). It is not likely that projects involving the provision of services of the same or similar nature

(which in the nature of the many specialized service providers is frequently the case) which if provided within "the framework of contracts", (which I assume means pursuant to contracts) concluded with the same enterprise or associated enterprises would always have "commercial coherence" nor should they automatically be considered to constitute connected projects. Rather, a connection must exist within the projects themselves not simply arising because they are carried on by the same client or related clients whose unrelated projects provide the work for the service provider. In other words, the projects are those which are developed by the client or related clients and the "connection" should be the connection that would exist between the projects themselves. In short, all projects developed by the same enterprise would not necessarily be connected. Therefore, the explanation in draft paragraph 42.40 cannot be correct explanation of the draft Article.

Paragraph 42.42

The draft Article in paragraph 42.22 might be improved if instead of the reference to "the first-mentioned enterprise", reference was made to "both enterprises".

I hope that these comments may be useful.

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