Docket: 2008-2540(IT)G

BETWEEN:

SAIPEM UK LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on April 15, 2010, at Montreal, Quebec.

Before: The Honourable Justice François Angers

Appearances:

Counsel for the Appellant:	Wilfrid Lefebvre Dominic Belley
Counsel for the Respondent:	Natalie Goulard Christina Ham

JUDGMENT

The appeals from the reassessments made under the *Income Tax Act* for the 2004, 2005 and 2006 taxation years are dismissed, with costs, in accordance with the attached reasons for judgment.

Signed at Ottawa, this 14th day of January 2011.

"François Angers"

Angers J.

Citation: 2011 TCC 25
Date: 20110114
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SAIPEM UK LIMITED,

Appellant,

and

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REASONS FOR JUDGMENT

Angers J.

[1] This is an appeal of the appellant's reassessments in respect of its taxation years ended December 31, 2004, 2005 and 2006, which reassessments are dated November 18, 2008. The reassessments were substituted for the initial assessments, which had been confirmed by the Minister of National Revenue on May 14, 2008.

[2] The appellant, a non-resident of Canada, claimed deductions in computing its taxable income, for the purposes of the *Income Tax Act* (the "*Act*"), from activities carried on by it in Canada through a "permanent establishment" (a "PE") within the meaning of the *Convention Between the Government of Canada and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains,* as amended (the "Canada-UK treaty").

[3] The deductions relate to certain non-capital losses from business activities carried on in Canada by a corporation — Saipem Energy International Limited (SEI) — that, at all material times, was related to the appellant within the meaning of the *Act*, and that was wound up, within the meaning of subsection 88(1.1) of the *Act*, into the appellant. The deductions claimed with respect to the SEI losses were $592,697 for the 2004 taxation year, $839,799 for the 2005 taxation year and $5,601,461 for

the 2006 taxation year, which deductions were disallowed by the Minister of National Revenue (the Minister).

[4] The parties submitted a Partial Agreed Statement of Facts, which is reproduced below:

1. The Appellant was incorporated in the United Kingdom and was at all material times a non-resident of Canada and a resident of the United Kingdom for purposes of the *Income Tax Act* and the *Canada-United Kingdom Tax Convention*.

2. Saipem Energy International Limited ("SEI") was incorporated in the United Kingdom and was at all material times a resident of the United Kingdom, and not of Canada, for purposes of the *Income Tax Act* and the *Canada-United Kingdom Tax Convention*.

3. SEI was incorporated as a wholly-owned subsidiary of Saipem International B.V. ("SIBV"), a company incorporated in, and at all material times a resident of, the Netherlands and not a resident of Canada.

4. The Appellant and SEI were part of the same group of related corporations (the ("Saipem Group")

The SEI losses

5. During the 2001, 2002 and 2003 taxation years, SEI carried on business in Canada through a permanent establishment, within the meaning of the *Canada-United Kingdom Tax Convention*.

6. As of December 31, 2003, the closing balance of SEI's non-capital losses for income tax purposes was $7,033,957. These losses were not deducted by SEI in computing its income.

7. The losses would have been deductible by SEI in the 2004, 2005 and 2006 taxation years, had SEI had such taxation years and sufficient income in those years.

The winding-up of SEI

8. On February 7, 2003, the Appellant notified certain employees of SEI that their employment would be transferred to the Appellant on April 1, 2003.

9. On May 19, 2003, SEI's Board of Directors recommended that SEI's shares, assets and business be transferred to the Appellant in order to facilitate the

Saipem Group reorganisation in the United Kingdom. The stated objective was to liquidate SEI in the Appellant.

10. By June 30, 2003, SEI has finished its trading activities and the majority of its personnel had been transferred to the Appellant.

11. On November 21, 2003, the Appellant's Board of Directors adopted a resolution to purchase all of the issued and outstanding shares of SEI from SIBV and to place SEI in the voluntary winding-up.

12. On December 9, 2003, SIBV's Managing Board resolved to sell to the Appellant all of the issued and outstanding shares of SEI.

13. On December 16, 2003, the shares of SEI were transferred to the Appellant.

14. On December 16, 2003, SEI sold some of its assets (office equipment and contracts) to the Appellant.

15. On July 10, 2006, the Liquidators Final Return for the winding-up of SEI was filed with the UK Companies House.

16. On October 13, 2006, SEI was struck off the register of the UK Companies House, pursuant to the *Insolvency Act, 1986 (UK).*

The Appellant's 2004, 2005 and 2006 taxation years

17. During its 2004, 2005 and 2006 taxation years, the Appellant carried on a business in Canada, through a permanent establishment, within the meaning of the *Canada-United Kingdom Tax Convention*.

18. The Appellant established November 21, 2003, as the commencement date of SEI's winding-up.

19. In filing its income tax returns for the 2004, 2005 and 2006 taxation years, the Appellant claimed deductions with respect to the SEI losses in the amounts of $592,697, $839,799 and $5,601,461 respectively.

20. In October 2007, the Minister of National Revenue issued Notices of Assessment for the Appellant's 2004, 2005 and 2006 taxation years, disallowing the deduction of the SEI losses. The Notices of Assessment were confirmed on May 14, 2008.

[5] The respondent has denied the deductions for the said taxation years on the basis that the requirement that the parent corporation, namely the appellant, and the wound-up subsidiary (SEI) be Canadian corporations as defined by subsection 89(1)

of the *Act* is not met. That fact is acknowledged by the appellant, but the appellant, submits that the deductions should be allowed on the basis that the Canadian corporation requirement found in subsection 88(1) of the *Act* amounts to discrimination based on nationality against a PE contrary to Article 22 of the Canada-UK Treaty.

[6] Subsection 89(1) of the *Act* defines a Canadian corporation as follows:

> "Canadian corporation" at any time means a corporation that is resident in Canada at that time and was
>
> (*a*) incorporated in Canada, or
> (*b*) resident in Canada throughout the period that began on June 18, 1971 and that ends at that time,
>
> and . . . .

[7] Subsection 89(1) therefore sets out two ways in which a corporation can be a “Canadian corporation”. It provides that a corporation must be resident in Canada and have been incorporated in Canada, or that a corporation not incorporated in Canada must have been resident in Canada since at least June 18, 1971 to be considered a “Canadian corporation”.

[8] In order to be resident in Canada, a corporation must satisfy the common law “management and control” residency test or be considered a Canadian resident under subsection 250(4) of the *Act*, which provides that a corporation incorporated in Canada after April 26, 1965 is deemed to be a Canadian resident.

[9] Subsection 250(5) of the *Act* is an exception to subsection 250(4) of the *Act* and provides as follows:

> Deemed non-resident — Notwithstanding any other provision of this Act (other than paragraph 126(1.1)(*a*)), a person is deemed not to be resident in Canada at a time if, at that time, the person would, but for this subsection and any tax treaty, be resident in Canada for the purposes of this Act but is, under a tax treaty with another country, resident in the other country and not resident in Canada.

[10] The tax treaty reference is a reference to the tie-breaker rule regarding resident status contained in tax treaties. The rule is stated in Article 4 of the Canada-UK Treaty, which clarifies the meaning of "resident of a contracting state".

[11] Subsection 88(1.1) of the *Act* (reproduced at the end of these reasons) sets out requirements, other than that the parent and subsidiary corporations be Canadian

corporations, that need to be met before the subsection can apply. These other requirements, such as the timing of the deductions, the nature of the loss, and the ownership requirement, are not issues in these appeals. The parties have so informed the Court.

[12] Paragraph 1 of Article 22 of the Canada-UK Treaty prohibits discrimination based on nationality. It reads as follows:

> I. The nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected.

[13] Paragraph 2 of Article 22 of the Canada-UK Treaty prohibits discrimination based on permanent establishment status. It reads:

> 2. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging either Contracting State to grant to individuals not resident in its territory those personal allowances and reliefs for tax purposes which are by law available only to individuals who are so resident.

[14] In a nutshell, the appellant is asking this Court whether the restricted application of subsection 88(1.1) of the *Act* to only "Canadian corporations", thereby excluding its application in respect of the winding-up of SEI into the appellant, violates the appellant's right, as a national of the United Kingdom and for the purposes of the Canada-UK Treaty, to non-discriminatory treatment guaranteed by paragraphs 1 and 2 of Article 22 of the Canada-UK Treaty reproduced above.

Principles of Tax Treaty Interpretation

[15] The former Income Tax Appeal Board in *Saunders v. M.N.R.*, 54 DTC 524, addressed the principles of tax treaty interpretation in the following words at page 526:

> The accepted principle appears to be that a taxing Act must be construed against either the Crown or the person sought to be charged, with perfect strictness — so far as the intention of Parliament is discoverable. Where a tax convention is involved, however, the situation is different and a liberal interpretation is usual, in the interests

> of the comity of nations. Tax conventions are negotiated primarily to remedy a subject's tax position by the avoidance of double taxation rather than to make it more burdensome. This fact is indicated in the preamble to the Convention. Accordingly, it is undesirable to look beyond the four corners of the Convention and Protocol when seeking to ascertain the exact meaning of a particular phrase or word therein.

[16] In *Crown Forest Industries Ltd. v. Canada*, [1995] 2 S.C.R. 802, Mr. Justice Iacobucci of the Supreme Court of Canada stated that "[i]n interpreting a treaty, the paramount goal is to find the meaning of the words in question. This process involves looking to the language used and the intentions of the parties" (paragraph 22). At paragraph 43, he stated:

> Reviewing the intentions of the drafters of a taxation convention is a very important element in delineating the scope of the application of that treaty. As noted by Addy J. in *J. N. Gladden Estate v. The Queen*, [1985] 1 C.T.C. 163 (F.C.T.D.), at pp. 166-67:
>
>> Contrary to an ordinary taxing statute a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated in so far as the particular item under consideration is concerned.

[17] The Organisation for Economic Co-operation and Development (OECD) has published Commentaries on its Model Convention with Respect to Taxes on Income and on Capital, July 2008 (the "Model Convention"). Article 24 of the Model Convention is similar to Article 22 of the Canada-UK Treaty, but Canada has reserved its position on Article 24. Although the Court cannot give legal weight to the OECD's Commentaries unless they have been interpreted in Canadian law, the courts have nonetheless used those Commentaries as a guide in the interpretation and application of tax treaties in cases where the parties have not registered an objection to the Commentaries. The Federal Court of Appeal in *Prévost Car Inc. v. The Queen*, 2009 FCA 57, stated that:

> 10 The worldwide recognition of the provisions of the Model Convention and their incorporation into a majority of bilateral conventions have made the Commentaries on the provisions of the OECD Model a widely-accepted guide to the interpretation and application of the provisions of existing bilateral conventions (see *Crown Forest Industries Ltd. v. Canada*, [1995] 2 S.C.R. 802 . . . .
>
> 11 The same may be said with respect to later commentaries, when they represent a fair interpretation of the words of the Model Convention and do not conflict with

> Commentaries in existence at the time a specific treaty was entered [into] and when, of course, neither treaty partner has registered an objection to the new Commentaries.

Discrimination Contrary to Article 22(1) of the Canada-UK Treaty

The Appellant's Position

[18] The appellant submits that, for tax purposes, non-residents carrying on business in Canada are treated as though they were residents with respect to those activities that they carry on in Canada. The appellant supports this position by referring to sections 111 and 115 of the *Act*. Section 115 defines the taxable income earned in Canada by a non-resident carrying on business in Canada and, according to the appellant, both the appellant's PE in Canada and the wound-up subsidiary's PE are subject to tax under section 115 of the *Act*.

[19] That being so, the appellant points out that non-residents carrying on a business in Canada are allowed deductions and, in particular, can deduct non-capital losses under subsection 111(1) in calculating their income for tax purposes. The appellant also refers to paragraph 115(1)(*f*) of the *Act*, which, in cases where all or substantially all of a non-resident's income is included in computing its taxable income earned in Canada for a taxation year, allows the non-resident to make such other deduction permitted for the purpose of computing taxable income as may reasonably be considered wholly applicable. So, under paragraph 115(1)(*d*) of the *Act*, there is no difference between a resident and a non-resident in terms of the treatment of losses.

[20] The appellant submits that subsection 88(1.1) of the *Act*, which allows a parent corporation to deduct its wound-up subsidiary's loss, complements section 111 of the *Act* and that subsection 88(1.1) is Parliament's recognition that losses can be used within a family group.

[21] Counsel for the appellant refers to the "Vienna Convention on the Law of Treaties", which spells out the rules of treaty interpretation. According to the appellant, treaties "should be interpreted very generously to give effect to the intent of the parties"; in other words, if the parties to a treaty say "we will have a clause in our agreement such as the non-discrimination clause", it must mean that sometimes that clause applies.

[22] Counsel for the appellant also quoted tax specialists Richard Lewin and J. Scott Wilkie in *Studies on International Fiscal Law*, vol. LXXVIIIb, at pages 357–358 in support of the proposition that:

> "To discriminate is to distinguish or differentiate in the treatment of persons for taxation purposes in ways or for reasons that are "unreasonable, arbitrary or irrelevant" with the result that the subject or object of discrimination is treated less favourably than the subject or object of comparison".

[23] The appellant also quotes the tax specialists' discussion on discrimination and tax policy in asserting that discriminatory provisions in the *Act* are allowable if they are justified on public policy grounds, and submits that there is no public policy justification for denying the appellant the benefit of subsection 88(1.1).

[24] Counsel for the appellant therefore submits that the "Canadian corporation" requirement found in subsection 88(1.1) of the *Act* is contrary to Article 22(1) of the Canada-UK Treaty, which prohibits discrimination based on nationality. The residency and incorporation requirements imposed by subsection 89(1) of the *Act*, which must be met in order for an entity to qualify as a "Canadian corporation", amount to requiring that the corporations be nationals of Canada. Counsel explains that the incorporation requirement in subsection 89(1) is based on nationality in that a corporation incorporated in Canada is a national of Canada. To support his submission, counsel for the appellant refers to subsection 250(4) of the *Act*, which deems corporations incorporated in Canada to be residents of Canada for the purposes of the *Act*. Thus, according to counsel for the appellant, a corporation must be incorporated in Canada (i.e. a national of Canada) in order to be a resident in Canada.

[25] With regard to the words "in the same circumstances" found in paragraph 22(1) of the Canada-UK Treaty, counsel for the appellant acknowledges that the Treaty only applies to taxpayers "in the same circumstances" as those of nationals of the state concerned, but does not agree that the appellant and a Canadian corporation are not in the same circumstances simply because one is a resident and the other is a non-resident of Canada. If that were to be accepted, counsel submits, paragraph 22(1) of the Canada-UK Treaty would never apply because the comparison is always between a resident and a non-resident. Counsel states his position as follows:

> Our position is that for 88(1.1) application, the residence of the Appellant is UK is not sufficient to distinguish the situation of that company as UK with reference to losses to that of a Canadian corporation, residence in itself is not a sufficient

> distinguishing feature. As I said already, the starting point is that 111 applies to all in the same way, residents or non-residents, so therefore the test is Canadian activities.

Counsel goes on to give his reasons in support of his position (pages 59–64 of transcript).

> . . . first . . . if SUK and SEI . . . have incorporated in Canada, each would be deemed by virtue of 250 sub 4 to be resident of Canada. So therefore . . . the resident element in the definition in 88(1.1) is collapsed into simply a corporation. . . . incorporation in Canada requirement. So, if Canadian incorporation is sufficient for 88(1.1) then no further conditions are imposed on Canadian nationals, the only condition would be Canadian incorporation. So discrimination is based on the location of incorporation in this case. If they had been both incorporated here, there would be no further conditions imposed.
>
> Second reason, non-residents are in same situation as Canadian residents with respect to their losses . . . section 115(1), 115(d) and it's exactly the same as that was allowed to residents confirmed by the convention.
>
> . . . third reason, 115(1)(d) is open ended and had there been impediments or had there been additional conditions imposed for the deductions as there is under 115(1)(f) and Parliament said, "you're going to get your losses but only, the carry back, carry forth, but only if ninety percent (90%) of your income is from Canadian activities."
>
> The fourth reason, residents and non-residents are similarly situated with respect to their PE . . . .
>
> . . . with respect to paragraph 1, the last reason . . . for purposes of 1 . . . it stands to reason that the residence of the Appellant. SUK, cannot be an acceptable basis for discrimination because otherwise you could violate paragraph 2 by saying, "well, I'm going to discriminate based on residence" and that . . . violating paragraph 2 would justify the violation of paragraph 1 . . . .

[26] In concluding, counsel for the Appellant gives examples of discrimination in the *Act* that are, in his view, justifiable for policy reasons, unlike the discrimination found in subsection 88(1.1) of the *Act*. Counsel submits the following:

> In the cases of losses, you cannot identify . . . a policy objective. If the activities are in Canada, all in Canada, and if losses are suffered, the mechanics of section . . . 111 apply and the only issue between us is, well do the wind-up provisions apply in the

> case of a treaty partner which the UK is in the case where we have a non-discrimination clause . . . .

[27] Counsel for the appellant agrees that there is a policy designed under our Canadian legislation that prohibits the importation into Canada of losses suffered abroad. He says that the comparison to be made is really between foreign entities carrying on business in Canada through their PE and Canadian entities carrying on similar activities in Canada. In other words, you take a Canadian parent corporation with a Canadian subsidiary and having access to the latter's losses and compare it to a foreign parent corporation with a Canadian PE and ask yourself if there is any policy reason not to let all losses from the Canadian activities be, through a winding-up, treated as losses of the family of entities and therefore accessible to the parent.

The Respondent's Position

[28] The respondent began by reminding the Court that, in order to benefit from subsection 88(1.1) of the *Act*, the parent corporation and the wound-up subsidiary each has to be a "Canadian corporation" as defined by the *Act*. On the following two bases, the respondent disagrees with the appellant's argument that the Canadian corporation requirement is reduced to an incorporation requirement in light of the deeming provision of subsection 250(4) of the *Act*:

(a) First, the respondent refers to the definition of "Canadian corporation" in subsection 89(1) of the *Act*. That section provides two ways that a corporation can qualify as a Canadian corporation. A corporation is a Canadian corporation if :

    (i) it is resident and incorporated in Canada, or
    (ii) it is resident in Canada under, for example, the common law test (the management and control residency test), but was incorporated elsewhere.

(b) Second, the respondent explains that there are three ways to determine the residency of corporations in Canada:

    (i) under statutory rules,
    (ii) at Common Law, or
    (iii) by virtue of international tax treaties.

[29] The respondent submits that it is possible for a corporation to be resident in more than one country. As an example, a corporation can be a resident in Canada by virtue of its Canadian incorporation, under subsection 250(4), and resident in the UK by virtue of the common law (management and control) test. In such a case, according to the respondent, subsection 250(5) of the *Act* applies, along with the tie-breaker rules in the Canada-UK Treaty, to determine the corporation's residency for tax purposes. Applying the tie-breaker rules, it might be determined that the corporation is not a resident of Canada even though it was incorporated in Canada. Another example would be a corporation incorporated in a particular jurisdiction (such as Canada) and continued in another jurisdiction. Such a corporation is deemed under subsection 250(5.1) of the *Act* not to have been incorporated in Canada and the deeming provision in subsection 250(4) of the *Act* does not apply so as to make it a resident of Canada.

[30] Regarding the principles of treaty interpretation, the respondent also referred to the *Crown Forest* case, *supra*, and the *Prévost Car* case, *supra*, to support the view that the paramount goal is to find the meaning of the words by looking at the language of the treaty and the intention of the parties. With regard to ascertaining the intention of the parties, the respondent reminds the Court that the Supreme Court of Canada and the Federal Court of Appeal, in those cases, accepted the use of the OECD Model Convention and the official Commentary thereon to assist in that respect. The Federal Court of Appeal also commented that a Commentary written after the parties have entered into a treaty can also be used when it does not conflict with the Commentary in existence at the time that specific treaty was entered into and where neither party thereto has registered an objection to the Commentary.

[31] The respondent submits that Article 22 of the Canada-UK Treaty is not a broad rule against all types of discrimination but rather eliminates discrimination in certain very specific situations. The respondent suggests that Canada has been conservative in extending non-discrimination rights in its treaties. In support of that view, the respondent quoted from a discussion by Joel Nitikman and Lincoln Schreiner of non-discrimination entitled "Non-discrimination at the Crossroads of International Taxation" and published in *Studies on International Fiscal Law*, vol. 93a (Rotterdam: International Fiscal Association, 2008). The excerpt quoted reads as follows (page 192):

> Although the model Canadian treaty is not open to the public, and there is little published government policy on ND clauses, Canada appears to be of the belief that it is entitled to discriminate on the basis of residence and will do so, as evidenced by the very recent treaty negotiations with Finland on one hand (an EU member), and

> the USA and Mexico on the other hand (both NAFTA members). These taken together clearly indicate that Canada is very conservative about extending ND rights in its DTCs. This supports the premise at the beginning of this report, that Canada reserves the right to discriminate where appropriate for Canadian public policy reasons.
>
> As a practical matter, discrimination for tax purposes is not a prominent issue in Canada with foreign nationals, as evidenced by the lack of litigation and because foreign persons simply see (with good advice) the differences before them, and then appropriately measure and weigh the additional cost of adapting . . . .

[32] The respondent submits that "Canada has made a reservation on the OECD Model with respect to non-discrimination, has adopted very specific non-discrimination clauses and . . . that unless we fall under those non-discrimination clauses, there is no broad rule that would prevent it and obviously we take the position that here the fact situation does not fall under either [of] those clauses".

[33] The respondent submits that Article 22(1) of the Canada-UK Treaty can be understood as providing that "the appellant, who is a national of the UK cannot be subjected in Canada to taxation that is other or more burdensome than the taxation to which a national of Canada who is in the same circumstances and this is key, is or may be subjected to". The respondent suggests that "in the same circumstances" means that all relevant factors, including, in particular, the country of residence of the taxpayer, are the same such that a corporation that is a non-resident of Canada for income tax purposes cannot be said to be in the same circumstances as a taxpayer who is a resident of Canada. It therefore follows, according to the respondent, that the appellant, as a national of the UK, cannot be subjected in Canada to taxation which is more burdensome than the taxation to which a national of Canada who is also a non-resident of Canada may be subjected.

[34] The Respondent goes on to suggest that in order to determine whether subsection 88(1.1) of the *Act* violates the appellant's rights under Article 22(1) of the Canada-UK Treaty, one must ascertain how subsection 88(1.1) applies to nationals of Canada who are non-residents. According to the respondent, a corporation that is a Canadian national but is not a resident of Canada cannot benefit from the application of subsection 88(1.1) of the *Act* because, as a non-resident, that corporation does not qualify as a "Canadian corporation". Hence, the appellant is not being treated any differently than Canadian nationals who are in the same circumstances as it.

[35] In support of her argument, the respondent refers to the OECD Model Convention and the Commentary thereon for the purpose of ascertaining the parties'

intention in entering into the Canada-UK Treaty. Article 24 of the Model Convention provides that:

> Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are . . . subjected.

[36] That provision according to the respondent, indicates that the issue of residency is a determining factor in establishing whether taxpayers are in the same circumstances. The respondent further referred to the Commentary on the Model Convention, which makes it clear that the expression "in the same circumstances" would be sufficient by itself to establish that a taxpayer who is a resident of a Contracting State and one who is not a resident of that State are not in the same circumstances.

[37] The respondent further explains that if the appellant was a resident of Canada under the common law and the treaty tie-breaker rules, Article 22(1) would come into play as long as the other requirements of subsection 88(1.1) were met, because the appellant would be in the same situation with respect to residence as a corporation that is a Canadian national. The respondent suggests that even if the appellant were a resident of Canada, it would not benefit from the application of subsection 88(1.1) of the *Act* because its wound-up subsidiary is not a Canadian corporation. The respondent asserts that there would be no discrimination in that case because a Canadian corporation that winds-up a foreign subsidiary that has a PE in Canada would likewise not benefit from the application of subsection 88(1.1) of the *Act*.

[38] In response to the issue raised by the appellant that corporations incorporated in Canada are automatically residents of Canada, the respondent referred to the Commentary on Article 24 of the Model Tax Convention, at paragraph 17:

> . . . A company will usually derive its status as such from the laws in force in the State in which it has been incorporated or registered. Under the domestic law of many countries, however, incorporation or registration constitutes the criterion, or one of the criteria, to determine the residence of companies for the purposes of Article 4. Since paragraph 1 of Article 24 prevents different treatment based on nationality but only with respect to persons or entities "in the same circumstances, in particular with respect to residence", it is therefore important to distinguish, for purposes of that paragraph, a different treatment that is solely based on nationality from a different treatment that relates to other circumstances and, in particular, residence. . . .

[39] The respondent submits that subsection 88(1.1) of the *Act* does not draw a distinction only between corporations incorporated here and those incorporated elsewhere. The first distinction it draws is with regard to whether the company is a company resident in Canada.

Analysis

[40] Paragraph 1 of Article 22 of the Canada-UK Treaty prohibits discrimination based on nationality. The term "national" in the Treaty means:

> (i) in relation to the United Kingdom, any British citizen, or any British subject not possessing the citizenship of any other Commonwealth country or territory, provided that citizen or subject has the right of abode in the United Kingdom; and any legal person, partnership, association or other entity deriving its status as such from the law in force in the United Kingdom;
>
> (ii) in relation to Canada, all citizens of Canada and all legal persons, partnerships and associations deriving their status as such from the law in force in Canada.

[41] It therefore follows that the nationality of a corporation is determined by its place of incorporation. (See also *Janson v. Driefontein Consolidated Mines, Ltd.,* [1902] A.C. 484 (H.L), at page 501, and *Daimler Co. v. Continental Tyre and Rubber Co. (Great Britain) Ltd.*, [1916] 2 A.C. 307 (H.L.). The prohibited discrimination is that based on nationality, not on residence.

[42] It is relevant and fair to say that there are no Canadian decisions on the application of a non-discrimination provision in a tax treaty. That being said, the Court of Appeal of New Zealand in *C.I.R. v. United Dominions Trust Ltd.*, [1973] 2 NZLR 555, had the opportunity to examine the application of Article XIX(1) of the Double Taxation Relief Agreement between the UK and New Zealand with regard to The *Land and Income Tax Act 1954* of New Zealand. Article XIX(1) is a non-discrimination provision, similar to Article 22(1) of the Canada-UK Tax Treaty, which prohibits tax discrimination on the basis of nationality. Article XIX(1) reads as follows:

> The nationals of one of the territories shall not be subjected in the other territory to any taxation or any requirement connected therewith which is more burdensome than the taxation and connected requirements to which the nationals of the latter territory in the same circumstances are or may be subjected.

[43] The relevant issues before the New Zealand Court of Appeal were whether United Dominions Trust Ltd., a UK banking and finance company carrying on business in England, had to pay income tax at a higher rate on the interest it received from its subsidiary, a company incorporated and carrying on business in New Zealand, than it would have had to pay had it been a resident of New Zealand, and whether it likewise had to pay tax at a higher rate on a proportionate share of the proprietary income of its New Zealand subsidiary for which it was assessed. The question was whether either issue involved a form of discrimination prohibited by Article XIX(1) of the Double Taxation Relief Agreement.

[44] The Court held that discrimination on the basis of residence does not amount to discrimination on the basis of nationality for the purpose of the non-discrimination provision in Article XIX(1). It is worth reproducing a part of McCarthy P.'s decision, found at pages 561–562.

> . . . the important words in deciding the first issue are "in the same circumstances". The word "same" carries the connotation of uniformity, of exactness in comparison. The phrase does not ordinarily mean in roughly similar circumstances: it means in substantially identical circumstances in all areas except nationality. Can then the difference in residence be accepted in this case as a valid basis for applying a different tax rate or must nationality be seen as the true basis of the distinction made.
>
> I bear in mind that these two terms, residence and nationality, and especially the latter, are treacherous words for they are somewhat artificial when applied to corporate bodies. But in the Agreement I find strong recognition of the importance of the concept of residence as the source of taxing power and of the right of contracting parties to impose different rates or conditions of tax on companies according to residence. I see this in the definitions in Article II, especially in para (1)(l) and (m), in Article VII, in Article XVII, and as I have already said, in Article XIX itself in paras (2) and (4). Moreover, the Agreement seems to me to accept the right of the taxing country to determine the criteria by which it determines residence, and I think that this can be said of the residence of companies as well as that of individuals. Article II(1)(l)(i), for example, defines the term "resident of New Zealand" as meaning a New Zealand company and any other person who is resident in New Zealand for the purposes of New Zealand tax [see Article 4(1) of the Canada-UK Treaty]. . . . So the words "for the purposes of New Zealand tax" seem to me to involve a recognition of the right of New Zealand to determine what corporate bodies, even possibly companies additional to those covered by the definition of New Zealand company appearing in Article II(1)(j), are to be treated as resident for the purposes of its taxation.
>
> I do not find the hypothetical example of the company incorporated in New Zealand but, in fact, located and trading overseas which was so much relied upon by Mr Patterson in his submissions to us, as an obstruction to the prominence I give the

> matter of residence when determining whether it can fairly be said that the discrimination in this case was based on nationality. It is true that the only difference between the hypothetical company and the respondent is the former's birth in this country, but birth is not an unimportant factor to be taken into account in prescribing a test of residence for companies. If a company obtains its existence and status wholly by virtue of the law of the country in which it was incorporated, it seems to me supportable, both as a matter of justice and on recognised tax practice, to base residence on the fact of incorporation. New Zealand has chosen to do that, and I think it is a little superficial to say, in such circumstances, that the essential substance of the difference between the two companies is a matter of nationality and not residence. It should not be overlooked that the test of residence can be of advantage to a company incorporated in the United Kingdom which as a result of having its centre of administrative management in New Zealand and not in the United Kingdom is taken, in terms of s 166, to be resident in this country and entitled to be assessed at the lower rate, whereas another company of the same birth but resident in the United Kingdom must be assessed at the higher rate.
>
> In my judgment the better view is that the discrimination against the respondent of which it complains is based on a difference of residence and not on nationality, and that this discrimination is not in breach of the Agreement. The respondent cannot claim to be "in the same circumstances" for the purposes of Article XIX(1) as a company which is resident in New Zealand. . . .

[45] It is also worth reproducing the OECD Commentary on Article 24, which is consistent with the New Zealand decision that nationals of one Contracting State that are non-residents of the other Contracting State are not in the same circumstances as resident nationals of that other Contracting State. The Commentary reads as follows:

> [t]he various provision of Article 24 prevent differences in tax treatment that are solely based on certain specific grounds (e.g. nationality, in the case of paragraph 1). Thus, for these paragraphs to apply, other relevant aspects must be the same. The various provisions of Article 24 use different wording to achieve that result (e.g. "in the same circumstances" in paragraphs 1 and 2; "carrying on the same activities" in paragraph 3 . . . .
>
> The expression "in the same circumstances" refers to taxpayers (individuals, legal persons, partnerships and associations) placed, from the point of view of the application of the ordinary taxation laws and regulations, in substantially similar circumstances both in law and in fact. The expression "in particular with respect to residence" [note: this expression is absent from Article 22(1) of the Canada-UK Treaty] makes clear that the residence of the taxpayer is one of the factors that are relevant in determining whether taxpayers are placed in similar circumstances. The expression "in the same circumstances" would be sufficient by itself to establish that

> a taxpayer who is resident of a Contracting State and one who is not a resident of that State are not in the same circumstances.
>
> By virtue of that definition [the definition of "national" at Article 3(1)(g) of the Model Convention], in the case of a legal person such as a company, " national of a Contracting State" means a legal person "deriving its status as such from the laws in force in that Contracting State". A company will usually derive its status as such from the laws in force in the State in which it has been incorporated or registered. Under the domestic law of many countries, however, incorporation or registration constitutes the criterion, or one of the criteria, to determine the residence of companies for the purposes of Article 4. Since paragraph 1 of Article 24 prevents different treatment based on nationality but only with respect to persons or entities "in the same circumstances, in particular with respect to residence", it is therefore important to distinguish, for purposes of that paragraph, a different treatment that is solely based on nationality from a different treatment that relates to other circumstances and, in particular, residence. . . . paragraph 1 only prohibits discrimination based on a different nationality and requires that all other relevant factors, including the residence of the entity, be the same. The different treatment of residents and non-residents is a crucial feature of domestic tax systems and tax treaties; when Article 24 is read in the context of the other Articles of the Convention, most of which provide for a different treatment of residents and non-residents, it is clear that two companies that are not residents of the same State for purposes of the Convention (under the rules of Article 4 [same article in the Canada-UK Treaty]) are usually not in the same circumstances for purposes of paragraph 1.

[46] In light of the Supreme Court of Canada decision in *Crown Forest*, *supra*, a case in which that court agreed to examine the OECD Commentary on an article of the Model Convention that differed slightly in wording from the article of the Canada-UK Tax Treaty at issue using the Commentary on Article 24(1) of the Model Convention as a tool to interpret Article 22(1) of the Canada-UK Treaty here should not be too problematic in this case either, even though Article 22(1) of the Treaty is not identical to Article 24(1) of the Model Convention.

[47] In Canadian Tax Paper No. 90, titled "Tax Discrimination Against Aliens, Non-Residents, and Foreign Activities: Canada, Australia, New Zealand, the United Kingdom, and the United States" (Canadian Tax Foundation, 1991, at pages 69–70), commentator Brian J. Arnold explains the interaction between nationality, incorporation and residency and arrives at the same conclusion as that in the OECD Commentary. According to him, a tax provision that discriminates on the basis of residency cannot be said to be discriminating on the basis of nationality unless it does so explicitly.

> . . . the place of incorporation of a corporation is similar in many respects to citizenship with respect to individuals. Citizenship is largely irrelevant in determining whether or not an individual is taxable on his worldwide income or only his Canadian source income. In contrast, incorporation in Canada (except for certain transitional arrangements) is determinative of a company's tax residence in Canada and accordingly its liability to Canadian tax on its worldwide income. Under the OECD model treaty and most tax treaties, a corporation is considered to be a national of the country under whose laws it derives its status. Therefore, tax provisions can be considered to discriminate on the basis of nationality where they treat corporations incorporated outside Canada less favourably than those incorporated in Canada. The difficulty is that, since Canada treats corporations incorporated in Canada as resident in Canada for tax purposes, it is impossible to differentiate between provisions that discriminate on the basis of nationality and those that discriminate on the basis of residence. The Canadian tax system contains many provisions that distinguish between resident and non-resident corporations and may therefore distinguish between corporations incorporated in and outside Canada. Most corporations incorporated in Canada, however, would also be considered to be resident in Canada on the basis of their central management and control in Canada, even if they were not incorporated in Canada. In effect, for most corporations, the place of incorporation test is a proxy for the central management and control test of residence. Therefore, only provisions that distinguish between corporations expressly on the basis of their place of incorporation can reasonably be considered to discriminate on the basis of nationality. In fact, there are no provisions in the Canadian tax system that discriminate on this basis.

[48] This brings me to the appellant's contention that the only corporations that can qualify as "Canadian corporations" under subsection 89(1) of the *Act* are corporations that are Canadian nationals and that the Canadian corporation requirement in subsection 88(1.1) of the *Act* thus amounts to discrimination founded on nationality contrary to Article 22(1) of the Canada-UK Treaty.

[49] It is true that paragraph (*a*) of the definition of "Canadian corporation" in subsection 89(1) of the *Act*, imposes a nationality requirement in that the corporation must have been incorporated in Canada, thereby becoming a national of Canada, but this requirement is in addition to the Canadian residency requirement laid down in the introductory portion of the definition. In addition, under paragraph (*b*) of the definition, a corporation that has been resident in Canada since at least June 18, 1971 qualifies as a Canadian corporation. That paragraph does not impose a nationality requirement because it does not require that the corporation have been incorporated in Canada. Therefore, had the appellant and its wound-up subsidiary each qualified as a "Canadian corporation" under paragraph (*b*) of the definition of that term in subsection 89(1) of the *Act*, the appellant could have deducted its subsidiary's losses under subsection 88(1.1) of the *Act*.

[50] In other words, paragraph (*a*) of the definition of "Canadian corporation" in subsection 89(1) imposes a nationality requirement combined with a residency requirement, but paragraph (*b*) does not impose a nationality requirement. Thus, a corporation need not have been incorporated in Canada in order to be a resident of Canada. Residency can also be determined by the application of subsections 250(4) and 250(5) of the *Act* or by the application of the common law "management and control" test. Therefore, a corporation that was not incorporated in Canada, can be a resident of Canada if its management and control is found to be in Canada or a corporation that was incorporated in Canada can be deemed a non-resident of Canada through the application of subsection 250(5) of the *Act*. Corporations do not qualify as "Canadian corporations" simply because of their Canadian nationality, as suggested by the appellant.

[51] The appellant's other contention is that subsection 88(1.1) is discriminatory because, as a national of the U.K., it is subjected to taxation which is more burdensome than the taxation to which nationals of Canada "in the same circumstances" are subjected. The appellant further suggests that for the purpose of determining whether subsection 88(1.1) is discriminatory, Article 22(1) of the Canada-UK Treaty calls for a comparison between the appellant and a national of Canada that is in the same circumstances as the appellant. Accordingly, the appellant suggests that it and its wound-up subsidiary are in the same circumstances as a Canadian entity carrying on a similar business in Canada that has the benefit of subsection 88(1.1) of the *Act* by virtue of being a "Canadian corporation" under paragraph (*a*) of the definition of that term in subsection 8a(1) of the *Act*. The only thing distinguishing both situations is, according to the appellant, the nationality of the corporations. I would agree with the appellant if residency was the equivalent of nationality, but I do not believe that to be the case. Not all Canadian nationals can be deemed to be resident in Canada under subsection 250(4) of the *Act* by virtue of their incorporation in Canada. Moreover, as mentioned earlier, subsection 250(5) of the *Act* deems corporations incorporated in Canada to be non-residents in certain circumstances.

[52] The proper comparison, in light of the above, would be to compare the appellant with a Canadian national that is a non-resident of Canada and that has a non-resident wound-up subsidiary. That non-resident Canadian national would not qualify as a "Canadian corporation" under subsection 89(1) and therefore would not have access to its wound-up subsidiary's losses under subsection 88(1.1) of the *Act*.

[53] I therefore conclude that the Canadian corporation requirement of subsection 88(1.1) does not amount to discrimination against the appellant that is based on nationality contrary to Article 22(1) of the Canada-UK Treaty.

[54] Finally, I would suggest that, as submitted by the respondent, in a situation where one was comparing the appellant with a corporation that is a Canadian national resident in Canada and having a wound-up subsidiary that is a Canadian national resident in Canada — the appellant (for the sake of argument) also being a resident of Canada and having a Canadian resident wound-up subsidiary and neither entity qualifying as a "Canadian corporation" under subsection 89(1) (because of the year of period of residency) — that situation would give rise to discrimination as the Canadian corporation resident in Canada would be able to deduct the non-capital losses of its wound-up subsidiary under subsection 88(1.1) of the *Act* while the appellant, also resident in Canada, would not be able to. Article 22(1) of the Canada-UK Treaty would, in my opinion, apply in such a circumstance.

Discrimination contrary to Article 22(2) of the Canada-UK Treaty

The Appellant's Position

[55] The appellant's interpretation of Article 22(2) of the Canada-UK Treaty is that Canada, by signing the Treaty, has agreed that an enterprise of the appellant in Canada should not be in a less favourable position than a Canadian national operating in Canada. Counsel for the appellant states that Article 22(2) extends to such an enterprise the application of sections 111 and 115 of the *Act* and of loss carry-back and carry-forward. The appellant quotes the 2003 version of the OECD commentary on Article 24(3) of the Model Convention, which reads as follows:

> Permanent establishments should also have the option that is available in most countries to resident enterprises of carrying forward or backward a loss brought out at the close of an accounting period within a certain period of time (e.g. 5 years). It is hardly necessary to specify that in the case of permanent establishments it is the loss on their own business activities, as shown in the separate accounts for these activities, which will qualify for such carry-forward.

The Respondent's Position

[56] The respondent reminds the Court that Article 22(2) of the Treaty refers to taxation of a permanent establishment and argues that what is being compared in Article 22(2) is the taxation of the PE of a non-resident and the taxation of enterprises resident in Canada.

[57] The respondent refers to Article 7 of the Canada-UK Treaty and states that Canada and the UK have agreed not to tax business profits earned in Canada or in the UK by residents of the other State unless the taxpayer has a PE in the source State. Article 7(2) provides that the profit attributed to the PE is profit which it might be expected to make if it were an enterprise dealing independently with the enterprise of which it is a permanent establishment. The respondent also refers to Article 7(3) which provides that the only deductions which can be taken into account when determining the profits of a PE are those for the expenses incurred for the purposes of the PE.

[58] The respondent argues that the taxation of a PE referred to in Article 22(2) of the Treaty is very much about the profits of that permanent establishment and the deduction of expenses incurred in the context of the activities of that permanent establishment. The scope of Article 22(2), according to the respondent, is limited to the taxation of the permanent establishment itself and does not deal with the taxation of the enterprise as a whole, nor does it extend to taking into account the relationship between an enterprise and other enterprises, in particular through rules that allow the transfer of losses between corporations. The respondent argues, and I quote from page 118 of the transcript:

> What subsection 88(1.1) deals with is with the inter-corporate transfer of losses which [is] a completely different thing than if you're looking at what you're taxing a permanent establishment. You're dealing with the inter-corporate losses of the enterprise, if you want, of the corporation within which the permanent establishment is found.

[59] The respondent therefore submits that Article 22(2) of the Treaty does not discriminate against the appellant because the losses being claimed are not losses resulting from its own business activities carried on through a PE, but are intercorporate losses. The respondent quoted the same excerpt from the OECD Commentary as that quoted by the appellant as well as the following paragraph added to the 2008 version of the OECD Commentary, which provides a more detailed explanation of the loss carry-forward and carry-back that should be available to PEs.

> As clearly stated in subparagraph c) above, the equal treatment principle of paragraph 3 [of Article 24, Model Convention] only applies to the taxation of the permanent establishment's own activities. That principle, therefore, is restricted to a comparison between the rules governing the taxation of the permanent establishment's own activities and those applicable to similar business activities carried on by an independent resident enterprise. It does not extend to rules that take

> account of the relationship between an enterprise and other enterprises (e.g. rules that allow consolidation, transfer of losses . . .) since the latter rules do not focus on the taxation of an enterprise's own business activities similar to those of the permanent establishment but, instead, on the taxation of a resident enterprise as part of a group of associated enterprises. Such rules will often operate to ensure or facilitate tax compliance and administration within a domestic group. It therefore follows that the equal treatment principle has no application.

[60] The respondent therefore submits that subsection 88(1.1) of the *Act* falls outside the scope of Article 22(2) of the Canada-UK Treaty. The respondent concludes by arguing that even if the appellant falls within the comparison groups, and I quote from page 123 of the transcript:

> . . . article 22.2 [22(2)] would still not assist the Appellant because the Appellant here is not being treated less favourably than an enterprise of Canada carrying on the same activities which is what the treatment is guaranteed by 22.2 [22(2)]. Canadian corporations, as I mentioned earlier, are not entitled to access non-capital losses of non-resident subsidiaries [that have a PE in Canada] and this is precisely what the Appellant is trying to do, access the losses of SEI which is non-resident.

(pages 123-24 of transcript)

Analysis

[61] Paragraph 2 of Article 22 of the Canada-UK Treaty provides as follows:

> **Non-Discrimination**
>
> The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. . . .

[62] That paragraph prohibits discrimination based on permanent establishment status. The words "enterprise of the other Contracting State" are defined in subparagraph 1(e) of Article 3 of the Canada-UK Treaty as meaning "an enterprise carried on by a resident of the other Contracting State".

[63] The OECD Commentary on Article 24(3) of the Model Convention, which is practically identical to Article 22(2) of the Canada-UK Treaty specifies that:

> Strictly speaking, the type of discrimination which this paragraph is designed to end is discrimination based not on nationality but on actual situs of an enterprise. It

> therefore affects without distinction, and irrespective of their nationality, all residents of a Contracting State who have a permanent establishment in the other Contracting State.
>
> (OECD Commentary of the Model Tax Convention – July 17, 2008, page 291, par. 33)

[64] Author Brian Arnold seems to follow the same line of thought in his Tax Paper No. 90 (*supra*), at pages 37–38, where he explains the operation of Article 24(4) (now Article 24(3)) of the Model Tax Convention and its interaction with Article 24(1).

> Unlike article 24(1), article 24(4) prohibits discrimination based on residence; nationality is irrelevant. A business carried on in country A by a resident of country B (whether or not a citizen of country A) through a permanent establishment located in country A must not be treated less favourably than the same business carried on in country A by a resident of country A. . . .
>
> . . .
>
> There is no same circumstances requirement under the permanent establishment provision, as there is in the nationality provision. Instead, the comparison of tax burdens must be made between the permanent establishment of a non-resident and the same business activities carried on by a resident. The reason for the difference is that a permanent establishment is obviously in different circumstances than a domestic enterprise, since a permanent establishment is not a separate entity but only a branch, a part of a foreign enterprise. There is no guidance in article 24 or in the commentary as to how to determine what are the same activities.
>
> Another difference between the nationality and permanent establishment provisions is that the nationality provision prohibits other or more burdensome taxation, whereas the permanent establishment provision prohibits less favourable taxation. Consequently, with respect to a permanent establishment, a country is entitled to impose different tax rules from those imposed on residents (that is, "other" taxation is not precluded) as long as the result is not less favourable.
>
> . . .
>
> The relationship between articles 24(1) and (4) of the OECD model treaty with respect to corporations is troublesome. A corporation established under the laws of a state is a national of that state for purposes of article 24(1), even if it is resident elsewhere. Although the corporation is not considered to be a national of the state in which it is resident for purposes of article 24(1), it is entitled to the protection of article 24(4) as a resident of that state. This interpretation suggests that where a corporation is both incorporated and resident in the same country and carries on

> business through a permanent establishment in the treaty partner, both articles 24(1) and (4) apply. The commentary, however, implicitly indicates that a permanent establishment cannot be in the same circumstances as a domestic enterprise. Therefore, article 24(1) does not apply to foreign corporations with permanent establishments; it applies only to foreign corporations deriving income from a country but not having a permanent establishment there.

(Emphasis added.)

[65] The OECD Commentary, at page 293, paragraph 40 and in particular paragraph 40(c), addresses the issue of loss carry-forward or carry-back in general, but does not address the matter of the transfer of loss deductions from a wound-up subsidiary to a parent corporation, as is allowed by subsection 88(1.1) of the *Act*. The Commentary does mention, though, that in the case of a PE, it is the loss from the PE's own business activities that would qualify for a carry-forward or carry-back:

> c) Permanent establishments should also have the option that is available in most countries to resident enterprises of carrying forward or backward a loss brought out at the close of an accounting period within a certain period of time . . . It is hardly necessary to specify that in the case of permanent establishments it is the loss on their own business activities, as shown in the separate accounts for these activities, which will qualify for such carry-forward.
>
> . . .
>
> 41. As clearly stated in subparagraph c) above, the equal treatment principle of paragraph 3 only applies to the taxation of the permanent establishment's own activities. The principle, therefore, is restricted to a comparison between the rules governing the taxation of the permanent establishment's own activities and those applicable to similar business activities carried on by an independent resident enterprise. It does not extend to rules that take account of the relationship between an enterprise and other enterprise (e.g. rules that allow consolidation, transfer of losses or tax-free transfers of property between companies under common ownership) since the latter rules do not focus on the taxation of an enterprise's own business activities similar to those of the permanent establishment but, instead, on the taxation of a resident enterprise as part of a group of associated enterprises.

[66] The above Commentary seems to be in line with the provisions found in paragraphs 1 to 3 of Article 7 of the Canada-UK Treaty, which deals with business profits of a permanent establishment. Paragraphs 1 to 3 read as follows:

> BUSINESS PROFITS

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on or has carried on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall be attributed to that permanent establishment profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In the determination of the profits of a permanent establishment situated in a Contracting State, there shall be allowed as deductions expenses of the enterprise (other than expenses which would not be deductible under the law of that State if the permanent establishment were a separate enterprise) which are incurred for the purposes of the permanent establishment including executive and general administrative expenses, whether incurred in the State in which the permanent establishment is situated or elsewhere.

[67] Paragraph 2 of Article 7 of the Canada-UK Treaty provides that the profits attributable to a PE are the profits which it might be expected to make if it were a distinct and separate enterprise dealing wholly independently with the enterprise of which it is a PE. Paragraph 3 of Article 7 specifies that the deductions available to a PE are expenses of the enterprise which are incurred for the purposes of the PE. Article 7 does not specifically deal with the deduction of losses, but it would seem logical to infer and conclude that the only loss deductions possible in determining the profits of the PE are those with respect to losses that would be attributable to the PE if it were dealing wholly independently with the enterprise of which it is a PE. This is what I believe the parties intended to agree to in Article 7.

[68] That being said, the appellant, in this fact situation, is seeking, in calculating the taxable income earned by its PE, to deduct losses that do not result from its PE's own activities in Canada, and such a deduction is not allowed under Article 7 of the Canada-UK Treaty. The respondent's refusal to allow the deduction does not violate the non-discrimination provision of Article 22(2) of the Canada-UK Treaty.

[69] Although I do find the appellant's arguments to be logical and in line with the spirit of the *Act* in terms of what is allowed as deductions for losses, I cannot ignore Article 7 of the Canada-UK Treaty or the OECD Commentary that suggests that the

equal treatment principle only applies to the taxation of the PE's own activities. It does not therefore extend to provisions that take into account the relationship between an enterprise and other enterprises and that allow the transfer of losses.

[70] I agree with the respondent that the appellant is not being treated less favourably in these circumstances than a Canadian enterprise carrying on the same activities and wanting to deduct non-capital losses of non-resident subsidiaries that have a PE in Canada, which is what the appellant is trying to do.

[71] The appeal is dismissed with costs.

Signed at Ottawa, Canada, this 14th day of January 2011.

"François Angers"

Angers J.

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