Docket: 2005-170(IT)G

BETWEEN:

AMERICAN INCOME LIFE INSURANCE COMPANY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

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Appeal heard on May 9, 10 and 11, 2007, at Toronto, Ontario,

By: The Honourable Justice Campbell J. Miller

Appearances:

| | |
|---|---|
| Counsel for the Appellant: | Salvatore Mirandola |
| Counsel for the Respondent: | Marie-Thérèse Boris |

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**JUDGMENT**

The appeals from the assessments under Parts I and XII.3 of the *Income Tax Act* for the 1996, 1997, 1998 and 1999 taxation years are allowed, and the assessments are vacated in respect of the tax, penalties and interest assessed on the basis that the Appellant did not carry on business in Canada through a permanent establishment in those years.

Costs are awarded to the Appellant.

Signed at Ottawa, Canada, this 16th day of May 2008.

"Campbell J. Miller"

C. Miller J.

Citation: 2008TCC306
Date: 20080516
Docket: 2005-170(IT)G

BETWEEN:

AMERICAN INCOME LIFE INSURANCE COMPANY,

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and

HER MAJESTY THE QUEEN,

Respondent.

## REASONS FOR JUDGMENT

Miller J.

[1] American Income Life Insurance Company (AIL) is an American company carrying on the insurance business in the United States, New Zealand and Canada. To be subject to tax in Canada, AIL must be found, in accordance with Article V of the *Canada-U.S. Tax Treaty* (the *Treaty*), to carry on its business through a permanent establishment in Canada. The Minister of National Revenue assessed AIL in Canada for the years 1996 to 1999 on the basis that it did carry on its business in Canada through a permanent establishment. AIL's position is that:

(i) it did not have a permanent establishment in Canada, as it did not have a fixed place of business in Canada as required by Article V(1) of the *Treaty*;

(ii) it did not have a deemed permanent establishment in Canada as:

(a) there was no person in Canada who habitually exercised authority to conclude contracts in AIL's name, as required by Article V(5) of the *Treaty*; and

(b) if there were such persons, they were agents of an independent status acting in the ordinary course of business, an exception to the deemed permanent establishment provision (Article V(7)).

If I find AIL has a permanent establishment in Canada and is consequently taxable in Canada, the secondary issue arises as to whether penalties are in order. Having decided AIL does not have a permanent establishment in Canada, it is unnecessary to address that secondary issue.

Facts

[2] The facts of this case were addressed through the evidence of Ms. Melinda-Rae Lyse, a Provincial General Agent in Quebec, three officers of AIL, Ms. Debbie Gamble, a Senior Vice-President, Mr. Gayle Emmert, a Vice-President and Actuary and Mr. John Rogers, the Controller.

[3] AIL is an American insurance company, wholly-owned by a public company, carrying on the insurance business in the United States, New Zealand and Canada. It offers whole life insurance (50% to 60% of its business), term and accidental and health insurance products. It has created a niche market, focussing on unions, credit unions and other member-based organizations. It reflects this union-based philosophy by both marketing unions and by ensuring its staff in the United States are unionized, and also by having its Canadian agents subject to collective agreements. The marketing approach is one of union people selling insurance to union people.

[4] AIL does not operate through a separate company in Canada, but utilizes a hierarchy of agents: Provincial or State General Agents (PGA), Master or Managing General Agents (MGA), General Agents (GA), Supervisory Agents (SA), Agents (A), Public Relations Representatives (PRR) and a Canadian Chief Agent.

Provincial General Agent

[5] PGAs have a specific territory within which they carry on business. In the years, in question there were three to seven PGAs in Canada. The PGA is the key cog in the agents' hierarchy, as it is the PGA who develops and expands the agency

by the recruitment, training and managing of agents at all other levels, as well as by offering leadership development for such agents, assuring the quality of their work and serving as a resource for these agents. The PGA enters an agency contract with AIL that provides, in part, for the following responsibilities:

(a) to devote full time exclusively to AIL. It was acknowledged by Ms. Gamble and Ms. Lyse that a PGA could carry on another business unrelated to the insurance business (an example was given of a Mr. Altig, a PGA, who carried on a printing business);

(b) to follow company regulations;

(c) to be responsible for agents "coded" to a PGA, including responsibility for any debts owed by an agent to AIL (for example, advances versus commissions);

(d) to keep records and give them to AIL on request;

(e) to hold, in trust, monies received for transmission to AIL;

(f) to use all business records etc only for the business purposes of AIL … and to recognize that such records are the property of AIL; and

(g) to advise AIL in writing whenever the provincial general agent becomes a representative of another insurance company. If this occurred, it was clear that AIL would terminate the contract.

[6] Included in the contract were several limitations on authority, providing that the PGA had no authority to obligate AIL except by the terms of the insurance application or written authority from AIL.
Ms. Gamble could not recall any instance where the company ever gave written authority to a PGA to bind the company. Other limitations were:

(a) not to alter the terms of any policy or contract of AIL;

(b) not to receive money on behalf of AIL except initial premiums on applications;

(c) not to accept renewal premiums for insurance; and

(d) not to use advertising or printed matter other than that provided or approved by the company.

AIL has authority to cease to do business in any territory without becoming liable to the PGA, and also to reject any application for insurance. The agency contract could be terminated on 30 days' notice. Finally, the agreement stipulates that the PGA is not an employee of AIL.

[7] AIL has no say where, within a territory, the PGA wishes to locate. The PGA determines the level of commission of an agent, though it is AIL who sets the category of parameters for different levels of agency. So, for example, an agent may be in a General Agent category for which AIL sets a range of percentage commission. It is then for the PGA to determine the exact commission. It is also the PGA's call as to which category the agent falls into, and also who advances from one category to the next. The lower level agent's contracts are signed by both AIL and the PGA. It is the PGA who would terminate an agent should the need arise.

[8] Ms. Lyse, a Quebec PGA, indicated that the PGA is remunerated based on a commission on initial premiums and also on renewal premiums. She moved from Alberta to Quebec to become a PGA due to the renewal opportunities as a PGA in Quebec. She anticipated she could build a large agency in Quebec, and it appears she has. It was clear that, as a PGA, she takes a very active role in monitoring the agents, assisting with their sales' approaches and motivating them. She instructs them on the mechanics of the commission arrangements.

Master General Agent, Regional General Agent, General Agent, Supervisory Agent

[9] I am lumping these categories of agents together as their roles are similar, the distinguishing feature being the level of commission. Their agency contract is signed by both AIL and the PGA, as it is the PGA who determines their level of commission. These agents all have some managerial responsibilities; the further up the hierarchy, the more supervisory and management responsibilities they assume, including recruiting and training other agents. These managerial agents will also try to expand business by obtaining agents coded to them. Managerial agents

receive commissions on the sales of those agents coded to them. So, for example, on an initial premium, 100% of the commission could be broken down to 57.5% for a General Agent, 12.5% commission override for a Master General Agent, and 30% commission override for a Provincial General Agent. The managerial agents will also engage in direct solicitations.

Agents

[10] The Agent, at the bottom of the ladder, is strictly a commission sales agent. There is no requirement of exclusivity, and the Agent may sell other insurance products, though this is highly unlikely, as the Agent will prosper by advancing up the hierarchy by selling exclusively AIL insurance.

[11] The Agents take their guidance and look for supervision primarily from the PGA. They need their license to sell insurance, products to sell, a vehicle, a cell phone and perhaps a home office. Apart from the insurance product itself, they provide the rest of these necessities themselves.

Public Relations Representative (PRR)

[12] Up until 1998-1999, these individuals had a contract with AIL, but thereafter the contract was between the PRR and PGA. The PRR's role is to provide leads of potential customers to the Agents. For example, they contact unions to attempt to put some blanket group coverage in place, which would lead to access to membership lists. The Agents would then approach the members for individual coverage. The PRRs are paid in accordance with their collective agreement on a per lead basis. It is the PGA who pays them for leads for the Agents.

Canadian Chief Agent (CCA)

[13] The Office of Superintendent of Financial Institutions (OSFI) requires that there be a Chief Agent in Canada. This individual is mandated to help ensure AIL adheres to Canadian regulatory requirements. The CCA for AIL in Canada was Mr. Cumine, a lawyer with a Toronto law firm. He acted as CCA for more than one insurance company. He was not involved in selling insurance products. He was also not an officer, director nor was he involved in management of AIL.

[14] AIL's actuary, Mr. Emmert, was responsible for ensuring that AIL management took reasonable steps to comply with Standards of Sound Business and Financial Practice for Life and Health Insurance. The CCA signs

a confirmation to this effect, which is submitted to OSFI. The CCA is not himself actively involved in ensuring such compliance. The CCA acts as an intermediary between OSFI and AIL, though the CCA is required by OSFI to maintain certain AIL files in Canada. Mr. Cumine also provided legal advice to AIL. He billed AIL as a client of the law firm.

[15] OSFI published a memo in November 1992 entitled "*Guideline - Role of CCA and Record Keeping Requirements*". It discusses the role of the CCA "in protecting the interest of the Canadian policyholder by fulfilling statutory obligations with respect to records and documents which shall be maintained at the Chief Canadian Agency". This is done by ensuring compliance with "ICA, Regulations, Policy, Guidelines and Statement completion requirements". The *Guideline* goes on to discuss the CCA's responsibilities to ensure an adequate margin of assets to liabilities is maintained in Canada. It appears the *Guideline* contemplates a more hands-on role for the CCA than what I understand in fact occurred. Mr. Emmert was clear that it is he, and not Mr. Cumine, who monitors and fully comprehends AIL's financial situation vis-à-vis the OSFI requirements.

[16] The *Guideline* also covers the record-keeping requirements, including a requirement that bank accounts in Canada be under the control of the CCA. The CCA must also sign policies.

[17] OSFI conducted an audit of AIL in 1997, acknowledging in their management letter to AIL of November 13, 1997, that the CCA did not have "an intimate working knowledge of the business being transacted in Canada". OSFI recommended the "establishment of a stronger presence in Canada by developing the Chief Agency into a functional branch office with employees dedicated to the Canadian business." Mr. Emmert testified this was never done and AIL has never been sanctioned by OSFI.

[18] OSFI also requested a business plan from AIL outlining what functions would be performed in Canada. AIL responded with a concise business plan indicating, in part:[1]

> "METHOD OF DISTRIBUTION" – American Income Life sells its insurance products only through state general agents and their agents who represent only American Income Life Insurance Company.

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[1] Exhibit A-1, Vol. 2, Tab 33.

> "COMMISSION STRUCTURE" – Commissions are established for state general agents, from which flow commissions to the various types of general agents and agents.
>
> Out of commissions the state general agents must pay their own operating and overhead expenses.

[19] The business plan did not address the thrust of OSFI's recommendations, and, again, Mr. Emmert advised no sanctions were forthcoming from OSFI. Finally, OSFI recommended that the CCA have control of the Canadian trust accounts and the Canadian disbursement accounts. The month after it received these recommendations, AIL passed directors' resolutions giving the CCA complete control over the AIL deposit account at CIBC, and sole signing authority for the CCA on the CIBC disbursement account for amounts less than $10,000. For amounts greater than $10,000, the CCA's and one AIL's officer's signature were required. AIL dealt with this by using a facsimile signature of the CCA.

[20] By Directors' Resolution of January 1998, AIL resolved that the CCA signature was required with that of one officer on any withdrawal from the trust account with RBC Trust Company. It was noted that the trust agreement between AIL and RBC Trust Company of May 13, 1993, had certain built-in protections required by OSFI, including the Superintendent's approval for vesting an asset in trust, or withdrawing an asset vested in trust, subject to exceptions on certain assets. Other protections included:

(i) an override of access by the Superintendent to income from vested assets;

(ii) a requirement to regularly report the value of assets in Canada;

(iii) access by the Superintendent to all assets held in trust; and

(iv) the requirement of such assets assigned to the Superintendent in certain events (for example, insolvency).

Operation of AIL's business

[21] The basic distinction between what business occurred in Canada and what occurred in the United States is as follows: the product (insurance) was developed and issued in the United States, and the underwriting process took place in the

United States; the sales force, however, was in Canada, through the hierarchy of commission agents. It is important to describe in greater detail the business carried on in Canada.

[22] Selling AIL insurance in Canada revolves around the PGA. In Ms. Lyse's case, it is her office, leased space at her expense, that is the centre for recruitment, training and monitoring the Agents. The office has a reception area with a fulltime office manager who greets Agents. There is an AIL sign at the reception. The office phone number is listed under AIL. Ms. Lyse also employs two other employees. She has one large office, four smaller offices for managers to meet with Agents and a supplies room. There is no office designated for an AIL representative. Ms. Lyse has had only one visit from a representative from AIL and that was a public relations visit. The Agents' business cards are required by law to name the insurer. The PGAs must describe themselves on their cards as being just that, Agents. It was clear from AIL memos to the PGAs that the PGAs were forbidden from using AIL's name on any leases, equipment purchases or incur any expenditure in AIL's name.

[23] The Agents follow up leads from the PRR or personal leads. Any new business is recorded by completing a new business transmittal form. With a new customer, the Agent will also complete the application form on which the customer will identify the specific insurance sought. The Agent will collect the first premium and provide either a premium receipt or, in the case of whole life, a conditional receipt. It is clear on the premium receipt that no obligation is incurred by AIL until the application is approved by the company after the underwriting process. The conditional receipt reads differently, providing coverage may be effective as early as the time of application and payment of the first premium. If an applicant dies while the underwriting process is ongoing, the applicant may still be covered if the underwriting would have led to approval.

[24] The Agents deliver the transmittal form and application to Ms. Lyse on Thursday. She checks the application and forwards the information to AIL in Waco, Texas.

[25] It is in Waco, in the United States, that the underwriting process is completed, which may, for example, include requests for more detailed medical information. Agents are not involved in that process. Once the underwriting process is complete and the risk fully assessed, AIL will accept the application as is, counter with different coverage or decline the application. If there is a counter-offer, an Agent may need to discuss this further with the customer. If the

application is accepted, AIL issues a policy from the United States. Renewals of coverage are handled directly with AIL in the United States. Often, premiums are arranged to be paid by automatic bank deductions. It is on the renewals that AIL makes its money, as in the first year of a policy AIL pays out all of the premium in commissions, but the commission rates drop on the renewals.

[26] As well as the transmittal forms, the PGA sends weekly production reports to Waco, and it in turn provides in the relevant years the following reports:

(1) a weekly underwriting bulletin indicating pending applications and requirements to complete the process;

(2) weekly advance reports showing business transmitted, cases declined or withdrawn;

(3) agents' progress and persistency report, showing the gross submissions, declines, withdrawals, cancellations and net submissions and retention rates; and

(4) a monthly ledger report showing all the policies in the books, premiums, renewals, etc., on an individual basis.

[27] Also, several forms were generated from Waco: application forms, underwriting questionnaires, claims statements, funeral benefit certificates, family information guides, summary worksheets of what policies will provide and some recruiting brochures.

[28] Both AIL and the PGA provide certain incentives for their Agents; for example, based on production, an Agent may qualify for a yearly trip to a resort from AIL. AIL also provides a leadership development seminar, which the Agents could attend at their own expense.

[29] OSFI also requires certain reports from AIL, through an appointed Canadian actuary, including a report covering the financial well-being of AIL, insolvency report (report on dynamic capital adequacy testing) and a test of adequacy of assets in Canada and margin requirements from foreign life insurance companies (TAAM). AIL also completed an annual return for OSFI(OSFI 55), a form especially for Canadian branches of foreign companies.

[30] AIL reported its Canadian income in the US in combination with its US income, though, for regulatory and internal management purposes, kept the Canadian income separate.

[31] The Respondent assessed AIL for tax under Part I and Part XII.3 of the *Income Tax Act* on the basis that AIL carried on its business through a permanent establishment in Canada. Tax assessed was as follows:

| | **1996** | **1997** | **1998** | **1999** |
|---|---|---|---|---|
| Part I | $1,486,013 | $1,793,873 | $3,027,728 | $3,672,488 |
| Part XII.3 | $28,710 | $44,623 | $64,489 | $88,031 |
| Part I interest | $779,507 | $838,705 | $901,057 | $939,126 |
| Waived | $(505,363) | $(416,803) | | |
| Part XII.3 interest | $5,649 | $10,556 | $20,649 | $23,767 |
| Penalty (Part I) | | $24,357 | $37,926 | $62,328 |
| Penalty (Part XII.3) | | $223 | | |

Issue

[32] AIL's liability for tax in Canada depends on the interpretation of the *Treaty*, the relevant provisions of which are attached as Schedule "A" to these reasons. AIL is liable for tax in Canada if it carries on its business in Canada through a permanent establishment. There are three questions to address in determining whether AIL had a permanent establishment in Canada:

(i) Did AIL have a permanent establishment as a result of having a fixed place of business in Canada (*Treaty*, Article V(1), (2) and (6))?

(ii) Did AIL have a deemed permanent establishment as a result of having agents in Canada who habitually exercised, in Canada, an authority to conclude contracts in the name of AIL (*Treaty*, Article V(5))? and

(iii) If so, were such agents general commission agents or any other agent of an independent status, acting in the ordinary course of their business (*Treaty*, Article V(7))? If so, AIL is not deemed to have a permanent establishment and, therefore, is not liable for Canadian tax.

If not, AIL is deemed to have a permanent establishment and therefore is liable for tax in Canada.

Analysis

[33] It is agreed by the parties that AIL, as a non-resident, carried on business in Canada within the meaning of paragraph 253*(b)* of the *Act*. AIL is therefore liable for tax in Canada pursuant to subsection 2(3) and Part XII.3 of the *Act*, subject to the relevant provisions of the *Treaty*, specifically Articles V and VII which require the business be conducted through a permanent establishment in Canada.

[34] The *Treaty* provides a two-pronged analysis to the question of "permanent establishment": Article V(1) (fixed place of business) and Articles V(5) and (7) (dependent agent). If the fixed place of business analysis does not result in a finding of permanent establishment, then one turns to the dependent agent permanent establishment analysis. While there is some overlap between the factors to consider in the two analyses, it is important, for clarity's sake, not to lose sight of which analysis is being undertaken. The key factors in the fixed place of business analysis are:

(i) the existence of a place of business;

(ii) a degree of permanence to such place; and

(iii) the carrying on by AIL of business through this fixed place.

[35] The key factors in the dependent agent permanent establishment analysis are:

(a) an agent's authority to conclude contracts in Canada;

(b) was the agent of independent status, both legally and economically; and

(c) was the agent acting in the ordinary course of his or her business.

[36] In both analyses, one issue to be determined is whose business is being carried on by the agents. The Appellant argues there are two businesses being carried on – AIL's business of the sale of insurance products and the agent's business of soliciting such sales as independent contractors. The Respondent's position is that the only business carried on is AIL's and the agents, in carrying out their responsibilities of soliciting sales, are in effect carrying on AIL's business.

This may seem to some as splitting hairs, but for better or worse, that is what law oft times is. What follows is the hair-splitting analysis.

Did AIL have a fixed place of business in Canada?

[37] The Organization for Economic Cooperation and Development ("OECD") has a model tax convention which in many ways, but not all, mirrors the provisions of the *Treaty*. It is helpful to consider the OECD commentary regarding "permanent establishment". The commentary identifies the following conditions for a permanent establishment arising from a fixed place of business:

- The existence of a "place of business", i.e. a facility such as premises or, in certain instances, machinery or equipment;
- This place of business must be fixed, i.e. it must be established at a distinct place with a certain degree of permanence; and
- The carrying on of the business of the enterprise through this fixed place of business. This means usually that persons who, in one way or another, are dependent on the enterprise (personnel), conduct the business of the enterprise in the state in which the fixed place is situated.

[38] The commentary goes on in paragraphs 4 and 10 as follows:

> 4. The term "place of business" covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is immaterial whether the premises, facilities or installations are owned or rented by or are otherwise at the disposal of the market place, or by a certain permanently used area in a customs depot (e.g. for the storage of dutiable goods). Again the place of business may be situated in the business facilities of another enterprise. This may be the case for instance where the foreign enterprise has at its constant disposal certain premises or a part thereof owned by the other enterprise.
>
> 10. The business of an enterprise is carried on mainly by the entrepreneur or persons who are in a paid-employment relationship with the enterprise (personnel). This personnel includes employees and other persons receiving instructions from the enterprise (e.g. dependent agents). The powers of such personnel in its relationship with third parties are irrelevant. It makes no difference whether or not the dependent agent is authorised to conclude contracts if he works at the fixed place of business (cf. paragraph 35 below). But a

> permanent establishment may nevertheless exist if the business of the enterprise is carried on mainly through automatic equipment, the activities of the personnel being restricted to setting up, operating, controlling and maintaining such equipment. Whether or not gaming and vending machines and the like set up by an enterprise of a State in the other State constitute a permanent establishment thus depends on whether or not the enterprise carries on a business activity besides the initial setting up of the machines. A permanent establishment does not exist if the enterprise merely sets up the machines and then leases the machines to other enterprises. A permanent establishment may exist, however, if the enterprise which sets up the machines also operates and maintains them for its own account. This also applies if the machines are operated and maintained by an agent dependent on the enterprise.

[39] I also draw guidance from case law, specifically the cases of *Sunbeam Corporation (Canada) Ltd. v. M.N.R.*[2], *The Queen v. Dudney*[3], *M.N.R. v. Panther Oil & Grease Manufacturing Co. of Canada Ltd.*[4], *American Income Life Insurance Co. v. Canada (Minister of National Revenue)*[5] and employee/independent contractor cases.

[40] The Respondent relied on *Panther Oil*, a 1961 decision of President Thorson, dealing with whether there existed a permanent establishment in Quebec, pursuant to the *Income Tax Regulation* 411(1)*(a)*, which reads:

> 411(1)(a) For the purpose of this Part, a "permanent establishment" includes branches, mines, oil wells, farms, timberlands, factories, workshops, warehouses, office, agencies and other fixed places of business.

President Thorson concluded it was not an essential requirement of the permanent establishment that there be a fixed place of business. He proceeded then to determine that a group of sales agents in Quebec constituted a branch or agency and, consequently, a permanent establishment by virtue of having a well established selling organization in Quebec. *Panther Oil* had sought a ruling that it

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2 62 DTC 1390 (S.C.C.).

3 2000 DTC 6169 (F.C.A.).

4 61 DTC 1222.

5 [2002] T.C.J. No. 368 (T.C.C.).

had a permanent establishment so it could claim a Quebec credit. President Thorson found they were entitled to such a credit.

[41] This case is clearly distinguishable on a very fundamental basis: the *Treaty*, unlike the *Regulations*, requires a fixed place of business, and a fixed place of business from which AIL carries on its business. This is not the same issue dealt with by President Thorson. Respondent's counsel stressed how integrated the agents in Canada were in AIL's business, and drew parallels to the agents in *Panther Oil*. I am not satisfied the parallels are justified given the very different legal parameters within which President Thorson rendered his decision, and the legal parameters provided by the *Treaty*. The question before me is whether AIL's business was being carried on at a fixed place of business, not whether there were "agencies".

[42] The reasoning in *Panther Oil* was not followed by the Supreme Court of Canada in the case of *Sunbeam*, published in 1962, even though the same regulations were at issue. The Court held that an Ontario manufacturer of electrical appliances which employed sales representatives, who maintained home offices, and junior salespeople in Quebec, did not have a permanent establishment in Quebec for purposes of the *Act*. The relevant salespeople received no rent or compensation from the Ontario company for maintaining their offices. The Court held that the sales representatives' home offices did not constitute a Quebec permanent establishment because the Quebec offices were not the Ontario company's fixed place of business. Justice Martland, in a concise judgment, found the Appellant had no permanent establishment. He stated:

> On this evidence I am not prepared to hold that the appellant had a "permanent establishment" in the Province of Quebec in the years in question. Interpreting those words, apart from the provisions of s. 411(1)*(a)* of the *Regulations*, my opinion is that the word "establishment" contemplates a fixed place of business of the corporation, a local habitation of its own. The word "permanent" means that the establishment is a stable one, and not of a temporary or tentative character.
>
> ...
>
> I do not agree that the fact that such employee, for the discharge of his duties under his contract, set up an office in his own premises constituted that office a branch, an office or an agency of the appellant. It is the appellant who must have the permanent establishment in the Province of Quebec to qualify for the tax deduction …

[43] In the case of *Dudney*, a more recent decision of the Federal Court of Appeal (2000), the Court dealt with Article XIV of the *Canada–U.S. Treaty*, which refers

to a “fixed base regularly available to him in Canada”. The Court, however, referred to the term “permanent establishment”, as used in Article V(1) of the *Treaty* and its reference to a fixed place of business.

[44] Mr. Dudney was a resident of the US. who was contracted to supply training to employees of a Canadian company. For the purposes of the training contract, he was given various offices at the premises of the Canadian company, which he was only allowed to enter at normal office hours. He was allowed to use the client’s telephone only on client’s business. He spent 300 days in one tax year, and 40 in the subsequent year at the premises. Both the Tax Court of Canada and the Federal Court of Appeal confirmed he had no fixed base in Canada. Justice Sharlow, at the Federal Court of Appeal, relying in part on the 1977 OECD Model Convention and citing international cases, concluded that the taxpayer did not have exclusive use of the client’s office and did not have control over the premises in which he worked. In addition, the taxpayer did not have freedom to enter the building whenever he chose and did not have a fixed base regularly available to him. At paragraphs 19 and 20 of the decision, Justice Sharlow stated that:

> [19] Thus, where a person is denied the benefit of Article XIV on the basis that he has a fixed base regularly available to him in Canada, the question to be asked is whether the person carried on his business at that location during the relevant period. The factors to be taken into account would include the actual use made of the premises that are alleged to be his fixed base, whether and by what legal right the person exercised or could exercise control over the premises, and the degree to which the premises were objectively identified with the person's business. This is not intended to be an exhaustive list that would apply in all cases, but it is sufficient for this case.
>
> [20] In this case, the Tax Court judge was correct to consider these factors to be relevant and determinative. The evidence as a whole gives ample support for the conclusion that the premises of PanCan were not a location through which Mr. Dudney carried on his business. Although Mr. Dudney had access to the offices of PanCan and he had the right to use them, he could do so only during PanCan's office hours and only for the purpose of performing services for PanCan that were required by his contract. He had no right to use PanCan's offices as a base for the operation of his own business. He could not and did not use PanCan's offices as his own.

[45] Although the issue of the independent status of the agents is most pertinent in considering the application of Articles V(5) and (7) (dependent agent permanent establishment), it also comes into play in considering a fixed place of business: dependent agents are an indication that the enterprise, in this case, AIL, carries on business from a fixed place. In effect, if the agents are dependent, they are seen as

carrying on AIL's business, not their own business. Counsel also referred me to the standard independent contractor versus employee test most recently reviewed by the Supreme Court of Canada in *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.*,[6] and by the Federal Court of Appeal in subsequent decisions of *Royal Winnipeg Ballet v. M.N.R.*[7] and *Combined Insurance Company of America v. Canada (National Revenue*[8]*)*, to name just a couple. Indeed, this was the very issue before Justice Rowe in the case of *American Income Life*, where he was faced with the same Appellant. He heard some of the same witnesses who appeared before me. He reviewed the factors of control, provision of equipment, degree of risk and responsibility for investment in management and opportunity for profit. He concluded:

> The agents were performing services as persons in business on their own account.

He stated:

> In the within appeals, it is apparent there are two different businesses operating at the same time. One of them – from the perspective of Burbank – arises from his activity as a self-employed person carrying on the business of soliciting insurance coverage from members of the public. He undertook the necessary steps to become licensed and trained in order to put himself in a position where he could earn commission revenue from policy sales. Once he had completed the application form and provided the necessary information – including a method for premium payment – his task was concluded. Whether or not a policy was issued depended on American, the insurer having the authority to underwrite the policy. Up to that point, he had to depend on his ability to use the leads wisely, and to utilize his administrative and organizational skills to set up appointments in an efficient and cost-effective manner and to maximize his presentation skills in order to close a higher proportion of sales in relation to sales calls. Again, it must be emphasized that the jurisprudence demands that the Court approach the analysis from the standpoint of the persons alleged to have been employees.

[46] The approach of the Federal Court of Appeal in decisions such as *Royal Winnipeg Ballet* and *Combined Insurance*, both subsequent to *Sagaz*, address the traditional determining factors in light of what the parties intended.

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6 [2001] 2 S.C.R. 983.

7 2006 FCA 87.

8 2007 FCA 60.

[47] What I draw from this review of the *Treaty* provisions, the OECD commentary and the case law are the following guidelines for the determination of what constitutes a fixed place of business and, consequently, a permanent establishment for purposes of Articles V(1) and (2).

1. A permanent establishment requires a fixed place of business meaning:

   (a) existence of a place of business;
   (b) degree of permanence to such place; and
   (c) the carrying on of the business of the enterprise through such fixed place.

2. The enterprise need not own or lease property for it to be a fixed place of business.

3. The premises need not be used exclusively by AIL.

4. To determine if AIL's business is being carried on from the fixed place of business, the following factors should be considered:

   - use of premises by AIL
   - control by AIL over premises
   - legal right to exercise control over premises
   - degree to which premises identified with AIL business
   - who paid for expenses of premises
   - who paid for equipment used at premises
   - who made management decisions
   - what contracts were concluded from premises
   - what AIL products were kept on premises
   - did AIL have any Canadian employees
   - who bore the risk of the operation from premises
   - how many principals were represented by the agent
   - were agents subject to detailed instructions or comprehensive control

[48] Respondent's counsel stressed the concept of integration, though apart from the case of *Panther Oil*, this does not appear to be a consideration, let alone a determinative factor.

[49] All agents work from a place, whether a PGA's office or the agent's home office, that meets the criteria of a place of business and one of permanence. It is the question of whose business is being carried on at such place that is the crux of this issue. AIL and the agents intended that the agents not carry on AIL's business but carry on their own business. Given that intention, do the factors to be considered in determining whose business is being carried on from the fixed place of business support that intention. I believe they do. I will consider each level of agent separately.

Chief Canadian Agent

[50] Mr. Cumine, the Chief Agent during the relevant period, is not an employee of AIL. He is a lawyer with the Toronto law firm of McLean & Kerr LLP. Among the legal tasks that he performs for some of his non-resident insurance clients is to act as Chief Agent for these clients, including the Appellant. Mr. Cumine's role is not to conclude insurance sales contracts on behalf of the Appellant or to perform the day-to-day running of the Appellant's business either in Canada or the United States. It was intended that his services be retained as a lawyer in Canada to fulfill the Canadian regulatory requirements pursuant to the *Insurance Companies Act*. His role, performed in his capacity as a lawyer of a Canadian law firm, is purely regulatory in nature.

[51] The *Insurance Companies Act* is clear that a Chief Agent is a statutory creation designed:

- to keep and maintain certain records in respect of the foreign insurance company;
- to receive reports of the actuary with a view to understanding the financial position of the foreign insurance company; and
- to receive reports of the auditor with a view to understanding the wellbeing of the foreign insurance company.

Also, the guideline of the Office of the Superintendent of Financial Institutions ("OSFI") talks in terms of insurance compliance to protect the Canadian policy holder. Notwithstanding recommendations from an OSFI review that the Chief Agent be developed into more of a functional branch office with employees dedicated to the Canadian business, AIL resisted. Mr. Cumine did not proceed with any such changes.

[52] AIL simply has no control over how Mr. Cumine fulfills his responsibilities, nor does it have any control over Mr. Cumine's premises. I am satisfied that whatever duties he carried out for AIL from his office, he did so carrying on his own legal business, not that of AIL.

PGAs

[53] Are the circumstances surrounding the PGA's operation consistent with the PGA carrying on its own business or that of AIL? There are certainly a number of factors that point to some involvement of AIL in the PGA's operation: signage, telephone listing, provision of forms and guidelines, promotional materials and being the sole provider of the insurance product. According to the Respondent, these point to a level of integration that renders PGA's activities part of AIL's business. I disagree. I find there are far more, and significant factors that suggest the PGA was truly engaged in carrying on his or her own business of soliciting sales and developing a hierarchy of agents beneath him or her. To be clear, I see the PGA's business as involving both solicitations and the building of a network of agents. The factors I rely upon to reach this conclusion are as follows:

- The PGA's premises were completely under their control; AIL had no interest in the premises, not even to the extent of having any space designated for an AIL representative, let alone any legal right to exercise control over the premises.
- The PGA's premises were used entirely in the PGA's operation.
- No expenses for the premises were paid by AIL; all expenses incurred in running the office were to the PGA's account.
- All equipment at the PGA's office was owned or leased by the PGA.
- Management decisions of the PGA were made without the involvement or influence of AIL; conversely, the PGA was not involved in any AIL management decisions.
- AIL had no employees working out of the PGA offices.
- The PGA assumed all risk for the operations of the PGA.
- While AIL provided some overall guidance to the PGA there was not the level of detailed instruction one would expect of an

entity carrying on its own business; in common vernacular, the PGA was left to his or her own devices.

- The PGA hired his/her own staff.

- The training of agents taking place at the PGA's offices was undertaken by the PGA for the purpose of broadening the agent base, and consequently increasing profits arising from the PGA's cut of the agent's commission.

- No expenses of training were reimbursed by AIL to the PGA.

- Notwithstanding that AIL set categories for commissions, the PGA negotiated the final rate of agent's commissions.

- PGAs cannot conclude the AIL sales contract.

[54] These factors lead me to the conclusion that the PGAs were independent contractors carrying on their own business and not carrying on AIL's business from their premises. AIL does not have a fixed place of business, and consequently, no permanent establishment through the PGA.

Subordinate Agents

[55] I will group together other categories of agents together, including the public relations representative. The fixed place of business for such individuals would, in most cases, be the home office. These agents divide their time between their home office, the PGA's office, the customer's place and their car. Their home office would be the only location that could constitute their fixed place of business. Do they carry on AIL's business from such fixed place? No. The responsibility for the establishment and the maintenance of these agents' business falls on them, or on them in conjunction with the agents superior to them in the PGA's hierarchy. It does not fall on AIL nor any employee of AIL.

[56] The factors which I have considered which lead me to this conclusion are similar as those referred to in dealing with the PGA:

- None of the executive, managerial or operational decisions in respect of AIL's business were made in the offices of any subordinate agents; such decisions were made in the Appellant's office in the United States.

- None of AIL's directors, officers or managers were located in the offices of any agent.

- The Appellant does not own or rent any of the home offices or other facilities in Canada out of which an agent works.

- Those assets that AIL does maintain in Canada, for example financial assets, are maintained in order to comply with Canada's insurance laws, and are not kept in any agent's offices.

- There is no space in any of the subordinate agent's offices at the disposal of employees of the Appellant, who would have no occasion to visit a home office in any event.

- AIL's agents in Canada are independent contractors.

- The agents incur the expenses required to maintain and operate their home offices, and the Appellant does not reimburse them for such expenses.

- The agents maintain their own books and records and are responsible for the preparation of their own financial information for tax and other business purposes.

- To the extent that agents negotiate their level of sales commissions, the negotiations take place with a provincial general agent, not with the Appellant.

- Agents undertake all of the risk inherent in their own business.

- Agents have no involvement in the Appellant's decisions regarding whether, and in what terms, the Appellant will accept or reject risks.
- Agents are not involved in the issuance of insurance policies, ongoing premium collection, policy renewals or the evaluation or payment of claims.

[57] I conclude it is the agent's business being carried on out of the home office, notwithstanding the exclusivity of the product.

Does AIL have a Dependent Agent Permanent Establishment? (Article V(5))

[58] As I have found AIL does not have a fixed place of business through any level of agent, does AIL have a dependent agent permanent establishment by virtue of having a Canadian agent who habitually exercises in Canada an authority to conclude contracts in the name of AIL (*Treaty* Article V(5)). I find AIL does not have a Canadian agent who exercises such authority.

[59] Again, it is useful to consider the OECD commentary, particularly as it relates to the type of contract which an agent has authority to conclude. The commentary states as follows:

> 32. Therefore, paragraph 5 proceeds on the basis that only persons having the authority to conclude contracts can lead to a permanent establishment for the enterprise maintaining them. In such a case the person has sufficient authority to bind the enterprise's participation in the business activity in the State concerned. The use of the term "permanent establishment" in this context presupposes, of course, that that person makes use of this authority repeatedly and not merely in isolated cases.
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> …
>
> 33. The authority to conclude contracts must cover contracts relating to operations which constitute the business proper of the enterprise. It would be irrelevant, for instance, if the person had authority to engage employees for the enterprise to assist that person's activity for the enterprise or if the person were authorised to conclude, in the name of the enterprise, similar contracts relating to internal operations only. Moreover the authority has to be habitually exercised in the other State; whether or not this is the case should be determined on the basis of the commercial realities of the situation. A person who is authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority "in that State", even if the contract is signed by another person in the State in which the enterprise is situated. Since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either.

[60] The Respondent argues there are two types of contracts which agents habitually have authority to conclude which bind AIL: the agent's contracts and the conditional receipt. I am somewhat perplexed by the Respondent's reliance on the agent's contracts as, for subordinate agents, these are signed by the PGA, who does their recruiting, and by AIL, often by means of facsimile stamped signatures. I was not left with the impression that PGA was signing on behalf of AIL, but on his or her own behalf as a responsible PGA. Indeed this is a strong indicator of the PGA carrying on its own business of developing the hierarchy of agents. I find that the evidence does not support a conclusion that the PGA was concluding these

agent's contracts in the name of AIL. I was not directed to any law dealing with facsimile signatures. I accept such a signature of an AIL officer as that officer's signature and that may bind AIL. It is not the PGA's signature that binds AIL.

[61] With respect to the conditional receipt, both parties spent considerable time on this issue. Does the conditional receipt signed by an agent bind AIL prior to actual delivery of an insurance policy? In other words, by signing the conditional receipt is the agent concluding a contract in Canada?

[62] The conditional receipt is clear that coverage may be effective prior to policy delivery, but only if and until all conditions of the receipt are met. AIL still goes through the underwriting process, and if the applicant is found to be insurable, then coverage will extend back to before the issuance of the policy. I distinguish between the effective time of concluding the contract and the effective time of coverage. Until AIL does something in the United States, there is no contract concluded; when AIL accepts that the applicant is insurable, there is a contract effective back to an earlier time. I do not interpret this as giving agents authority, by having them sign conditional receipts, to conclude contracts in Canada. This is hammered home by the inclusion in the receipt itself of the words "no agent has authority to alter the terms or conditions of this receipt".

[63] The Respondent, however, refers to the Federal Court decision in *London Life Insurance Company v. The Queen*[9] for the proposition that agents could bind a principal to interim coverage and that the interim coverage is a contract completed in the agent's jurisdiction, in that case, Bermuda. Appellant's counsel went to great lengths to persuade me not to rely on this particular case.

[64] The cases upon which *London Life* relied, *Zurich Life Insurance Company of Canada v. Davies*[10] and *Matchett et al. v. London Life Insurance Co.*[11], do not address the question of interim coverage being a separate contract. It was also notable that in *London Life*, the Court found that the ultimate policy issued was also issued in Bermuda. There is no question that the ultimate policy issued by AIL was issued in the US.

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9 87 DTC 5312 (F.C.T.D.).

10 [1981] S.C.R. 670.

11 14 C.C.L.I. 89 (Sask C.A.).

[65] In the subsequent case of *Wagner Brothers Holdings Inc. v. Laurier Life Insurance Co.*,[12] the Ontario Court of Appeal overturned the trial Judge's finding that the traditional insurance policy was separate from the final underlying policy, and held that the application and the policy constitute one contract.

[66] Justice Berger in *Rainer v. Primerica Life Insurance Co. of Canada*[13] addressed the same issue as follows:

> In *Wagner Brothers Holdings Inc. v. Laurier Life Insurance* Co. (1992), 8 O.R. (3d) 609, cited by the Appellant, the Ontario Court of Appeal stated that the trial judge erred in holding that the main policy and the conditional insurance agreement were separate and distinct contracts. However, the Court of Appeal's decision rested upon the specific words of the application which clearly provided that the policy would take effect in accordance with the conditional insurance agreement. The case does not then stand for a universal proposition that all conditional insurance agreements and policies are one contract. Whether they are one contract or two distinct contracts will rest upon the wording of the application, the receipt and the policy. (emphasis added)

[67] I conclude from these cases that the question of one contract or two contracts depends on whether a sufficient link can be established between the insurance application and the interim coverage on one side, and the underlying insurance policy on the other. I find assistance on this issue also in legislation. For example, subsection 151(2) of the *Manitoba Insurance Act*[14] provides that for most kinds of life insurance policies the provisions in (a) the application; (b) the policy; and (c) any document attached to the policy when issued; and (d) any amendment to the contract agreed upon in writing after the policy is issued, constitutes the entire contract.

[68] The link between the application (the conditional receipt) and the AIL policy is found in the policy itself which stipulates "the entire contract consists of the application and the policy". Combined with the wording of the conditional receipt, which includes little detail of the separate contract, I am satisfied there is only one contract. That insurance contract was not concluded in Canada on the signing of the conditional receipt, but was only concluded in the United States by AIL personnel. This was only done after completion of the underwriting process and the

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12 (1992), 8 O.R. (3d) 609 (C.A.).

13 [2002] A.J. No. 297 (Alta. C.A.) at para. 23.

14 R.S.M. 1987, c. 140.

issuance of the policy, the effective date of the policy being immaterial to the conclusion of the contract.

[69] There were two other possibilities of Canadian agents having authority to conclude contracts in Canada: the Chief Canadian agent's signing authority on bank accounts, and an agent signing a collective agreement on behalf of AIL. The former is more of an internal matter, and the latter is neither an authority exercised habitually nor does it go to the exercise of the business aspect of selling insurance. I conclude there is no agent in Canada who habitually exercises, in Canada, authority to conclude contracts in the name of AIL. Consequently, there is no deemed permanent establishment pursuant to *Treaty* provision V(5).

[70] If my conclusion is wrong in this respect, is AIL saved by the application of Article V(7); that is, are the agents in Canada agents of an independent status acting in the ordinary course of their business? As is apparent from my comments dealing with a fixed place of business, I find the agents are independent contractors acting in the ordinary course of their business, though that does not fully answer the issue. The analysis in this context is slightly different from the fixed place of business analysis, which addresses, specifically, the question of whose business is being carried on from the fixed place. I found the agents were carrying on their own business. There remains though the question of whether they were independent or dependent on AIL, a subtle difference from the independent contractor status. A few comments on independent status are in order.

[71] Certainly, Justice Rowe found in the AIL case dealing with the issue of employment versus independent contractor that the agents were independent contractors. That goes more to the question of whose business is it. The issue presented by the interplay between Article V(5) and V(7) raises the question of whether the agents, even in their own business, are independent. This leads to the interesting possibility of an independent contractor carrying on its own business, but doing so as a dependent agent. This is not unlike the situation in the case of *The Taisei Fire and Marine Insurance Co., Ltd., et al. v. Commissioner of Internal Revenue.*[15] on which I will have more to say later.

[72] What is meant by dependent versus independent? Is it enough to conclude that because the agents are carrying on their own business, they are therefore of independent status? No it is not.

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[15] 104 T.C. 535 (U.S. Tax Court, May 2, 1995).

[73] The OECD commentary is clear that the agent must be independent both legally and economically. The commentary states:

> 38. Whether a person is independent of the enterprise represented depends on the extent of the obligations which this person has vis-à-vis the enterprise. Where the person's commercial activities for the enterprise are subject to detailed instructions or to comprehensive control by it, such person cannot be regarded as independent of the enterprise. Another important criterion will be whether the entrepreneurial risk has to be borne by the person or by the enterprise the person represents.
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> …
>
> 38.3 An independent agent will typically be responsible to his principal for the results of his work but not subject to significant control with respect to the manner in which that work is carried out. He will not be subject to detailed instructions from the principal as to the conduct of the work. The fact that the principal is relying on the special skill and knowledge of the agent is an indication of independence.
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> …
>
> 38.6 Another factor to be considered in determining independent status is the number of principals represented by the agent. Independent status is less likely if the activities of the agent are performed wholly or almost wholly on behalf of only one enterprise over the lifetime of the business or a long period of time. However, this fact is not by itself determinative. All the facts and circumstances must be taken into account to determine whether the agent's activities constitute an autonomous business conducted by him in which he bears risk and receives reward through the use of his entrepreneurial skills and knowledge. …
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> 38.7 Persons cannot be said to act in the ordinary course of their own business if, in place of the enterprise, such persons perform activities which, economically, belong to the sphere of the enterprise rather than to that of their own business operations. …

[74] In *Taisei*, the U.S. Tax Court dealt with similar provisions in the *U.S. Japan Tax Treaty*, specifically addressing the interpretation of the expression "agent of an independent status". In that case, the issue was whether four unrelated Japanese insurance companies who wrote re-insurance through a North Carolina company ("Fortress") had a permanent establishment in the US. The parties agreed that Fortress habitually concluded contracts in the name of the Japanese insurance companies, and that Fortress was acting in its ordinary course of business in

representing the insurance companies, so that the only issue was whether Fortress was an agent of independent status. The U.S. Tax Court concluded that Fortress was an agent of independent status because it was both legally and economically independent of the Japanese insurance companies. The case provides some useful guidelines regarding legal and economic independence, notwithstanding the Respondent's view that the facts were significantly dissimilar from the case before me. That may be so, but it is the Court's comments on the question of independence that I find helpful. On the issue of legal independence, the Court considered:

- There is a separate management agreement in respect of each of the Japanese insurance companies.

- The Japanese insurance companies had no ownership interest in Fortress.

- No representative of any of the Japanese insurance companies was a director, officer or employee of fortress.

- Fortress had independence with respect to its day-to-day operations.

- There is no evidence that the Japanese insurance companies acted in concert to control Fortress.

- Fortress acted separately in respect of each of the Japanese insurance companies, and it was incorrect for the Internal Revenue Service to suggest that Fortress acted exclusively for one principal.

[75] With respect to economic independence, the Court noted:

- There is no guarantee of revenue to Fortress.

- Fortress was not protected from loss due to insufficient revenue.

- Fortress had four separate clients, any of whom could terminate its contract with Fortress on six months notice.

- Fortress' profits were significant.

[76] Based on the OECD commentary, domestic law such as *Sagaz* and *Royal Winnipeg Ballet* (though dealing with the issues of employee versus independent contractor), and also based on the U.S. Tax Court's comments in *Taisei*, I conclude that the PGA and other agents were both legally and economically independent of AIL. The factors I have considered are: firstly, with respect to legal independence:

- The agents in AIL intended that the agents have no legal dependence on AIL.

- AIL has little control, apart from the provisions of certain forms, in how the agents carried on their business.

- AIL had no ownership interest in the agent's business.

- AIL did not own any capital assets in Canada.

- AIL did not reimburse agents for costs of acquisition or use of assets.

- The workers engaged by the PGAs were the PGA's, not AIL's responsibility.

- Agents were not involved in making final decisions on coverage or claims.

- Although agents were part of the collective agreement, the evidence was that this was more a marketing ploy than to create any dependence of the agents legally on AIL.

[77] With respect to economic independence, the Respondent argues that even had the agents been carrying on their own business, they were economically dependent on AIL to such a degree that they could not be considered of independent status. With respect, I disagree. The factors I rely upon in concluding the agents were economically independent are as follows:

- As commission agents, profit was tied to the agent's own abilities and results.

- The initial premium created the agent's income.

- AIL's income derived from renewals. Dependence in effect is one of AIL on the agents rather than vice versa.

- There are no caps on income nor minimum levels guaranteed by AIL.

- Agents could solicit from anyone, not just PRR leads.

- Apart from PGAs, agents were not required to act exclusively for AIL.

- The agents bore all their own economic risks.

- The fact that PGAs and most agents dealt with only AIL products is not determinative of economic dependency.

- The supply of product in and of itself is not sufficient to create an economic dependence; it was the expansion of the agent's hierarchy that drove profits.

[78] The Respondent ties the question of economic dependency closely to the concept of integration. Without AIL's product and support, there would be no profits for the agents: their work was inextricably linked to AIL. I see the situation differently. Certainly, there was product and some support, but the economic success hinged on the agent's efforts in soliciting and in establishing networks of other agents, activities over which they had complete control.

[79] With respect to the Chief Agent, I conclude Mr. Cumine was a lawyer acting as such when serving as AIL's Chief Agent, and can in no manner be seen as legally or economically dependent on AIL.

[80] Finally, Appellant's counsel referred me to paragraph 39 of the OECD commentary:

> According to the definition of the term "permanent establishment" an insurance company of one State may be taxed in the other State on its insurance business, if it has a fixed place of business within the meaning of paragraph 1 or if it carries on business through a person within the meaning of paragraph 5. Since agencies of foreign insurance companies sometimes do not meet either of the above requirements, it is conceivable that these companies do large-scale business in a State without being taxed in that State on their profits arising from such business. In order to obviate this possibility, various conventions concluded by OECD Member countries include a provision which stipulates that insurance companies of a State are deemed to have a permanent establishment in the other State if they collect premiums in that other State through an agent established there – other than an agent who already constitutes a permanent establishment by virtue of paragraph 5 – or insure risks situated in that territory through such an agent.

[81] The Appellant argued that the fact that there was no such insurance provision in the *Canada–U.S. Treaty* suggests that it is possible, and perhaps expected, that a non-resident insurance company can do large-scale business in Canada without there being a permanent establishment in Canada. Without further detail in the commentary regarding the nature and organization of "large scale business", it is difficult to conclude determinatively that the AIL arrangement is what was contemplated. I do not place much merit in this approach, nor is it necessary to do so to reach the conclusion I have reached. My conclusion is that if the Canadian and American Governments intend to render AIL's profits taxable in Canada through a permanent establishment, it is for them to amend the *Treaty* accordingly.

Experts

[82] To this point, my reasons for the most part were written prior to hearing any expert evidence. At the time of the trial in May 2007, it was determined that I defer judgment until I had heard expert evidence called by the Knights of Columbus in their appeal before this Court, evidence I heard in January, 2008. Any such expert evidence would be heard as part of both the Knights of Columbus case and this case.

[83] At the beginning of the Knights of Columbus trial in January 2008, the Respondent brought a motion for an order declaring that the expert evidence of the Appellant's proposed witnesses is inadmissible. For reasons delivered from the bench at that time, I decided to hear the three expert witnesses and determine admissibility thereafter. All three experts were extremely well qualified to provide evidence with respect to the interpretation of the OECD Model Convention (Messrs. Vann and Arnold), the development of the OECD Model Convention and

the United Nations Model Double Taxation (Mr. Vann), and the interpretation of the Canada-US Convention from an American perspective (Mr. Rosenbloom). I have determined to admit their evidence, but to a limited extent. My reasons on these matters are more fully provided in my decision in *The Knights of Columbus*[16] released simultaneously with this decision.

[84] How has the experts' evidence impacted on my reasons to this point? Their evidence does not alter my ultimate decision to allow the appeal, but supports that decision.

[85] There are two aspects of the experts' opinion that I found particularly useful. First, was their evidence with respect to the absence of a special provision in the *Treaty* deeming a permanent establishment of an insurance company to exist in Canada if a non-resident insurer collects premiums in Canada, or insures Canadian risks (an "insurance clause"). An insurance clause is referred to in paragraph 39 of the OECD commentary reproduced at paragraph 80 of these Reasons. The Respondent asked me not to infer that, because of the absence of such a clause, Canadian authorities have acknowledged that AIL could carry on extensive business in Canada without having a permanent establishment in Canada: the insurance clause is simply a different test. That is not how I heard the experts. Mr. Vann, in particular, went into some detail regarding the history and development of the insurance clause. He pointed out how the UN model was drafted to include an insurance clause. The OECD had extensively studied the problem of the possibility of a lot of insurance activities carried on in a country through agents without the establishment of a permanent establishment. Paragraph 39 of the commentary recognizes this and addresses the very type of insurance clause the UN was at that time drafting. The OECD decided against such a provision for what Professor Vann described as reciprocal reasons; that is, an attitude that "we'd collect the same amount from them as they collect from our people". This is all well and good with developed countries dealing with one another, but becomes problematic in treaties between developed and developing countries. Though, as Professor Vann pointed out, nothing precludes countries, at whatever stage of development, from inserting such an insurance clause. A state's decision to do so relates to the balance between States. With respect to insurance clauses, Professor Vann concluded:

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16 2008TCC307.

> If countries don't include them in their convention, then I think it's a strong assumption that they are willing to let go this kind of situation, the one I outlined where the underwriting decision is taken in head office and the contract is concluded when the underwriting decision is made in head office.

[86] I conclude the lack of insurance clause does suggest that Canada and the US do recognize considerable activity of an insurance business can take place without finding there is a permanent establishment. I find this evidence supportive of my conclusion.

[87] The second element of expert testimony that cemented my view with respect to the fixed place of business permanent establishment is the experts' testimony regarding the need for a power of disposal of the premises. The Respondent maintains that the paragraphs of the OECD commentary casts doubt on this principle, confirmed by both Mr. Rosenbloom and Mr. Vann, that a fixed place of business can only exist if the premises are at the disposal of the non-resident. I disagree with the Respondent. The commentary gives several examples. I read nothing in them that diminishes the importance of the power of disposal: quite the contrary. I concluded that AIL did not have a fixed place of business. The experts' testimony regarding the need for a power of disposal, applied to the facts before me, confirms my view that AIL does not have a fixed place of business in Canada, as there are no premises over which AIL has any power of disposition.

[88] With respect to a deemed permanent establishment, the Appellant referred to expert evidence regarding the following issues:

(i) Was the conditional receipt one contract or two?

(ii) If the conditional receipt is a separate contract, was it concluded in Canada?

(iii) Were the agents of an independent status?

With respect, none of these issues required expert evidence, and did not form any part of the written opinion provided by the experts. Their evidence on these matters arose primarily in cross examination. Consequently, my conclusion on these matters remains as set out earlier in these Reasons.

Conclusion

[89] I conclude that AIL does not have a permanent establishment, as it has neither a fixed place of business through which it carries on its business, nor does it operate through agents who habitually exercise in Canada an authority to conclude contracts in its name. Further, even had I found agents did have such an authority, then there is still no permanent establishment as the agents are agents of independent status within the meaning of paragraphs 5 and 7 of Article V of the *Treaty*. The appeal is therefore allowed, and the assessments are vacated on the basis that AIL did not have a permanent establishment in Canada in the years in question.

[90] Costs are awarded to the Appellant.

Signed at Ottawa, Canada, this 16th day of May 2008.

"Campbell J. Miller"

C. Miller J.

# Schedule "A"

## Article V – Permanent Establishment

1. For the purposes of this Convention, the term **"permanent establishment"** means a fixed place of business through which the business of a resident of a Contracting State is wholly or partly carried on.

2. The term "permanent establishment" shall include especially:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop; and

(f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

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

4. The use of an installation or drilling rig or ship in a Contracting State to explore for or exploit natural resources constitutes a permanent establishment if, but only if, such use is for more than three months in any twelve-month period.

5. A person acting in a Contracting State on behalf of a resident of the other Contracting State – other than an agent of an independent status to whom paragraph 7 applies – shall be deemed to be a permanent establishment in the first-mentioned State if such person has, and habitually exercises in that State, an authority to conclude contracts in the name of the resident.

6. Notwithstanding the provisions of paragraphs 1, 2 and 5, the term "permanent establishment" shall be deemed not to include a fixed place of business used solely for, or a person referred to in paragraph 5 engaged solely in, one or more of the following activities:

(a) the use of facilities for the purpose of storage, display or delivery of goods or merchandise belonging to the resident;

(b) the maintenance of a stock of goods or merchandise belonging to the resident for the purpose of storage, display or delivery;

(c) the maintenance of a stock of goods or merchandise belonging to the resident for the purpose of processing by another person;

(d) the purchase of goods or merchandise, or the collection of information, for the resident; and

(e) advertising, the supply of information, scientific research or similar activities which have a preparatory or auxiliary character, for the resident.

7. A resident of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because such resident carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business**.**

8. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not constitute either company a permanent establishment of the other.

9. For the purposes of the Convention, the provisions of this Article shall be applied in determining whether any person has a permanent establishment in any State.

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| DATES OF HEARING: | May 9, 10 and 11, 2007 |
| REASONS FOR JUDGMENT BY: | The Honourable Justice Campbell J. Miller |
| DATE OF JUDGMENT: | May 16, 2008 |

APPEARANCES:

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| Counsel for the Appellant: | Salvatore Mirandola |
| Counsel for the Respondent: | Marie-Thérèse Boris |

COUNSEL OF RECORD:

For the Appellant:

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|---|---|
| Name: | Salvatore Mirandola |
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| For the Respondent: | John H. Sims, Q.C.<br>Deputy Attorney General of Canada<br>Ottawa, Canada |