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**Committee of Experts on International  
Cooperation in Tax Matters  
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Item 3 (b) of the provisional agenda

**Update of the UN Model Double Taxation Convention between Developed and  
Developing Countries - Permanent Establishment**

*Summary*

This note contains a number of possible changes to the Commentary to Article 5 of the UN Model for the Committee to consider for the next update of the UN Model. The proposed changes aim to achieve two objectives.

First, in its efforts to revise Article 5 and its Commentaries for the 2017 UN Model update, the former Committee prioritized adopting the changes to the OECD Model and Commentary that resulted from the Action 7 work of the BEPS project. Prior to initiating the BEPS work, the OECD's Working Party 1 had developed a number of Article 5 Commentary changes unrelated to Action 7, several of which were finalized and incorporated into the 2017 OECD Model Commentary. Unfortunately, due to time constraints, the former Committee did not have an opportunity to consider these changes for possible adoption into the UN Model. This note presents most of those changes for the current Committee to discuss.

Second, this note aims to update the numbering of the quoted paragraphs of the OECD Model Commentaries. The current UN Commentary adopts quotes from various iterations of the OECD Model, and the numbering can be confusing to readers. This renumbering exercise would conform the quotations in the UN Commentary to the current OECD Commentary.

On February 20, 2019, this note was circulated for comment by the Secretariat to the Subcommittee in charge of the next revision of the UN Model. Comments were received from one Member of the Subcommittee. Those comments are shown in the text boxes that explain each proposal, along with preliminary responses that are intended to facilitate discussion of the note at the Subcommittee's meeting on April 22.

## Article 5

### PERMANENT ESTABLISHMENT

#### A. GENERAL CONSIDERATIONS

1. Article 5 of the United Nations Model Convention is based on Article 5 of the OECD Model Convention but contains several significant differences. In essence these are that under the United Nations Model Convention:

- there is a six-month test for a building or construction site constituting a permanent establishment, rather than the twelve-month test under the OECD Model Convention, and it expressly extends to assembly projects, as well as supervisory activities in connection with building sites and construction, assembly or installation projects (paragraph 3 (a));
- the furnishing of services by an enterprise through employees or other personnel results in a permanent establishment where such activities continue for a total of more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned (paragraph 3 (b));
- Article 14 (Independent personal services) has been retained, whereas in the OECD Model Convention, Article 14 has been deleted, and Article 5 addresses cases that were previously considered under the “fixed base” test of that Article. As noted below (in paragraph 15.1 and thereafter), while the United Nations Model Convention has retained Article 14, the present Commentary provides guidance for those countries not wishing to have such an article in their bilateral tax agreements;
- in the list of what is deemed not to constitute a permanent establishment in paragraph 4 (often referred to as the list of “preparatory and auxiliary activities”) “delivery” is not mentioned in the United Nations Model Convention but is mentioned in the OECD Model Convention. Therefore, a delivery activity might result in a permanent establishment under the United Nations Model Convention, without doing so under the OECD Model Convention;
- the actions of a “dependent agent” may constitute a permanent establishment, even without having and habitually exercising the authority to conclude contracts in the name of the enterprise, where that person habitually maintains a stock of goods or merchandise and regularly makes deliveries from the stock (paragraph 5 (b));
- there is a special provision specifying when a permanent establishment is created in the case of an insurance business; consequently, a permanent establishment is more likely to exist under the United Nations Model Convention approach (paragraph 6); and

These differences are considered in more detail below.

2. The concept of “permanent establishment” is used in bilateral tax treaties to determine the right of a State to tax the profits of an enterprise of the other State. Specifically, the profits of an enterprise of one State are taxable in the other State only if the enterprise maintains a permanent establishment in the latter State and only to the extent that the profits are attributable to the permanent establishment. The concept of permanent establishment is found in the early model conventions including the 1928 model conventions of the League of Nations. The United Nations Model Convention reaffirms the concept.

## B. COMMENTARY ON THE PARAGRAPHS OF ARTICLE 5

### *Paragraph 1*

3. This paragraph, which reproduces Article 5, paragraph 1 of the OECD Model Convention, defines the term “permanent establishment”, emphasizing its essential nature as a “fixed place of business” with a specific “situs”. According to paragraph 2 of the OECD Model Commentary, this definition contains the following conditions:

- 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;
- 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.

The OECD Model Commentary goes on to observe:

[37](#). It could perhaps be argued that in the general definition some mention should also be made of the other characteristic of a permanent establishment to which some importance has sometimes been attached in the past, namely that the establishment must have a productive character, *i.e.* contribute to the profits of the enterprise. In the present definition this course has not been taken. Within the framework of a well-run business organisation it is surely axiomatic to assume that each part contributes to the productivity of the whole. It does not, of course, follow in every case that because in the wider context of the whole organisation a particular establishment has a “productive character” it is consequently a permanent establishment to which profits can properly be attributed for the purpose of tax in a particular territory (see Commentary on paragraph 4).

EXPLANATION: This is merely a paragraph numbering change to conform to the current OECD Model Commentary.

[8](#). It is also important to note that the way in which business is carried on evolves over the years so that the facts and arrangements applicable at one point in time may no longer be relevant after a change in the way that the business activities are carried on in a given State. Clearly, whether or not a permanent establishment exists in a State during a given period must be determined on the basis of the circumstances applicable during that period and not those applicable during a past or future period, such as a period preceding the adoption of new arrangements that modified the way in which business is carried on.

EXPLANATION: Paragraph 8 above is one of the Commentary changes that WP1 had developed before the Action 7 work began. It was drafted to address PE issues related to so-called business restructurings where assets, risks or functions may be managed or

performed by a converted local entity. WP1 concluded that no distinction should be made when applying Article 5 based on whether or not the facts and arrangements relevant to the determination of a PE resulted from a business restructuring, and that the universal concepts should apply, namely – are the premises of the local entity at the disposal of the foreign enterprise and is the business of the foreign enterprise carried on through the local entity.

Paragraph 8 does not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance and wishes to quote it in the UN Model.

**COMMENTS RECEIVED:**

“The paragraph is not confined to situations of business restructurings alone but is of general applicability that facts and circumstances applicable during past or future be not reckoned for deciding existence of PE. There may be situations requiring taking into account circumstances and facts in past or future. For instance, Article 3(b) of UN Model takes into account period before or after the fiscal year for which determination of Service PE is being made. Service PE concept is not there in OECD MTC. Quoting para 8 in UN MTC Commentary may not be done to avoid conflict or ambiguity.”

**RESPONSE:** The comment received raises a technically valid point. However, paragraph 8 of the OECD Commentary is intended to be an interpretation of Article 5(1). As a possible way forward, the Subcommittee may wish to discuss whether, as a policy matter, it is in agreement with principles of Commentary paragraph 8 for the purposes of interpreting Article 5(1) of the UN Model. If the Subcommittee does so agree, the UN Commentary could explain in a sentence that the Committee agrees with paragraph 8 only in the context of interpreting Article 5(1) of the Model.

[9. Also, the determination of whether or not an enterprise of a Contracting State has a permanent establishment in the other Contracting State must be made independently from the determination of which provisions of the Convention apply to the profits derived by that enterprise. For instance, a farm or apartment rental office situated in a Contracting State and exploited by a resident of the other Contracting State may constitute a permanent establishment regardless of whether or not the profits attributable to such permanent establishment would constitute income from immovable property covered by Article 6; whilst the existence of a permanent establishment in such cases may not be relevant for the application of Article 6, it would remain relevant for the purposes of other provisions such as paragraphs 4 and 5 of Article 11, subparagraph c\) of paragraph 2 of Article 15 and paragraph 3 of Article 24.](#)

**EXPLANATION:** Paragraph 9 above is one of the Commentary changes that WP1 had developed before the Action 7 work began. The intent of the paragraph is to clarify that it is irrelevant which Article of the Convention applies to tax the profits of an enterprise when determining whether that enterprise has a PE.

Paragraph 9 does not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance and wishes to quote it in the UN Model.

**COMMENTS RECEIVED:**

“Determination of PE independent of nature of income is the principle laid in this para. Purpose is stated to be for application of Article 11(5,6), 15(2)© and 24(3). As per Art 11(4), carrying on of business through the PE to which debt claim is effectively connected is the condition for application of Art 7 instead of Art 11(1&2). Even if a PE is determined for a farm irrespective of nature of income falling under Article 6, application of Article 7 may not be possible for interest income as per Art 11(4) if income is falling under Article 6. The reason for determination of PE independently of what would be nature of income through it is hence not clear. Quoting this para in UN MTC Commentary is hence not suggested.”

**RESPONSE:** The value added by OECD Commentary paragraph 9 is to refute arguments that a permanent establishment cannot exist if the taxation of the relevant income is not governed by Article 7. The example given is that of a farm that derives income from agriculture falling under Article 6. Commentary paragraph 9 makes clear that even though the taxation of the income is governed by Article 6, the farm may nevertheless constitute a permanent establishment if it satisfies the definition in Article 5, and that the PE determination may be relevant for applying other provisions of the Convention. In the example of interest paid to a farm put forth in the above comments, Commentary paragraph 9 would provide that the interest, being attributable to a PE, would be taxed under Article 7, by virtue of Article 11(4). Article 7(6) would then apply to resolve any conflicts between Articles 6 (if, for instance, the interest is characterized as income from agriculture falling under Article 6) and 7. If, on the other hand paragraph 9 is not adopted, the argument that the farm may be precluded from being considered a PE is not clearly rejected. In such a case, the two potentially applicable Articles of the treaty would be Articles 6 and 11, and there is no rule to resolve that conflict. Therefore, it would seem desirable to clarify that the farm is a PE so that Article 7 may apply in case the interest is not “income from agriculture” and, if it is indeed “income from agriculture,” Article 6 would prevail over Article 7 (whereas it is less clear that it would prevail over Article 11).

**410.** 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 enterprise. A place of business may thus be constituted by a pitch in a 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.

~~4.1~~11. As noted above, the mere fact that an enterprise has a certain amount of space at its disposal which is used for business activities is sufficient to constitute a place of business. No formal legal right to use that place is therefore required. Thus, for instance, a permanent establishment could exist where an enterprise illegally occupied a certain location where it carried on its business.

EXPLANATION: This is merely a paragraph numbering change to conform to the current OECD Model Commentary.

~~4.2~~12. Whilst no formal legal right to use a particular place is required for that place to constitute a permanent establishment, the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise. *Whether a location may be considered to be at the disposal of an enterprise in such a way that it may constitute a “place of business through which the business of [that] enterprise is wholly or partly carried on” will depend on that enterprise having the effective power to use that location as well as the extent of the presence of the enterprise at that location and the activities that it performs there. This is illustrated by the following examples. Where an enterprise has an exclusive legal right to use a particular location which is used only for carrying on that enterprise’s own business activities (e.g. where it has legal possession of that location), that location is clearly at the disposal of the enterprise. This will also be the case where an enterprise is allowed to use a specific location that belongs to another enterprise or that is used by a number of enterprises and performs its business activities at that location on a continuous basis during an extended period of time. This will not be the case, however, where the enterprise’s presence at a location is so intermittent or incidental that the location cannot be considered a place of business of the enterprise (e.g. where employees of an enterprise have access to the premises of associated enterprises which they often visit but without working in these premises for an extended period of time). Where an enterprise does not have a right to be present at a location and, in fact, does not use that location itself, that location is clearly not at the disposal of the enterprise; thus, for instance, it cannot be considered that a plant that is owned and used exclusively by a supplier or contract-manufacturer is at the disposal of an enterprise that will receive the goods produced at that plant merely because all these goods will be used in the business of that enterprise (see also paragraphs 65, 66 and 121 below). It is also important to remember that even if a place is a place of business through which the activities of an enterprise are partly carried on, that place will be deemed not to be a permanent establishment if paragraph 4 applies to the business activities carried on at that place.* [the rest of prior paragraph 4.2 is moved to new paragraphs 13 and 4]

13. These principles are illustrated by the following *additional* examples where representatives of one enterprise are present on the premises of another enterprise.

14. A first example is that of a salesman who regularly visits a major customer to take orders and meets the purchasing director in his office to do so. In that case, the customer’s premises are not at the disposal of the enterprise for which the salesman is working and therefore do not constitute a ~~fixed~~ place of business through which the business of that enterprise is carried on

(depending on the circumstances, however, paragraph 5 could apply to deem a permanent establishment to exist).

Paragraphs 12-14 above are revisions to prior paragraph 4.2. New paragraph 12 provides additional guidance including through an example to the concept of a place of business being at the disposal of an enterprise.

The revised paragraphs do not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance. If so, quoted paragraph 4.2 should be deleted and replaced with new paragraphs 12-14.

COMMENTS RECEIVED:

It will be difficult to draw a line how intermittent presence at a location should be to regard it as a place of business. It will depend on facts and circumstances of each case. This part is hence suggested to be not quoted.

RESPONSE: The above comment is with regard to the fifth sentence of OECD Commentary paragraph 12, which reads as follows: “This will not be the case, however, where the enterprise’s presence at a location is so intermittent or incidental that the location cannot be considered a place of business of the enterprise (e.g. where employees of an enterprise have access to the premises of associated enterprises which they often visit but without working in these premises for an extended period of time).” The Subcommittee should determine how widely held the view expressed in the comment is within the Subcommittee. If that view is held only by a small number of Subcommittee members, then assuming the same is true for the full Committee, a possible way forward could be to quote the OECD Commentary while also expressing the dissenting view of a minority of Committee members. Moreover, the administrative difficulty of where to “draw a line” arguably exists as a general matter for the interpretation of Article 5 paragraph 1.

COMMENTS RECEIVED:

India Position on this OECD Commentary is of disagreement. (See SI 54 of Position on page 623 of OECD MTC. This sentence is not suggested to be quoted in UN MTC Commentary

RESPONSE: The above comment is with regard to the sixth sentence of OECD Commentary paragraph 12, which reads as follows: “Where an enterprise does not have a right to be present at a location and, in fact, does not use that location itself, that location is clearly not at the disposal of the enterprise; thus, for instance, it cannot be considered that a plant that is owned and used exclusively by a supplier or contract-manufacturer is at the disposal of an enterprise that will receive the goods produced at that plant merely because all these goods will be used in the business of that enterprise(see also paragraphs 65, 66 and 121 below).” The Subcommittee should determine how widely held the view expressed in the comment is within the Subcommittee. If that view is held only by a small number of Subcommittee members, then assuming the same is true for the full Committee,

a possible way forward could be to quote the OECD Commentary while also expressing the dissenting view of a minority of Committee members.

[4.3.15](#). A second example is that of an employee of a company who, for a long period of time, is allowed to use an office in the headquarters of another company (e.g. a newly acquired subsidiary) in order to ensure that the latter company complies with its obligations under contracts concluded with the former company. In that case, the employee is carrying on activities related to the business of the former company and the office that is at his disposal at the headquarters of the other company will constitute a permanent establishment of his employer, provided that the office is at his disposal for a sufficiently long period of time so as to constitute a “fixed place of business” (see paragraphs [6-28](#) to [6-334](#)) and that the activities that are performed there go beyond the activities referred to in paragraph 4 of the Article.

[4.4.16](#). A third example is that of a road transportation enterprise which would use a delivery dock at a customer’s warehouse every day for a number of years for the purpose of delivering goods purchased by that customer. In that case, the presence of the road transportation enterprise at the delivery dock would be so limited that that enterprise could not consider that place as being at its disposal so as to constitute a permanent establishment of that enterprise.

[4.5.17](#). A fourth example is that of a painter who, for two years, spends three days a week in the large office building of its main client. In that case, the presence of the painter in that office building where he is performing the most important functions of his business (i.e. painting) constitute a permanent establishment of that painter.

EXPLANATION: This is merely a paragraph numbering change to conform to the current OECD Model Commentary. New paragraph 15 above contains a few updated cross references to paragraphs that are already quoted in the UN Model, but which will need to be renumbered to synch with the current OECD Commentary.

[18. Even though part of the business of an enterprise may be carried on at a location such as an individual’s home office, that should not lead to the automatic conclusion that that location is at the disposal of that enterprise simply because that location is used by an individual \(e.g. an employee\) who works for the enterprise. Whether or not a home office constitutes a location at the disposal of the enterprise will depend on the facts and circumstances of each case. In many cases, the carrying on of business activities at the home of an individual \(e.g. an employee\) will be so intermittent or incidental that the home will not be considered to be a location at the disposal of the enterprise \(see paragraph 12 above\). Where, however, a home office is used on a continuous basis for carrying on business activities for an enterprise and it is clear from the facts and circumstances that the enterprise has required the individual to use that location to carry on the enterprise’s business \(e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office\), the home office may be considered to be at the disposal of the enterprise.](#)

[19. A clear example is that of a non-resident consultant who is present for an extended period in a given State where she carries on most of the business activities of her own consulting enterprise from an office set up in her home in that State; in that case, that home office constitutes a location at the disposal of the enterprise. Where, however, a cross-frontier worker](#)



performs most of his work from his home situated in one State rather than from the office made available to him in the other State, one should not consider that the home is at the disposal of the enterprise because the enterprise did not require that the home be used for its business activities. It should be noted, however, that since the vast majority of employees reside in a State where their employer has at its disposal one or more places of business to which these employees report, the question of whether or not a home office constitutes a location at the disposal of an enterprise will rarely be a practical issue. Also, the activities carried on at a home office will often be merely auxiliary and will therefore fall within the exception of paragraph 4.

EXPLANATION: Paragraphs 18 and 19 above is one of the Commentary changes that WP1 had developed before the Action 7 work began. The intent of the paragraphs is to provide guidance including through an example of when the home office of an employee could constitute a PE of an enterprise.

The new paragraphs do not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance. If so, paragraphs 18 and 19 should be quoted in the UN Model.

COMMENTS RECEIVED:

In such a case, the home of employee can be considered as being at disposal of enterprise, for purpose of application of Article 5. India Position (SI No. 55/page 623/OECD MTC 2017) is also the same. For following sentences, it cannot be said that this issue would not arise if an enterprise has one or more places of business to which employees report. There can be exceptions. On the whole, except first sentence, para 19 is not suggested to be quoted in UN Commentary.

RESPONSE: The comment above is with regard to the second, third and fourth sentences of OECD Commentary Paragraph 19, which read as follows: “Where, however, a cross-frontier worker performs most of his work from his home situated in one State rather than from the office made available to him in the other State, one should not consider that the home is at the disposal of the enterprise because the enterprise did not require that the home be used for its business activities. It should be noted, however, that since the vast majority of employees reside in a State where their employer has at its disposal one or more places of business to which these employees report, the question of whether or not a home office constitutes a location at the disposal of an enterprise will rarely be a practical issue. Also, the activities carried on at a home office will often be merely auxiliary and will therefore fall within the exception of paragraph 4.” The Subcommittee should determine how widely held the view expressed in the comment is within the Subcommittee. If that view is held only by a small number of Subcommittee members, then assuming the same is true for the full Committee, a possible way forward could be to quote the OECD Commentary while also expressing the dissenting view of a minority of Committee members.

4.620. The words “through which” must be given a wide meaning so as to apply to any situation where business activities are carried on at a particular location that is at the disposal

of the enterprise for that purpose. Thus, for instance, an enterprise engaged in paving a road will be considered to be carrying on its business “through” the location where this activity takes place.

[215](#). According to the definition, the place of business has to be a “fixed” one. Thus, in the normal way there has to be a link between the place of business and a specific geographical point. It is immaterial how long an enterprise of a Contracting State operates in the other Contracting State if it does not do so at a distinct place, but this does not mean that the equipment constituting the place of business has to be actually fixed to the soil on which it stands. It is enough that the equipment remains on a particular site (but see paragraph [20-57](#) below).

[5.122](#). Where the nature of the business activities carried on by an enterprise is such that these activities are often moved between neighbouring locations, there may be difficulties in determining whether there is a single “place of business” (if two places of business are occupied and the other requirements of Article 5 are met, the enterprise will, of course, have two permanent establishments). As recognised in paragraphs [18-51](#) and [20-57](#) below a single place of business will generally be considered to exist where, in light of the nature of the business, a particular location within which the activities are moved may be identified as constituting a coherent whole commercially and geographically with respect to that business.

[5.223](#). This principle may be illustrated by examples. A mine clearly constitutes a single place of business even though business activities may move from one location to another in what may be a very large mine as it constitutes a single geographical and commercial unit as concerns the mining business. Similarly, an “office hotel” in which a consulting firm regularly rents different offices may be considered to be a single place of business of that firm since, in that case, the building constitutes a whole geographically and the hotel is a single place of business for the consulting firm. For the same reason, a pedestrian street, outdoor market or fair in different parts of which a trader regularly sets up his stand represents a single place of business for that trader.

The OECD Commentary then examines some examples relating to the provision of services. In quoting the following two paragraphs, the Committee notes that Article 5, paragraph 3, subparagraph (b) of the United Nations Model Convention provides a specific provision in relation to furnishing of services by an enterprise through employees or personnel engaged for that purpose. In practice, therefore, the points made in paragraphs [5.324](#) and [5.425](#) of the OECD Commentary (as with other parts of the OECD Commentary to Article 5, paragraph 1) may have less significance for the United Nations Model Convention than in their original context.

[5.324](#). By contrast, where there is no commercial coherence, the fact that activities may be carried on within a limited geographic area should not result in that area being considered as a single place of business. For example, where a painter works successively under a series of unrelated contracts for a number of unrelated clients in a large office building so that it cannot be said that there is one single project for repainting the building, the building should not be regarded as a single place of business for the purpose of that work. However, in the different example of a painter who, under a single contract, undertakes work throughout a building for a single client, this constitutes a single project for that painter and the building as a whole can then be regarded as a single place of business for the purpose of that work as it would then constitute a coherent whole commercially and geographically.

5.425. Conversely, an area where activities are carried on as part of a single project which constitutes a coherent commercial whole may lack the necessary geographic coherence to be considered as a single place of business. For example, where a consultant works at different branches in separate locations pursuant to a single project for training the employees of a bank, each branch should be considered separately. However, if the consultant moves from one office to another within the same branch location, he should be considered to remain in the same place of business. The single branch location possesses geographical coherence which is absent where the consultant moves between branches in different locations.

EXPLANATION: The above changes are merely paragraph numbering change to conform to the current OECD Model Commentary. The cross references to paragraphs 51 and 57 are not problematic because those paragraphs have already been quoted in the UN Commentary.

The OECD Commentary then continues:

26. A ship that navigates in international waters or within one or more States is not fixed and does not, therefore, constitute a fixed place of business (unless the operation of the ship is restricted to a particular area that has commercial and geographic coherence). Business activities carried on aboard such a ship, such as the operation of a shop or restaurant, must be treated the same way for the purposes of determining whether paragraph 1 applies (paragraph 5 could apply, however, to some of these activities, e.g. where contracts are concluded when such shops or restaurants are operated within a State).

EXPLANATION: Paragraph 26 above is one of the Commentary changes that WP1 had developed before the Action 7 work began. The intent of the paragraphs is to provide guidance regarding the question of whether a ship in international waters can constitute a fixed place of business.

This paragraph does not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance. If so, paragraph 26 should be quoted in the UN Model.

628. Since the place of business must be fixed, it also follows that a permanent establishment can be deemed to exist only if the place of business has a certain degree of permanency, *i.e.* if it is not of a purely temporary nature. A place of business may, however, constitute a permanent establishment even though it exists, in practice, only for a very short period of time because the nature of the business is such that it will only be carried on for that short period of time. It is sometimes difficult to determine whether this is the case. Whilst the practices followed by member countries have not been consistent in so far as time requirements are concerned, experience has shown that permanent establishments normally have not been considered to exist in situations where a business had been carried on in a country through a place of business that was maintained for less than six months (conversely, practice shows

that there were many cases where a permanent establishment has been considered to exist where the place of business was maintained for a period longer than six months). *[the rest of the paragraph is moved to new paragraphs 29 to 31]*

29. One exception to *this general practice* has been where the activities were of a recurrent nature; in such cases, each period of time during which the place is used needs to be considered in combination with the number of times during which that place is used (which may extend over a number of years). *That exception is illustrated by the following example. An enterprise of State R carries on drilling operations at a remote arctic location in State S. The seasonal conditions at that location prevent such operations from going on for more than three months each year but the operations are expected to last for five years. In that case, given the nature of the business operations at that location, it could be considered that the time requirement for a permanent establishment is met due to the recurring nature of the activity regardless of the fact that any continuous presence lasts less than six months; the time requirement could similarly be met in the case of shorter recurring periods of time that would be dictated by the specific nature of the relevant business.*

30. Another exception to this *general* practice has been made where activities constituted a business that was carried on exclusively in that country; in this situation, the business may have short duration because of its nature but since it is wholly carried on in that country, its connection with that country is stronger. *That exception is illustrated by the following example. An individual resident of State R has learned that a television documentary will be shot in a remote village in State S where her parents still own a large house. The documentary will require the presence of a number of actors and technicians in that village during a period of four months. The individual contractually agrees with the producer of the documentary to provide catering services to the actors and technicians during the four month period and, pursuant to that contract, she uses the house of her parents as a cafeteria that she operates as sole proprietor during that period. These are the only business activities that she has carried on and the enterprise is terminated after that period; the cafeteria will therefore be the only location where the business of that enterprise will be wholly carried on. In that case, it could be considered that the time requirement for a permanent establishment is met since the restaurant is operated during the whole existence of that particular business. This would not be the situation, however, where a company resident of State R which operates various catering facilities in State R would operate a cafeteria in State S during a four-month production of a documentary. In that case, the company's business, which is permanently carried on in State R, is only temporarily carried on in State S.*

31. For ease of administration, countries may want to consider these practices *reflected in paragraphs 28 to 30* when they address disagreements as to whether a particular place of business that exists only for a short period of time constitutes a permanent establishment.

EXPLANATION: WP1 had developed the changes above before the Action 7 work began. The changes update prior paragraph 6, which is quoted in the UN Commentary. The revisions are intended to provide additional guidance, including through examples, of how and when activities of a recurring nature constitute a fixed place of business.

These changes do not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance. If so, the quote of prior paragraph 6 should be replaced with a quotation of the above paragraphs 28-31.

COMMENTS RECEIVED:

Operation of catering facilities in this example meets the time requirement for constituting a PE. See India Position also (Para 56/Page 623, OECD MTC 2017).

Last two sentences are not suggested to be quoted in UN MTC.

RESPONSE: The comment above is with regard to the final two sentences of OECD Commentary paragraph 30, which read as follows:—<sup>44</sup>: “This would not be the situation, however, where a company resident of State R which operates various catering facilities in State R would operate a cafeteria in State S during a four month production of a documentary. In that case, the company’s business, which is permanently carried on in State R, is only temporarily carried on in State S.” The Subcommittee should determine how widely held the view expressed in the comment is within the Subcommittee. If that view is held only by a small number of Subcommittee members, then assuming the same is true for the full Committee, a possible way forward could be to quote the OECD Commentary while also expressing the dissenting view of a minority of Committee members.

~~One exception has been where the activities were of a recurrent nature; in such cases, each period of time during which the place is used needs to be considered in combination with the number of times during which that place is used (which may extend over a number of years). Another exception has been made where activities constituted a business that was carried on exclusively in that country; in this situation, the business may have short duration because of its nature but since it is wholly carried on in that country, its connection with that country is stronger. For ease of administration, countries may want to consider these practices when they address disagreements as to whether a particular place of business that exists only for a short period of time constitutes a permanent establishment.~~

The Committee agrees with the approach taken in paragraph 6 of the OECD Commentary, while recognizing that such exceptional situations will not often arise in practice, and that special care should therefore be taken when relying on paragraph 6 as applicable in an actual case. The OECD Commentary continues:

~~6.132.~~ As mentioned in paragraphs ~~11 and 19~~<sup>44 and 55</sup>, temporary interruptions of activities do not cause a permanent establishment to cease to exist. Similarly, as discussed in paragraph 6, where a particular place of business is used for only very short periods of time, but such

usage takes place regularly over long periods of time, the place of business should not be considered to be of a purely temporary nature.

~~6.2~~33. Also, there may be cases where a particular place of business would be used for very short periods of time by a number of similar businesses carried on by the same or related persons in an attempt to avoid that the place be considered to have been used for more than purely temporary purposes by each particular business. The remarks of paragraphs 52 and 53 ~~18~~ on arrangements intended to abuse the [six] month period provided for in paragraph 3 would equally apply to such cases.

~~6.3~~34. Where a place of business which was, at the outset, designed to be used for such a short period of time that it would not have constituted a permanent establishment but is in fact maintained for such a period that it can no longer be considered as a temporary one, it becomes a fixed place of business and thus—retrospectively—a permanent establishment. A place of business can also constitute a permanent establishment from its inception even though it existed, in practice, for a very short period of time, if as a consequence of special circumstances (*e.g.* death of the taxpayer, investment failure), it was prematurely liquidated.

~~7~~35. For a place of business to constitute a permanent establishment the enterprise using it must carry on its business wholly or partly through it. As stated in paragraph ~~3-7~~ above, the activity need not be of a productive character. Furthermore, the activity need not be permanent in the sense that there is no interruption of operation, but operations must be carried out on a regular basis.

~~8~~36. Where tangible property such as facilities, industrial, commercial or scientific (ICS) equipment, buildings, or intangible property such as patents, procedures and similar property, are let or leased to third parties through a fixed place of business maintained by an enterprise of a Contracting State in the other State, this activity will, in general, render the place of business a permanent establishment. The same applies if capital is made available through a fixed place of business. If an enterprise of a State lets or leases facilities, ICS equipment, buildings or intangible property to an enterprise of the other State without maintaining for such letting or leasing activity a fixed place of business in the other State, the leased facility, ICS equipment, building or intangible property, as such, will not constitute a permanent establishment of the lessor provided the contract is limited to the mere leasing of the ICS equipment etc. This remains the case even when, for example, the lessor supplies personnel after installation to operate the equipment provided that their responsibility is limited solely to the operation or maintenance of the ICS equipment under the direction, responsibility and control of the lessee. If the personnel have wider responsibilities, for example participation in the decisions regarding the work for which the equipment is used, or if they operate, service, inspect and maintain the equipment under the responsibility and control of the lessor, the activity of the lessor may go beyond the mere leasing of ICS equipment and may constitute an entrepreneurial activity. In such a case a permanent establishment could be deemed to exist if the criterion of permanency is met. When such activity is connected with, or is similar in character to, those mentioned in paragraph 3, the time limit of [six] months applies. Other cases have to be determined according to the circumstances.

EXPLANATION: The above changes are merely paragraph numbering change to conform to the current OECD Model Commentary. Paragraph 44 is already quoted in the UN Commentary as paragraph 11. The Committee will need to discuss whether to quote
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paragraph 55, which deals with how to take into account days of activity by an enterprise, either through employees or subcontractors, at a construction site, even after the construction has been completed and the site delivered to the customer. Paragraphs 52 and 53 are already quoted in the UN Commentary. Paragraph 7 is already quoted in the UN Commentary as paragraph 3.

3409. *There are different ways in which an enterprise may carry on its business. In most cases, 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 of the enterprise (see paragraph 10035 below). [the rest of the existing paragraph 10 is moved to new paragraph 41] As explained in paragraph 8.11 of the Commentary on Article 15, however, there may be cases where individuals who are formally employed by an enterprise will actually be carrying on the business of another enterprise and where, therefore, the first enterprise should not be considered to be carrying on its own business at the location where these individuals will perform that work. Within a multinational group, it is relatively common for employees of one company to be temporarily seconded to another company of the group and to perform business activities that clearly belong to the business of that other company. In such cases, administrative reasons (e.g. the need to preserve seniority or pension rights) often prevent a change in the employment contract. The analysis described in paragraphs 8.13 to 8.15 of the Commentary on Article 15 will be relevant for the purposes of distinguishing these cases from other cases where employees of a foreign enterprise perform that enterprise's own business activities.*

40. *An enterprise may also carry on its business through subcontractors, acting alone or together with employees of the enterprise. In that case, a permanent establishment will only exist for the enterprise if the other conditions of Article 5 are met (this, however, does not address the separate question of how much profit is attributable to such a permanent establishment). In the context of paragraph 1, the existence of a permanent establishment in these circumstances will require that these subcontractors perform the work of the enterprise at a fixed place of business that is at the disposal of the enterprise. Whether a fixed place of business where subcontractors perform work of an enterprise is at the disposal of that enterprise will be determined on the basis of the guidance in paragraph 12; in the absence of employees of the enterprise, however, it will be necessary to show that such a place is at the disposal of the enterprise on the basis of other factors showing that the enterprise clearly has the effective power to use that site, e.g. because the enterprise owns or has legal possession of that site and controls access to and use of the site. Paragraph 54 illustrates such a situation in the case of a construction site; this could also happen in other situations. An example would be where an enterprise that owns a small hotel and rents out the hotel's rooms through the Internet has subcontracted the on-site operation of the hotel to a company that is remunerated on a cost-plus basis.*

41. ~~But a~~ *Also, a permanent establishment may 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.*

EXPLANATION: WP1 had developed the changes above before the Action 7 work began. New paragraphs 39-41 are a revision of prior paragraph 10. The new paragraphs are intended to provide clarification regarding the issue of when an enterprise should be considered as carrying on its business through the activities of subcontractors.

With respect to the cross references, paragraph 100 has not yet been quoted in the UN Commentary, and that will need to be resolved. Paragraphs 8.13-8.15 of the OECD Commentary to Article 15 have already been quoted by the UN Model. The prior version of paragraph 12 (formerly numbered as 4.2) has also already been quoted by the UN Model. Paragraph 54 is also already quoted in the UN Commentary under its prior number 19.

The new paragraphs do not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance and wishes to quote them in the UN Model.

COMMENTS RECEIVED:

If the business of enterprise is to set up such vending machines and derive rental income, in such situation, it may still constitute a PE. Also see India Position (para 27/page 620 on OECD Commentary on Art 5). This sentence may not be quoted in UN MTC Commentary.

RESPONSE: The comment above is with regard to the third sentence in OECD Commentary paragraph 41, which reads as follows: “A permanent establishment does not exist if the enterprise merely sets up the machines and then leases the machines to other enterprises.” The Subcommittee should determine how widely held the view expressed in the comment is within the Subcommittee. If that view is held only by a small number of Subcommittee members, then assuming the same is true for the full Committee, a possible way forward could be to quote the OECD Commentary while also expressing the dissenting view of a minority of Committee members.

42. *It follows from the definition of “enterprise of a Contracting State” in Article 3 that this term, as used in Article 7, and the term “enterprise” used in Article 5, refer to any form of*



enterprise carried on by a resident of a Contracting State, whether this enterprise is legally set up as a company, partnership, sole proprietorship or other legal form. Different enterprises may collaborate on the same project and the question of whether their collaboration constitutes a separate enterprise (e.g. in the form of a partnership) is a question that depends on the facts and the domestic law of each State. Clearly, if two persons each carrying on a separate enterprise decide to form a company in which these persons are shareholders, the company constitutes a legal person that will carry on what becomes another separate enterprise. It will often be the case, however, that different enterprises will simply agree to each carry on a separate part of the same project and that these enterprises will not jointly carry on business activities, will not share the profits thereof and will not be liable for each other's activities related to that project even though they may share the overall output from the project or the remuneration for the activities that will be carried on in the context of that project. In such a case, it would be difficult to consider that a separate enterprise has been set up. Although such an arrangement would be referred to as a "joint venture" in many countries, the meaning of "joint venture" depends on domestic law and it is therefore possible that, in some countries, the term "joint venture" would refer to a distinct enterprise.

43. In the case of an enterprise that takes the form of a fiscally transparent partnership, the enterprise is carried on by each partner and, as regards the partners' respective shares of the profits, is therefore an enterprise of each Contracting State of which a partner is a resident. If such a partnership has a permanent establishment in a Contracting State, each partner's share of the profits attributable to the permanent establishment will therefore constitute, for the purposes of Article 7, profits derived by an enterprise of the Contracting State of which that partner is a resident (see also paragraph 56 below).

EXPLANATION: WP1 had developed the changes above before the Action 7 work began. New paragraph 42 is intended to provide clarification regarding the issue of when two enterprises that may be collaborating in a business capacity should be viewed as creating a single enterprise of a Contracting State. New paragraph 43 clarifies the application Articles 5 and 7 when the enterprise takes the form of a fiscally transparent entity such as a partnership.

With respect to the cross references, a previous version of paragraph 56, numbered 19.1, has already been quoted. The Committee will need to consider new paragraph 56 as part of deciding whether to quote paragraph 43.

New paragraphs 42 and 43 does not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance and wishes to quote it in the UN Model.

COMMENTS RECEIVED:

Paras 42 and 43 may be discussed to see if these really add much clarity. Depending on that, decision to quote these may be taken.

~~H~~44. A permanent establishment begins to exist as soon as the enterprise commences to carry on its business through a fixed place of business. This is the case once the enterprise prepares, at the place of business, the activity for which the place of business is to serve permanently. The period of time during which the fixed place of business itself is being set up by the enterprise should not be counted, provided that this activity differs substantially from the activity for which the place of business is to serve permanently. The permanent establishment ceases to exist with the disposal of the fixed place of business or with the cessation of any activity through it, that is when all acts and measures connected with the former activities of the permanent establishment are terminated (winding up current business transactions, maintenance and repair of facilities). A temporary interruption of operations, however, cannot be regarded as a closure. If the fixed place of business is leased to another enterprise, it will normally only serve the activities of that enterprise instead of the lessors; in general, the lessors permanent establishment ceases to exist, except where he continues carrying on a business activity of his own through the fixed place of business.

EXPLANATION: The above change is merely paragraph numbering change to conform to the current OECD Model Commentary.

3.1 In 2017, a number of changes were made to Article 5 and, consequently, to this Commentary. Changes related to the addition of paragraph 4.1 and the modification of paragraphs 4, 5 and 6 of the Article that were made as a result of the adoption of the Report on Action 7 of the OECD/G20 Base Erosion and Profit Shifting Project are prospective only and, as such, do not affect the interpretation of the former provisions of the United Nations Model Tax Convention and of treaties in which these provisions are included, in particular as regards the interpretation of paragraphs 4 and 5 of the Article as they read before these changes.

### ***Paragraph 2***

4. Paragraph 2, which reproduces Article 5, paragraph 2 of the OECD Model Convention, lists examples of places that will often constitute a permanent establishment. However, the provision is not self-standing. While paragraph 2 notes that offices, factories, etc., are common types of permanent establishments, when one is looking at the operations of a particular enterprise, the requirements of paragraph 1 must also be met. Paragraph 2 therefore simply provides an indication that a permanent establishment may well exist; it does not provide that one necessarily does exist. This is also the stance of the OECD Model Commentary, where it is assumed that States interpret the terms listed “in such a way that such places of business constitute permanent establishments only if they meet the requirements of paragraph 1”. Developing countries often wish to broaden the scope of the term “permanent establishment” and some believe that a warehouse should be included among the specific examples. However, the deletion of “delivery” from the excluded activities described in subparagraphs (a) and (b) of paragraph 4 means that a “warehouse” used for any purpose is (subject to the conditions in paragraph 1 being fulfilled) a permanent establishment under the general principles of the Article. The OECD Commentary points out in paragraph ~~13~~46 that the term “place of

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management” is mentioned separately because it is not necessarily an “office” and that “where the laws of the two Contracting States do not contain the concept of a ‘place of management’ as distinct from an ‘office’, there will be no need to refer to the former term in their bilateral convention”.

5. In discussing subparagraph (f), which provides that the term “permanent establishment” includes mines, oil or gas wells, quarries or any other place of extraction of natural resources, the OECD Commentary states that “the term ‘any other place of extraction of natural resources’ should be interpreted broadly” to include, for example, all places of extraction of hydrocarbons whether on or offshore. Because subparagraph (f) does not mention exploration for natural resources, whether on or offshore, paragraph 1 governs whether exploration activities are carried on through a permanent establishment. The OECD Commentary states:

1548. [...] Since, however, it has not been possible to arrive at a common view on the basic questions of the attribution of taxation rights and of the qualification of the income from exploration activities, the Contracting States may agree upon the insertion of specific provisions. They may agree, for instance, that an enterprise of a Contracting State, as regards its activities of exploration of natural resources in a place or area in the other Contracting State:

- a) shall be deemed not to have a permanent establishment in that other State; or
- b) shall be deemed to carry on such activities through a permanent establishment in that other State; or
- c) shall be deemed to carry on such activities through a permanent establishment in that other State if such activities last longer than a specified period of time.

The Contracting States may moreover agree to submit the income from such activities to any other rule.

EXPLANATION: The above change is merely paragraph numbering change to conform to the current OECD Model Commentary.

6. As mentioned above, in subparagraph (f) the expression “any other place of extraction of natural resources” should be interpreted broadly. Some have argued that, for this purpose, a fishing vessel could be treated as a place of extraction or exploitation of natural resources since “fish” constitute a natural resource. In their analysis, although it is true that all places or apparatus designated as “permanent establishments” in subparagraphs (a) to (e) in paragraph 2 have a certain degree of permanence or constitute “immovable property”, fishing vessels can be considered as a place used for extraction of natural resources, which may not necessarily mean only minerals embedded in the earth. In this view, fishing vessels can be compared to the movable drilling platform that is used in offshore drilling operations for gaining access to oil or gas. Where such fishing vessels are used in the territorial waters or the exclusive economic zone of the coastal State, their activities would constitute a permanent establishment, situated in that State. However, others are of the view that such an interpretation was open to objection in that it constituted too broad a reading of the term “permanent establishment” and of the natural language of the subparagraph. Accordingly, in their opinion, any treaty partner countries which sought to advance such a proposition in

respect of fishing activities, should make that explicit by adopting it as a new and separate category in the list contained in this Article. Consequently, the interpretation on the nature of this activity has been left to negotiations between Contracting States so that, for example, countries which believe that a fishing vessel can be a permanent establishment might choose to make that explicit in this Article, such as by the approach outlined in paragraph 13 of this Commentary. The interpretation as to the nature of this activity would, therefore, be left to negotiations between Contracting States.

### ***Paragraph 3***

7. This paragraph covers a broader range of activities than Article 5, paragraph 3 of the OECD Model Convention, which states, “A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months”. In addition to the term “installation project” used in the OECD Model Convention, subparagraph (a) of paragraph 3 of the United Nations Model Convention includes an “assembly project” as well as “supervisory activities” in connection with “a building site, a construction, assembly or installation project”. Another difference is that while the OECD Model Convention uses a time limit of 12 months, the United Nations Model Convention reduces the minimum duration to six months. In special cases, this six-month period could be reduced in bilateral negotiations to not less than three months. The Committee notes that there are differing views about whether subparagraph (a) of paragraph 3 is a “self-standing” provision (so that no resort to paragraph 1 is required) or whether (in contrast) only building sites and the like that meet the criteria of paragraph 1 would constitute permanent establishments, subject to there being a specific six-month test. However, the Committee considers that where a building site exists for six months, it will in practice almost invariably also meet the requirements of paragraph 1. In fact, an enterprise having a building site, etc., at its disposal, through which its activities are wholly or partly carried on will also meet the criteria of paragraph 1.

8. Some countries support a more elaborate version of subparagraph (a) of paragraph 3, which would extend the provision to encompass a situation “where such project or activity, being incidental to the sale of machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or activities exceed 10 per cent of the sale price of the machinery or equipment”. Other countries believe that such a provision would not be appropriate, particularly if the machinery were installed by an enterprise other than the one doing the construction work.

9. Article 5, paragraph 3, subparagraph (b) deals with the furnishing of services, including consultancy services, the performance of which does not, of itself, create a permanent establishment in the OECD Model Convention. Many developing countries believe that management and consultancy services should be covered because the provision of those services in developing countries by enterprises of industrialized countries can generate large profits. In the 2011 revision of the United Nations Model Convention, the Committee agreed to a slight change in the wording of subparagraph (b) of paragraph 3, which was amended to read: “but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned”, rather than, “but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve-month

period”, as it formerly read. This was seen as providing greater consistency with the approach taken in Article 14, paragraph 1, subparagraph (b). In the 2017 revision the Committee made a further change to subparagraph (b) to remove the words in parenthesis “(for the same or a connected project)” altogether. This change is discussed in more detail in paragraph 12 below.

10. A few developing countries oppose the six-month (or 183 days) thresholds in subparagraphs (a) and (b) of paragraph 3 altogether. They have two main reasons: first, they maintain that construction, assembly and similar activities could, as a result of modern technology, be of very short duration and still result in a substantial profit for the enterprise; second, and more fundamentally, they simply believe that the period during which foreign personnel remain in the source country is irrelevant to their right to tax the income (as it is in the case of artistes and sportspersons under Article 17). Other developing countries oppose a time limit because it could be used by foreign enterprises to set up artificial arrangements to avoid taxation in their territory. However, the purpose of bilateral treaties is to promote international trade, investment, and development, and the reason for the time limit (indeed for the permanent establishment threshold more generally) is to encourage businesses to undertake preparatory or ancillary operations in another State that will facilitate a more permanent and substantial commitment later on, without becoming immediately subject to tax in that State.

11. In this connection, the 2017 OECD Model Commentary observes, with changes in parentheses to take account of the different time periods in the two Models:

51. The [six] month test applies to each individual site or project. In determining how long the site or project has existed, no account should be taken of the time previously spent by the contractor concerned on other sites or projects which are totally unconnected with it. A building site should be regarded as a single unit, even if it is based on several contracts, provided that it forms a coherent whole commercially and geographically. Subject to this proviso, a building site forms a single unit even if the orders have been placed by several persons (*e.g.* for a row of houses).

52. The [six] month threshold has given rise to abuses; it has sometimes been found that enterprises (mainly contractors or subcontractors working on the continental shelf or engaged in activities connected with the exploration and exploitation of the continental shelf) divided their contracts up into several parts, each covering a period less than [six] months and attributed to a different company, which was, however, owned by the same group. Apart from the fact that such abuses may, depending on the circumstances, fall under the application of legislative or judicial antiavoidance rules, these abuses could also be addressed through the application of the anti-abuse rule of paragraph 9 of Article 29, as shown by example J [and example N] in paragraph [182] of the Commentary on Article 29. Some States may nevertheless wish to deal expressly with such abuses. Moreover, States that do not include paragraph 9 of Article 29 in their treaties should include an additional provision to address contract splitting. Such a provision could, for example, be drafted along the following lines:

For the sole purpose of determining whether the [six] month period referred to in paragraph 3 has been exceeded,

- a) where an enterprise of a Contracting State carries on activities in the other Contracting State at a place that constitutes a building site or construction [,

assembly] or installation project [or supervisory activities in connection therewith] and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding [six] months, and

- b) connected activities are carried on at the same building site, or construction [, assembly] or installation project [or supervisory activities in connection therewith,] during different periods of time, each exceeding 30 days, by one or more enterprises closely related to the first-mentioned enterprise,

these different periods of time shall be added to the period of time during which the first-mentioned enterprise has carried on activities at that building site or construction [, assembly] or installation project [or supervisory activities in connection therewith].

The concept of “closely related enterprises” that is used in the above provision is defined in paragraph [9] of the Article (see paragraphs 119 to 121 below).

53. For the purposes of the alternative provision found in paragraph 52, the determination of whether activities are connected will depend on the facts and circumstances of each case. Factors that may especially be relevant for that purpose include:

- whether the contracts covering the different activities were concluded with the same person or related persons;
- whether the conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with that person or related persons;
- whether the activities would have been covered by a single contract absent tax planning considerations;
- whether the nature of the work involved under the different contracts is the same or similar;
- whether the same employees are performing the activities under the different contracts

The Committee points out that measures to counteract abuses would apply equally in cases under Article 5, paragraph 3, subparagraph (b). The anti-contract splitting rule provided in paragraph 52 of the OECD Commentary can be amended to also counteract abuses under subparagraph (b). A further possibility is to include the following text immediately after subparagraph (b), which is based on a similar provision found in the 2016 treaty between Chile and Japan, but utilizes the closely related enterprise wording contained in the OECD provision:

The duration of activities under subparagraphs (a) and (b) shall be determined by aggregating the periods during which activities are carried on in a Contracting State by closely related enterprises, provided that the activities of such a closely related enterprise in that Contracting State are connected with the activities carried on in that Contracting State by its closely related enterprises. The period during which two or more closely related enterprise are carrying on concurrent activities shall be counted only once for the purpose of determining the duration of activities.

The Commentary of the ~~2014~~ OECD Model Convention contains the following relevant passages:

~~19. A site exists from the date on which the contractor begins his work, including any preparatory work, in the country where the construction is to be established, e.g. if he installs a planning office for the construction. In general, it continues to exist until the work is completed or permanently abandoned. A site should not be regarded as ceasing to exist when work is temporarily discontinued. Seasonal or other temporary interruptions should be included in determining the life of a site. Seasonal interruptions include interruptions due to bad weather. Temporary interruption could be caused, for example, by shortage of material or labour difficulties. Thus, for example, if a contractor started work on a road on 1st May, stopped on 1st [August] because of bad weather conditions or a lack of materials but resumed work on 1st [October], completing the road on 1st [January the following year], his construction project should be regarded as a permanent establishment because [eight] months elapsed between the date he first commenced work (1st May) and the date he finally finished (1st [January] of the following year). If an enterprise (general contractor) which has undertaken the performance of a comprehensive project subcontracts parts of such a project to other enterprises (subcontractors), the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor on the building project. The subcontractor himself has a permanent establishment at the site if his activities there last more than [six] months.~~<sup>54</sup>. A site exists from the date on which the contractor begins his work, including any preparatory work, in the country where the construction is to be established, e.g. if he installs a planning office for the construction. [the six subsequent sentences have been moved to new paragraph 55] If an enterprise (general contractor) which has undertaken the performance of a comprehensive project subcontracts *all or* parts of such a project to other enterprises (subcontractors), the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor on the building project *for purposes of determining whether a permanent establishment exists for the general contractor. In that case, the site should be considered to be at the disposal of the general contractor during the time spent on that site by any subcontractor where circumstances indicate that, during that time, the general contractor clearly has the construction site at its disposal by reason of factors such as the fact that he has legal possession of the site, controls access to and use of the site and has overall responsibility for what happens at that location during that period.* The subcontractor himself has a permanent establishment at the site if his activities there last more than twelve months.

55. [previously included in paragraph 19] In general, it *a construction site* continues to exist until the work is completed or permanently abandoned. *The period during which the building or its facilities are being tested by the contractor or subcontractor should therefore generally be included in the period during which the construction site exists. In practice, the delivery of the building or facilities to the client will usually represent the end of the period of work, provided that the contractor and subcontractors no longer work on the site after its delivery for the purposes of completing its construction.* A site should not be regarded as ceasing to exist when work is temporarily discontinued. Seasonal or other temporary interruptions should be included in determining the life of a site. Seasonal interruptions include interruptions due to bad weather. Temporary interruption could be caused, for example, by shortage

of material or labour difficulties. Thus, for example, if a contractor started work on a road on 1 May, stopped on 1 November because of bad weather conditions or a lack of materials but resumed work on 1 February the following year, completing the road on 1 June, his construction project should be regarded as a permanent establishment because thirteen months elapsed between the date he first commenced work (1 May) and the date he finally finished (1 June of the following year). *Work that is undertaken on a site after the construction work has been completed pursuant to a guarantee that requires an enterprise to make repairs would normally not be included in the original construction period. Depending on the circumstances, however, any subsequent work (including work done under a guarantee) performed on the site during an extended period of time may need to be taken into account in order to determine whether such work is carried on through a distinct permanent establishment. For example, where after delivery of a technologically advanced construction project, employees of the contractor or subcontractor remain for four weeks on the construction site to train the owner's employees, that training work shall not be considered work done for the purposes of completing the construction project. Concerns related to the splitting-up of contracts for the purposes of avoiding the inclusion of subsequent construction work in the original construction project are dealt with in paragraph 52 above.*

EXPLANATION: WP1 had developed the changes above before the Action 7 work began. New paragraphs 54 and 55 are revisions to former paragraph 19. Revised paragraph 54 is intended to provide clearer guidance about how Article 5 will apply in the case that a foreign enterprise subcontracts some or all parts of a contract to other enterprises. Revised paragraph 55 is intended to provide guidance about how to count days for the purpose of determining if a construction site constitutes a PE.

If new paragraph 54 is quoted in the UN Commentary, the clarification immediately below would no longer be needed and thus could be deleted.

With respect to the cross references, paragraph 52 of the OECD Commentary is already quoted in the current UN Commentary.

New paragraphs 54 and 55 do not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance and wishes to quote them in the UN Model.

COMMENTS RECEIVED:

“See India Position on OECD Commentary at para 49/Page 622 that any work undertaken on the site shortly after the construction work has been completed, including repair works undertaken pursuant to a guarantee, may be taken into account as part of the original construction period, for determining, whether a PE exists. This sentence may hence not be quoted in UN Commentary.”

RESPONSE: The comment above is with regard to the following sentences in OECD Commentary paragraph 55, which read as follows: “*Work that is undertaken on a site after the construction work has been completed pursuant to a guarantee that*



*requires an enterprise to make repairs would normally not be included in the original construction period. Depending on the circumstances, however, any subsequent work (including work done under a guarantee) performed on the site during an extended period of time may need to be taken into account in order to determine whether such work is carried on through a distinct permanent establishment. For example, where after delivery of a technologically advanced construction project, employees of the contractor or subcontractor remain for four weeks on the construction site to train the owner's employees, that training work shall not be considered work done for the purposes of completing the construction project.*" The Subcommittee should determine how widely held the view expressed in the comment is within the Subcommittee. If that view is held only by a small number of Subcommittee members, then assuming the same is true for the full Committee, a possible way forward could be to quote the OECD Commentary while also expressing the dissenting view of a minority of Committee members.

~~The Committee considers that the reference in the penultimate sentence of this paragraph of the OECD Commentary to "parts" of such a project should not be taken to imply that an enterprise subcontracting all parts of the project could never have a permanent establishment in the host State.~~

~~The Commentary of the 2014 OECD Model Convention continues as follows:~~

~~19.1 In the case of fiscally transparent partnerships, the [six]-month test is applied at the level of the partnership as concerns its own activities. If the period of time spent on the site by the partners and the employees of the partnership exceeds [six] months, the enterprise carried on by the partnership will therefore be considered to have a permanent establishment. Each partner will thus be considered to have a permanent establishment for purposes of the taxation of his share of the business profits derived by the partnership regardless of the time spent by himself on the site.~~

56. In the case of fiscally transparent partnerships, the twelve-month test is applied at the level of the partnership as concerns its own activities. If the period of time spent on the site by the partners and the employees of the partnership exceeds twelve months, the enterprise carried on by *through* the partnership will therefore be considered to have a permanent establishment. Each partner will thus be considered to have a permanent establishment for purposes of the taxation of his share of the business profits derived by the partnership regardless of the time spent by himself on the site. *Assume for instance that a resident of State A and a resident of State B are partners in a partnership established in State B which carries on its construction activities on a construction site situated in State C that lasts 10 months. Whilst the tax treaty between States A and C is identical to the OECD Model, paragraph 3 of Article 5 of the treaty between State B and State C provides that a construction site constitutes a permanent establishment only if it lasts more than 8 months. In that case, the time threshold of each treaty would be applied at the level of the partnership but only with respect to each partner's share of the profits covered by that treaty; since the treaties provide for different time-thresholds, State C will have the right to tax the share of the profits of the partnership attributable to the partner who is a resident of State B but will not have the right to tax*

*the share attributable to the partner who is a resident of State A. This results from the fact that whilst the provisions of paragraph 3 of each treaty are applied at the level of the same enterprise (i.e. the partnership), the outcome differs with respect to the different shares of the profits of the partnership depending on the time-threshold of the treaty that applies to each share.*

EXPLANATION: WPI had developed the changes above before the Action 7 work began. New paragraph 56 revises former paragraph 19.1, which is already quoted in the UN Model. The revised paragraph provides greater guidance, by way of an example, about how the time thresholds of paragraph 3 will apply to a fiscally transparent partnership, including when the foreign partners are residents of countries that have different time thresholds.

New paragraph 56 does not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance and wishes to quote it in the UN Model.

~~20~~57. The very nature of a construction or installation project may be such that the contractor's activity has to be relocated continuously or at least from time to time, as the project progresses. This would be the case for instance where roads or canals were being constructed, waterways dredged, or pipelines laid. Similarly, where parts of a substantial structure such as an offshore platform are assembled at various locations within a country and moved to another location within the country for final assembly, this is part of a single project. In such cases the fact that the work force is not present for [six] months in one particular location is immaterial. The activities performed at each particular spot are part of a single project, and that project must be regarded as a permanent establishment if, as a whole, it lasts for more than [six] months.

EXPLANATION: The above change is merely paragraph numbering change to conform to the current OECD Model Commentary.

12. Until the 2017 update the UN Model contained the words “(for the same or a connected project)” in subparagraph (b). This wording was removed as the “project” limitation was easy to manipulate and created difficult interpretive issues and factual determinations for tax authorities, which in particular for developing countries is an undesired administrative burden. Moreover, from a policy perspective, if a non-resident provides services in a country for more than 183 days, the non-resident's involvement in the commercial life of that country clearly justifies the country taxing the income from those services whether the services are provided for one project or multiple projects. The degree of the non-resident's involvement in the source country's economy is the same, regardless of the number of projects involved. It has been argued that taxpayers can more easily monitor the location of the activities of their employees and independent contractors on a project-by-project basis. Requiring enterprises, even large enterprises with multiple projects, to keep records with regard to the countries in which their employees and independent contractors are working does not appear to be unduly onerous or

unreasonable—especially in light of technological advances. However, for countries that are concerned about the uncertainty involved in adding together unrelated projects and the undesirable distinction it creates between an enterprise with, for example, one project of 95 days duration and another enterprise with two unrelated projects, each of 95 days duration, one following the other, may add the words “(for the same or a connected project)” in paragraph 3 subparagraph (b).

12.1 The Committee observed in general terms that broadening the scope of subparagraph 3(b) means that the revised provision will apply in certain circumstances instead of the new Article 12A in relation to technical service fees.

13. If States wish to treat fishing vessels in their territorial waters as constituting a permanent establishment (see paragraph 6 above), they could add a suitable provision to paragraph 3, which, for example, might apply only to catches over a specified level, or by reference to some other criterion.

14. If a permanent establishment is considered to exist under paragraph 3, only profits attributable to the activities carried on through that permanent establishment are taxable in the source country.

15. The following passages of the ~~2010~~ [2008](#) OECD Model Commentary are relevant to Article 5, paragraph 3, subparagraph (a) of the United Nations Model Convention, although the reference to an “assembly project” in the United Nations Model Convention and not in the OECD Model Convention, and the six-month period in the United Nations Model Convention should, in particular, be borne in mind:

16. This paragraph provides expressly that a building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months. Any of those items which do not meet this condition does not of itself constitute a permanent establishment, even if there is within it an installation, for instance an office or a workshop within the meaning of paragraph 2, associated with the construction activity. Where, however, such an office or workshop is used for a number of construction projects and the activities performed therein go beyond those mentioned in paragraph 4, it will be considered a permanent establishment if the conditions of the Article are otherwise met even if none of the projects involve a building site or construction or installation project that lasts more than twelve months. In that case, the situation of the workshop or office will therefore be different from that of these sites or projects, none of which will constitute a permanent establishment, and it will be important to ensure that only the profits properly attributable to the functions performed and risks assumed through that office or workshop are attributed to the permanent establishment. This could include profits attributable to functions performed and risks assumed in relation to the various construction sites but only to the extent that these functions and risks are properly attributable to the office.

17. The term “building site or construction or installation project” includes not only the construction of buildings but also the construction of roads, bridges or canals, the renovation (involving more than mere maintenance or redecoration) of buildings, roads, bridges or canals, the laying of pipe-lines and excavating and dredging. Additionally, the term “installation project” is not restricted to an installation related to a construction project; it

also includes the installation of new equipment, such as a complex machine, in an existing building or outdoors. On-site planning and supervision of the erection of a building are covered by paragraph 3. States wishing to modify the text of the paragraph to provide expressly for that result are free to do so in their bilateral conventions. *Alternative text for countries wishing to delete Article 14*

15.1 Some countries have taken the view that Article 14 should be deleted, and its coverage introduced into Articles 5 and 7. Countries taking such a view often do so because they perceive that the “fixed base” concept in Article 14 has widely acknowledged uncertainties and that the “permanent establishment” concept can accommodate the taxing rights covered by Article 14. This approach is expressed by the Commentary on Article 5 of the ~~2017~~ OECD Model Convention as follows:

2. Before 2000, income from professional services and other activities of an independent character was dealt with under a separate Article, *i.e.* Article 14. The provisions of that Article were similar to those applicable to business profits, but it used the concept of fixed base rather than that of permanent establishment since it had originally been thought that the latter concept should be reserved to commercial and industrial activities. The elimination of Article 14 in 2000 reflected the fact that there were no intended differences between the concepts of permanent establishment, as used in Article 7, and fixed base, as used in Article 14, or between how profits were computed, and tax was calculated according to which of Article 7 or 14 applied. The elimination of Article 14 therefore meant that the definition of permanent establishment became applicable to what previously constituted a fixed base.

15.2 Many countries disagree with these views and do not believe they are sufficient to warrant deletion of Article 14. Further some countries consider that differences in meaning exist between the “fixed base” (Article 14) and “permanent establishment” (Article 5) concepts. In view of these differences, the removal of Article 14 and reliance on Articles 5 and 7 will, or at least may, in practice lead to a reduction of source State taxing rights. Considering the differences of views in this area, differences which could not be bridged by a single provision, the Committee considers that Article 14 should be retained in the United Nations Model Convention but that guidance in the form of an alternative provision would be provided in this Commentary for countries wishing to delete Article 14.

15.3 This alternative differs from that provided for under the OECD Model Convention, which reflected in its changes the conclusions of an OECD report on Article 14 released in 2000.<sup>1</sup> That report suggested certain changes to Articles of the OECD Model Convention (and bilateral treaties) as well as consequential changes to the Commentaries. Since most countries deleting Article 14 will be doing so for the reasons outlined in the OECD report, and are likely to follow the recommendations in the OECD Model Convention, the changes to the Articles proposed in that report, as they now appear in the OECD Model Convention, are addressed in the paragraphs below regarding the possible deletion of Article 14. The differences between that approach and the alternative wording provided below, result from relevant differences

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<sup>1</sup> *Issues Related to Article 14 of the OECD Model Tax Convention*. Reproduced in Volume II of the full-length version of the OECD Model Convention at page R(16)-1.  
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between Article 14 of the United Nations Model Convention and Article 14 as it previously appeared in the OECD Model Convention.

15.4 Since the deletion of Article 14 is merely presented as an option that some countries may prefer to follow, the entire discussion on the consequential implications of such an approach is addressed in this Commentary on Article 5, including identifying the possibility, and in most cases the need, to make certain consequential changes reflecting the deletion of Article 14, the need to remove references to “independent personal services” and “fixed base” and the possibility of removing references to “dependent personal services” for the sake of clarity.

#### Changes to Articles 14 and 5

15.5 Article 14 would be deleted. Subparagraph (b) of paragraph 3 of Article 5 would read as follows:

- (b) the furnishing of services, ~~including consultancy services~~, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days within any twelve-month period commencing or ending in the fiscal year concerned;

15.6 The changes to the version of this subparagraph in the 1999 United Nations Model Convention are minor, comprising (i) the deletion of the words “including consultancy services”, after the words “the furnishing of services”, on the basis that the wording was unnecessary and confusing, such services being clearly covered; (ii) the replacement of the six-month test with the 183 days test, as noted in paragraph 9 above; and (iii) the use of a semicolon rather than a period at the end of the subparagraph, with the introduction of subparagraph (c). In 2017, the Committee removed the words in parenthesis, “(for the same or connected project)” from subparagraph (b). Countries that are concerned about the uncertainty this might create may continue to include this text.

15.7 A new subparagraph (c) of paragraph 3 would also be inserted, as follows:

- (c) for an individual, the performing of services in a Contracting State by that individual, but only if the individual’s stay in that State is for a period or periods aggregating more than 183 days within any twelve-month period commencing or ending in the fiscal year concerned.

15.8 Subparagraph (c) is intended to ensure that any situation previously covered by Article 14 would now be addressed by Articles 5 and 7. The wording reflects the fact that deletion of Article 14 of the United Nations Model Convention would involve deletion of the “days of physical presence” test found in subparagraph (b) of paragraph 1 of Article 14 of that Model, which had no counterpart in the OECD Model Convention when the deletion of Article 14 was agreed for that Model.

15.9 It should be noted that subparagraph (c), in attempting to reflect the operation of the current Article 14, paragraph 1, subparagraph (b), more explicitly indicates that the subparagraph only applies to individuals. In this respect, it follows and makes clearer the

interpretation found in paragraph 9 of the Commentary on Article 14, to the effect that Article 14 deals only with individuals. The Committee notes that some countries do not accept that view and should seek to clarify the issue when negotiating Article 14.

15.10 It should also be noted that the last part of Article 14, paragraph 1, subparagraph (b) has not been transposed into Article 5: (“... in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State”). The reason for this is that Article 7 provides its own attribution rules, which, in most cases, means that only the profits of an enterprise attributable to that permanent establishment (that is, the “physical presence” in subparagraph (c) of paragraph 3) may be taxed by the State where the permanent establishment exists. Where a “limited force of attraction” rule as provided in Article 7 has been adopted in bilateral treaties, other business activities of a same or similar kind as those effected through the physical presence permanent establishment may be taxed by the State where the permanent establishment exists, which can be justified as treating various forms of permanent establishment in the same way. In the event of States agreeing to a limited force of attraction rule in Article 7 and also to deletion of Article 14, but not wishing to apply the limited force of attraction rule to cases formerly dealt with by Article 14, paragraph 1, subparagraph (b), it could explicitly be provided that such a rule did not apply to subparagraph (c) of paragraph 3 cases.

#### Consequential changes to other Articles

15.11 In paragraph 1 of Article 3, existing subparagraphs (c) to (f) should be renumbered as subparagraphs (d) to (g) and the following new subparagraphs (c) and (h) added:

- (c) the term “enterprise” applies to the carrying on of any business;
- (h) the term “business” includes the performance of professional services and of other activities of an independent character.

15.12 The reasoning for this change is reflected in paragraphs 4 and 10.2 of the OECD Commentary on Article 3 as follows:

4. The question whether an activity is performed within an enterprise or is deemed to constitute in itself an enterprise has always been interpreted according to the provisions of the domestic laws of the Contracting States. No exhaustive definition of the term “enterprise” has therefore been attempted in this Article. However, it is provided that the term “enterprise” applies to the carrying on of any business. Since the term “business” is expressly defined to include the performance of professional services and of other activities of an independent character, this clarifies that the performance of professional services or other activities of an independent character must be considered to constitute an enterprise, regardless of the meaning of that term under domestic law. States which consider that such clarification is unnecessary are free to omit the definition of the term “enterprise” from their bilateral conventions.

10.2 The Convention does not contain an exhaustive definition of the term “business”, which, under paragraph 2, should generally have the meaning which it has under the domestic law of the State that applies the Convention. Subparagraph *h*), however, provides expressly that the term includes the performance of professional services and of other activities of an independent character. This provision was added in 2000 at the same time as Article 14, which dealt with Independent Personal Services, was deleted

from the Convention. This addition, which ensures that the term “business” includes the performance of the activities which were previously covered by Article 14, was intended to prevent that the term “business” be interpreted in a restricted way so as to exclude the performance of professional services, or other activities of an independent character, in States where the domestic law does not consider that the performance of such services or activities can constitute a business. Contracting States for which this is not the case are free to agree bilaterally to omit the definition.

15.13 Paragraph 4 of Article 6 should be amended by removing the reference to independent personal services as follows:

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise ~~and to income from immovable property used for the performance of independent personal services.~~

15.14 Paragraph 4 of Article 10 should be amended as follows:

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident through a permanent establishment situated therein ~~or performs in that other State independent personal services from a fixed base situated therein~~ and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment ~~or fixed base~~. In such case the provisions of Article 7 ~~or Article 14, as the case may be,~~ shall apply.

15.15 Paragraph 5 of Article 10 should be amended as follows:

5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment ~~or a fixed base~~ situated in that other State, nor subject the company’s undistributed profits to a tax on the company’s undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

15.16 Paragraph 4 of Article 11 should be amended as follows:

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, ~~or performs in that other State independent personal services from a fixed base situated therein,~~ and the debt claim in respect of which the interest is paid is effectively connected with (a) such permanent establishment ~~or fixed base~~, or with (b) business activities referred to in (c) of paragraph 1 of Article 7. In such cases the provisions of Article 7 ~~or Article 14, as the case may be,~~ shall apply.

15.17 Paragraph 5 of Article 11 should be amended as follows:

5. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident

of a Contracting State or not, has in a Contracting State a permanent establishment ~~or a fixed base~~ in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment ~~or a fixed base~~, then such interest shall be deemed to arise in the State in which the permanent establishment ~~or a fixed base~~ is situated.

15.18 Paragraph 4 of Article 12 should be amended as follows:

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, ~~or performs in that other State independent personal services from a fixed base situated therein~~, and the right or property in respect of which the royalties are paid is effectively connected with (a) such permanent establishment, ~~or a fixed base~~, or with (b) business activities referred to in (c) of paragraph 1 of Article 7. In such cases the provisions of Article 7 ~~or Article 14, as the case may be~~, shall apply.

15.19 Paragraph 5 of Article 12 should be amended as follows:

5. Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment ~~or a fixed base~~ in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment ~~or fixed base~~, then such royalties shall be deemed to arise in the State in which the permanent establishment ~~or fixed base~~ is situated.

15.20 Paragraph 2 of Article 13 should be amended as follows:

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State ~~or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services~~, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) ~~or of such fixed base~~, may be taxed in that other State.

15.21 If Article 14 is deleted, it would depend on agreement between the countries as to whether the following Articles are renumbered, but the usual practice is to renumber those Articles, or to rename an additional article as Article 14.

15.22 Countries may wish to replace the title of Article 15 as follows: “INCOME FROM EMPLOYMENT ~~DEPENDENT PERSONAL SERVICES~~”, as provided for in the 2000 and subsequent OECD Model Conventions. The basis for this change is that where Article 14 is removed it will usually represent a conscious decision to move away from the concepts of independent and dependent personal services, and an acceptance that Article 15 deals only with employment services, any other provision of services, being dealt with under Article 7 or by specific articles such as Articles 16 or 17.

15.23 Subparagraph (c), paragraph 2 of Article 15 should be amended by removing references to the fixed base concept, as follows:



- (c) the remuneration is not borne by a permanent establishment ~~or a fixed base~~ which the employer has in the other State.

15.24 The following amendments should be made to Article 17 so as to remove references to the deleted Article 14 and so as to add references to Article 7:

(a) Modify paragraph 1 of Article 17 to read as follows:

1. Notwithstanding the provisions of Articles ~~14~~ 7 and 15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsperson, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.

(b) Modify paragraph 2 of Article 17 to read as follows:

2. Where income in respect of personal activities exercised by an entertainer or a sportsperson in his capacity as such accrues not to the entertainer or sportsman himself but to another person, that income may, notwithstanding the provisions of Articles ~~7-14~~ 7 and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsperson are exercised.

15.25 Paragraph 2 of Article 21 should be amended as follows:

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, ~~or performs in that other State independent personal services from a fixed base situated therein,~~ and the right or property in respect of which the income is paid is effectively connected with such permanent establishment ~~or fixed base~~. In such case, the provisions of Article 7 ~~or Article 14, as the case may be,~~ shall apply.

15.26 Paragraph 2 of Article 22 should be amended as follows:

2. Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State ~~or by movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services,~~ may be taxed in that other State.

#### ***Paragraph 4***

16. In 2017, the Committee agreed to include in the update to the United Nations Model Convention, an amended paragraph 4 of Article 5. The changes made were based on the recommendations of the OECD/G20 Final Report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status). Paragraph 4 was modified so that all of the activities covered by paragraph 4 are subject to the condition that they are preparatory or auxiliary.

17. The new paragraph 4 of Article 5 in the United Nations Model Tax Convention still omits the reference to “delivery” in subparagraphs (a) and (b). The deletion of the word “delivery”

reflects the majority view of the Committee that a “warehouse” used for that purpose should, if the requirements of paragraph 1 are met, be a permanent establishment.

17.1 In view of the similarities to the recommended text and the general relevance of its Commentary, the general principles of Article 5, paragraph 4 under both Models are first noted below and then the practical relevance of the deletion of references to “delivery” in the United Nations Model Convention is considered.

18. Following the changes to the OECD Commentary to reflect the changes to paragraph 4 of Article 5 of the OECD Model Convention, the 2017 OECD Model Commentary now reads as follows:

58. This paragraph lists a number of business activities which are treated as exceptions to the general definition laid down in paragraph 1 and which, when carried on through fixed places of business, are not sufficient for these places to constitute permanent establishments. The final part of the paragraph provides that these exceptions only apply if the listed activities have a preparatory or auxiliary character. Since subparagraph e) applies to any activity that is not otherwise listed in the paragraph (as long as that activity has a preparatory or auxiliary character), the provisions of the paragraph actually amount to a general restriction of the scope of the definition of permanent establishment contained in paragraph 1 and, when read with that paragraph, provide a more selective test, by which to determine what constitutes a permanent establishment. To a considerable degree, these provisions limit the definition in paragraph 1 and exclude from its rather wide scope a number of fixed places of business which, because the business activities exercised through these places are merely preparatory or auxiliary, should not be treated as permanent establishments. It is recognised that such a place of business may well contribute to the productivity of the enterprise, but the services it performs are so remote from the actual realisation of profits that it is difficult to allocate any profit to the fixed place of business in question. Moreover, subparagraph f) provides that combinations of activities mentioned in subparagraphs a) to e) in the same fixed place of business shall be deemed not to be a permanent establishment, subject to the condition, expressed in the final part of the paragraph, that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character. Thus, the provisions of paragraph 4 are designed to prevent an enterprise of one State from being taxed in the other State if it only carries on activities of a purely preparatory or auxiliary character in that State. The provisions of paragraph 4.1 (see below) complement that principle by ensuring that the preparatory or auxiliary character of activities carried on at a fixed place of business must be viewed in the light of other activities that constitute complementary functions that are part of a cohesive business and which the same enterprise or closely related enterprises carry on in the same State.

59. It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity.

60. As a general rule, an activity that has a preparatory character is one that is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole. Since a preparatory activity precedes another activity, it will often be carried on during a relatively short period, the duration of that period being determined by the nature of the core activities of the enterprise. This, however, will not always be the case as it is possible to carry on an activity at a given place for a substantial period of time in preparation for activities that take place somewhere else. Where, for example, a construction enterprise trains its employees at one place before these employees are sent to work at remote work sites located in other countries, the training that takes place at the first location constitutes a preparatory activity for that enterprise. An activity that has an auxiliary character, on the other hand, generally corresponds to an activity that is carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a whole. It is unlikely that an activity that requires a significant proportion of the assets or employees of the enterprise could be considered as having an auxiliary character.

61. Subparagraphs a) to e) refer to activities that are carried on for the enterprise itself. A permanent establishment would therefore exist if such activities were performed on behalf of other enterprises at the same fixed place of business. If, for instance, an enterprise that maintained an office for the advertising of its own products or services were also to engage in advertising on behalf of other enterprises at that location, that office would be regarded as a permanent establishment of the enterprise by which it is maintained.

62. Subparagraph a) relates to a fixed place of business constituted by facilities used by an enterprise for storing, displaying or delivering its own goods or merchandise. Whether the activity carried on at such a place of business has a preparatory or auxiliary character will have to be determined in the light of factors that include the overall business activity of the enterprise. Where, for example, an enterprise of State R maintains in State S a very large warehouse in which a significant number of employees work for the main purpose of storing and delivering goods owned by the enterprise that the enterprise sells online to customers in State S, paragraph 4 will not apply to that warehouse since the storage and delivery activities that are performed through that warehouse, which represents an important asset and requires a number of employees, constitute an essential part of the enterprise's sale/distribution business and do not have, therefore, a preparatory or auxiliary character.

63. Subparagraph a) would cover, for instance, a bonded warehouse with special gas facilities that an exporter of fruit from one State maintains in another State for the sole purpose of storing fruit in a controlled environment during the custom clearance process in that other State. It would also cover a fixed place of business that an enterprise maintained solely for the delivery of spare parts to customers for machinery sold to those customers. Paragraph 4 would not apply, however, where an enterprise maintained a fixed place of business for the delivery of spare parts to customers for machinery supplied to those customers and, in addition, for the maintenance or repair of such machinery, as this would go beyond the pure delivery mentioned in subparagraph a) and would not constitute preparatory or auxiliary activities since these after-sale activities constitute an essential and significant part of the services of an enterprise vis-à-vis its customers.

64. Issues may arise concerning the application of the definition of permanent establishment to facilities such as cables or pipelines that cross the territory of a country. Apart from the fact that income derived by the owner or operator of such facilities from their use by other enterprises is covered by Article 6 where these facilities constitute immovable property under paragraph 2 of Article 6, the question may arise as to whether subparagraph a) applies to them. Where these facilities are used to transport property belonging to other enterprises, subparagraph a), which is restricted to delivery of goods or merchandise belonging to the enterprise that uses the facility, will not be applicable as concerns the owner or operator of these facilities. Subparagraph e) also will not be applicable as concerns that enterprise since the cable or pipeline is not used solely for the enterprise and its use is not of preparatory or auxiliary character given the nature of the business of that enterprise. The situation is different, however, where an enterprise owns and operates a cable or pipeline that crosses the territory of a country solely for purposes of transporting its own property and such transport is merely incidental to the business of that enterprise, as in the case of an enterprise that is in the business of refining oil and that owns and operates a pipeline that crosses the territory of a country solely to transport its own oil to its refinery located in another country. In such case, subparagraph a) would be applicable. A separate question is whether the cable or pipeline could constitute a permanent establishment for the customer of the operator of the cable or pipeline, i.e. the enterprise whose data, power or property is transmitted or transported from one place to another. In such a case, the enterprise is merely obtaining transmission or transportation services provided by the operator of the cable or pipeline and does not have the cable or pipeline at its disposal. As a consequence, the cable or pipeline cannot be considered to be a permanent establishment of that enterprise.

65. Subparagraph b) relates to the maintenance of a stock of goods or merchandise belonging to the enterprise. This subparagraph is irrelevant in cases where a stock of goods or merchandise belonging to an enterprise is maintained by another person in facilities operated by that other person and the enterprise does not have the facilities at its disposal as the place where the stock is maintained cannot therefore be a permanent establishment of that enterprise. Where, for example, a logistics company operates a warehouse in State S and continuously stores in that warehouse goods or merchandise belonging to an enterprise of State R to which the logistics company is not closely related, the warehouse does not constitute a fixed place of business at the disposal of the enterprise of State R and subparagraph b) is therefore irrelevant. Where, however, that enterprise is allowed unlimited access to a separate part of the warehouse for the purpose of inspecting and maintaining the goods or merchandise stored therein, subparagraph b) is applicable and the question of whether a permanent establishment exists will depend on whether these activities constitute a preparatory or auxiliary activity.

66. For the purposes of the application of subparagraphs a) and b), it does not matter whether the storage or delivery takes place before or after the goods or merchandise have been sold, provided that the goods or merchandise belong to the enterprise whilst they are at the relevant location (e.g. the subparagraphs could apply regardless of the fact that some of the goods that are stored at a location have already been sold as long as the property title to these goods only passes to the customer upon or after delivery). Subparagraphs a) and b) also cover situations where a facility is used, or a stock of

goods or merchandise is maintained, for any combination of storage, display and delivery since facilities used for the delivery of goods will almost always be also used for the storage of these goods, at least for a short period. For the purposes of subparagraphs, a) to d), the words “goods” and “merchandise” refer to tangible property and would not cover, for example, immovable property and data (although the subparagraphs would apply to tangible products that include data such as CDs and DVDs).

67. Subparagraph c) covers the situation where a stock of goods or merchandise belonging to one enterprise is processed by a second enterprise on behalf of, or for the account of, the first-mentioned enterprise. As explained in the preceding paragraph, the mere presence of goods or merchandise belonging to an enterprise does not mean that the fixed place of business where these goods or merchandise are stored is at the disposal of that enterprise. Where, for example, a stock of goods belonging to RCO, an enterprise of State R, is maintained by a toll-manufacturer located in State S for the purposes of processing by that toll-manufacturer, no fixed place of business is at the disposal of RCO and the place where the stock is maintained cannot therefore be a permanent establishment of RCO. If, however, RCO is allowed unlimited access to a separate part of the facilities of the toll-manufacturer for the purpose of inspecting and maintaining the goods stored therein, subparagraph c) will apply and it will be necessary to determine whether the maintenance of that stock of goods by RCO constitutes a preparatory or auxiliary activity. This will be the case if RCO is merely a distributor of products manufactured by other enterprises as in that case the mere maintenance of a stock of goods for the purposes of processing by another enterprise would not form an essential and significant part of RCO’s overall activity. In such a case, unless paragraph 4.1 applies, paragraph 4 will deem a permanent establishment not to exist in relation to such a fixed place of business that is at the disposal of the enterprise of State R for the purposes of maintaining its own goods to be processed by the toll-manufacturer.

68. The first part of subparagraph d) relates to the case where premises are used solely for the purpose of purchasing goods or merchandise for the enterprise. Since this exception only applies if that activity has a preparatory or auxiliary character, it will typically not apply in the case of a fixed place of business used for the purchase of goods or merchandise where the overall activity of the enterprise consists in selling these goods and where purchasing is a core function in the business of the enterprise. The following examples illustrate the application of paragraph 4 in the case of fixed places of business where purchasing activities are performed:

- *Example 1:* RCO is a company resident of State R that is a large buyer of a particular agricultural product produced in State S, which RCO sells from State R to distributors situated in different countries. RCO maintains a purchasing office in State S. The employees who work at that office are experienced buyers who have special knowledge of this type of product and who visit producers in State S, determine the type/quality of the products according to international standards (which is a difficult process requiring special skills and knowledge) and enter into different types of contracts (spot or forward) for the acquisition of the products by RCO. In this example, although the only activity performed through the office is the purchasing of products for RCO, which is an activity covered by subparagraph d), paragraph 4 does not apply and the office therefore

constitutes a permanent establishment because that purchasing function forms an essential and significant part of RCO's overall activity.

- *Example 2:* RCO, a company resident of State R which operates a number of large discount stores, maintains an office in State S during a two-year period for the purposes of researching the local market and lobbying the government for changes that would allow RCO to establish stores in State S. During that period, employees of RCO occasionally purchase supplies for their office. In this example, paragraph 4 applies because subparagraph f) applies to the activities performed through the office (since subparagraphs d) and e) would apply to the purchasing, researching and lobbying activities if each of these was the only activity performed at the office) and the overall activity of the office has a preparatory character.

69. The second part of subparagraph d) relates to a fixed place of business that is used solely to collect information for the enterprise. An enterprise will frequently need to collect information before deciding whether and how to carry on its core business activities in a State. If the enterprise does so without maintaining a fixed place of business in that State, subparagraph d) will obviously be irrelevant. If, however, a fixed place of business is maintained solely for that purpose, subparagraph d) will be relevant and it will be necessary to determine whether the collection of information goes beyond the preparatory or auxiliary threshold. Where, for example, an investment fund sets up an office in a State solely to collect information on possible investment opportunities in that State, the collecting of information through that office will be a preparatory activity. The same conclusion would be reached in the case of an insurance enterprise that sets up an office solely for the collection of information, such as statistics, on risks in a particular market and in the case of a newspaper bureau set up in a State solely to collect information on possible news stories without engaging in any advertising activities: in both cases, the collecting of information will be a preparatory activity.

70. Subparagraph e) applies to a fixed place of business maintained solely for the purpose of carrying on, for the enterprise, any activity that is not expressly listed in subparagraphs a) to d); as long as that activity has a preparatory or auxiliary character, that place of business is deemed not to be a permanent establishment. The wording of this subparagraph makes it unnecessary to produce an exhaustive list of the activities to which the paragraph may apply, the examples listed in subparagraphs a) to d) being merely common examples of activities that are covered by the paragraph because they often have a preparatory or auxiliary character.

71. Examples of places of business covered by subparagraph e) are fixed places of business used solely for the purpose of advertising or for the supply of information or for scientific research or for the servicing of a patent or a know-how contract, if such activities have a preparatory or auxiliary character. Paragraph 4 would not apply, however, if a fixed place of business used for the supply of information would not only give information but would also furnish plans etc. specially developed for the purposes of the individual customer. Nor would it apply if a research establishment were to concern itself with manufacture. Similarly, where the servicing of patents and know-how is the purpose of an enterprise, a fixed place of business of such enterprise exercising such an activity cannot get the benefits of paragraph 4. A fixed place of business which has the function of managing an enterprise or even only a part of an

enterprise or of a group of the concern cannot be regarded as doing a preparatory or auxiliary activity, for such a managerial activity exceeds this level. If an enterprise with international ramifications establishes a so-called “management office” in a State in which it maintains subsidiaries, permanent establishments, agents or licensees, such office having supervisory and co-ordinating functions for all departments of the enterprise located within the region concerned, subparagraph e) will not apply to that “management office” because the function of managing an enterprise, even if it only covers a certain area of the operations of the concern, constitutes an essential part of the business operations of the enterprise and therefore can in no way be regarded as an activity which has a preparatory or auxiliary character within the meaning of paragraph 4.

72. Also, where an enterprise that sells goods worldwide establishes an office in a State and the employees working at that office take an active part in the negotiation of important parts of contracts for the sale of goods to buyers in that State without habitually concluding contracts or playing the principal role leading to the conclusion of contracts (e.g. by participating in decisions related to the type, quality or quantity of products covered by these contracts), such activities will usually constitute an essential part of the business operations of the enterprise and should not be regarded as having a preparatory or auxiliary character within the meaning of subparagraph e) of paragraph 4. If the conditions of paragraph 1 are met, such an office will therefore constitute a permanent establishment.

73. As already mentioned in paragraph 58 above, paragraph 4 is designed to provide exceptions to the general definition of paragraph 1 in respect of fixed places of business which are engaged in activities having a preparatory or auxiliary character. Therefore, according to subparagraph f), the fact that one fixed place of business combines any of the activities mentioned in the subparagraphs a) to e) does not mean of itself that a permanent establishment exists. As long as the combined activity of such a fixed place of business is merely preparatory or auxiliary a permanent establishment should be deemed not to exist. Such combinations should not be viewed on rigid lines, but should be considered in the light of the particular circumstances.

74. Unless the anti-fragmentation provisions of paragraph 4.1 are applicable (see below), subparagraph f) is of no relevance in a case where an enterprise maintains several fixed places of business to which subparagraphs a) to e) apply as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists.

75. The fixed places of business to which paragraph 4 applies do not constitute permanent establishments so long as the business activities performed through those fixed places of business are restricted to the activities referred to in that paragraph. This will be the case even if the contracts necessary for establishing and carrying on the business are concluded by those in charge of the places of business themselves. The conclusion of such contracts by these employees will not constitute a permanent establishment of the enterprise under paragraph 5 as long as the conclusion of these contracts satisfies the conditions of paragraph 4 (see paragraph 33 below). An example would be where the manager of a place of business where preparatory or auxiliary research activities are conducted concludes the contracts necessary for establishing and maintaining that place of business as part of the activities carried on at that location.

76. If, under paragraph 4, a fixed place of business is deemed not to be a permanent establishment, this exception applies likewise to the disposal of movable property forming part of the business property of the place of business at the termination of the enterprise's activity at that place (see paragraph 11 above and paragraph 2 of Article 13). Where, for example, the display of merchandise during a trade fair or convention is excepted under subparagraphs *a*) and *b*), the sale of that merchandise at the termination of the trade fair or convention is covered by subparagraph e) as such sale is merely an auxiliary activity. The exception does not, of course, apply to sales of merchandise not actually displayed at the trade fair or convention.

77. Where paragraph 4 does not apply because a fixed place of business used by an enterprise for activities that paragraph 4 is also used for other activities that go beyond what is preparatory or auxiliary, that place of business constitutes a single permanent establishment of the enterprise and the profits attributable to the permanent establishment with respect to both types of activities may be taxed in the State where that permanent establishment is situated.

19. The Committee took note that some members thought that the scope of paragraph 4 is too wide and poses challenges (see above paragraph 18 quoting paragraph ~~24.1~~<sup>59</sup> of the OECD Commentary) which may be particularly difficult for developing countries to handle due to the lack of administrative capacity. Countries that have those concerns may consider eliminating the paragraph entirely. Another option that may also be considered for those that want to limit the scope of the paragraph is to eliminate subparagraphs which may be regarded as too extensive in scope, in particular members mentioned subparagraphs e) and f). However, negotiators of an agreement should make sure that the application of the remaining paragraph is limited by the preparatory or auxiliary requirement in order for the paragraph to only eliminate from the permanent establishment concept in paragraph 1, work being of no or very little significance in view of the other work performed by the enterprise.

19.1 It was also noted that some States may consider that the activities in paragraph 4 are intrinsically preparatory or auxiliary in nature and take the view that these activities should not be subject to the preparatory or auxiliary condition since any concern about the inappropriate use of these exceptions are addressed through the provisions of paragraph 4.1. States that share this view are free to amend paragraph 4 as follows (and may also agree to delete some of the activities listed in subparagraphs a) to d) below if they consider that these activities should be subject to the preparatory or auxiliary condition in subparagraph e)):

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

- (a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
- (b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;
- (c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- (d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;



- (e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character; or
- (f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

20. As noted above, the United Nations Model Convention, in contrast to the OECD Model Convention, does not refer to “delivery” in subparagraphs (a) or (b). The question whether the use of facilities for the “delivery of goods” should give rise to a permanent establishment has been debated extensively. A 1997 study revealed that almost 75 per cent of the tax treaties of developing countries *included* the “delivery of goods” in the list of exceptions in subparagraphs (a) and (b) of paragraph 4. Nevertheless, some countries regard the omission of the expression in the United Nations Model Convention as an important point of departure from the OECD Model Convention, believing that a stock of goods for prompt delivery facilitates sales of the product and thereby the earning of profit in the host country.

21. In reviewing the United Nations Model Convention, the Committee retains the existing distinction between the two Models, but it notes that even if the delivery of goods is treated as giving rise to a permanent establishment, it may be that little income could properly be attributed to this activity. Tax authorities might be led into attributing too much income to this activity if they do not give the issue close consideration, which would lead to prolonged litigation and inconsistent application of tax treaties. Therefore, although the reference to “delivery” is absent from the United Nations Model Convention, countries may wish to consider both points of view when entering into bilateral tax treaties, for the purpose of determining the practical results of utilizing either approach.

#### ***Paragraph 4.1***

21.1 In 2017 the Committee decided to adopt a new paragraph 4.1 in Article 5. The new paragraph 4.1 is an anti-fragmentation rule that was recommended for the OECD Model Tax Convention in the OECD/G20 Final Report on Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status). The purpose of this new paragraph is to prevent an enterprise from fragmenting its activities—either within the enterprise or between closely related enterprises—in order to qualify for the specific activity exemptions in paragraph 4 of Article 5. The Final Report also includes new Commentary to provide guidance on the application of paragraph 4.1 to situations where an enterprise or a group of closely related enterprises attempt to circumvent the preparatory or auxiliary activity rule in paragraph 4 by fragmenting a cohesive business operation into several small operations. The new 2017 OECD Commentary states:

79. [...] Under paragraph 4.1, the exceptions provided for by paragraph 4 do not apply to a place of business that would otherwise constitute a permanent establishment where the activities carried on at that place and other activities of the same enterprise or of closely related enterprises exercised at that place or at another place in the same State constitute complementary functions that are part of a cohesive business operation. For paragraph 4.1 to apply, however, at least one of the places where these activities are

exercised must constitute a permanent establishment or, if that is not the case, the overall activity resulting from the combination of the relevant activities must go beyond what is merely preparatory or auxiliary.

80. The provisions of paragraph [9] are applicable in order to determine whether an enterprise is a closely related enterprise with respect to another one (see paragraphs 119 to 121 below).

81. The following examples illustrate the application of paragraph 4.1:

- *Example A:* RCO, a bank resident of State R, has a number of branches in State S which constitute permanent establishments. It also has a separate office in State S where a few employees verify information provided by clients that have made loan applications at these different branches. The results of the verifications done by the employees are forwarded to the headquarters of RCO in State R where other employees analyse the information included in the loan applications and provide reports to the branches where the decisions to grant the loans are made. In that case, the exceptions of paragraph 4 will not apply to the office because another place (i.e. any of the other branches where the loan applications are made) constitutes a permanent establishment of RCO in State S and the business activities carried on by RCO at the office and at the relevant branch constitute complementary functions that are part of a cohesive business operation (i.e. providing loans to clients in State S).
- *Example B:* RCO, a company resident of State R, manufactures and sells appliances. SCO, a resident of State S that is a wholly-owned subsidiary of RCO, owns a store where it sells appliances that it acquires from RCO. RCO also owns a small warehouse in State S where it stores a few large items that are identical to some of those displayed in the store owned by SCO. When a customer buys such a large item from SCO, SCO employees go to the warehouse where they take possession of the item before delivering it to the customer; the ownership of the item is only acquired by SCO from RCO when the item leaves the warehouse. In this case, paragraph 4.1 prevents the application of the exceptions of paragraph 4 to the warehouse and it will not be necessary, therefore, to determine whether paragraph 4, and in particular subparagraph 4 a) thereof, applies to the warehouse. The conditions for the application of paragraph 4.1 are met because
  - SCO and RCO are closely related enterprises;
  - SCO's store constitutes a permanent establishment of SCO (the definition of permanent establishment is not limited to situations where a resident of one Contracting State uses or maintains a fixed place of business in the other State; it applies equally where an enterprise of one State uses or maintains a fixed place of business in that same State); and
  - The business activities carried on by RCO at its warehouse and by SCO at its store constitute complementary functions that are part of a cohesive business operation (i.e. storing goods in one place for the purpose of delivering these goods as part of the obligations resulting from the sale of these goods through another place in the same State).

**Paragraph 5**

22. In 2017 the Committee decided to modify paragraphs 5 and 7 of Article 5. The new paragraphs address the artificial avoidance of PE status through commissionaire arrangements and similar strategies. These changes to the United Nations Model Convention and relevant Commentary are in line with recommendations for the OECD Model Convention in the OECD/G20 Final Report on Action 7, (Preventing the Artificial Avoidance of Permanent Establishment Status).

22.1 It is generally accepted that, if a person acts in a State for an enterprise in such a way as to closely tie up the activity of the enterprise with the economic life of that State, the enterprise should be treated as having a permanent establishment in that State—even if it does not have a fixed place of business in that State under paragraph 1. Paragraph 5 achieves this by deeming a permanent establishment to exist if the person is a so-called dependent agent who carries out on behalf of the enterprise an activity specified in subparagraph (a) or (b).

22.2 Subparagraph (a) follows the substance of the OECD Model Convention and proceeds on the basis that if a person habitually concludes contracts in the name of the enterprise, for the transfer of ownership or the granting of the right to use the enterprise's property, or for the provision of services by that enterprise creates for that enterprise a sufficiently close association with a State (or if they are habitually playing the principal role leading to the conclusion of such contracts), then it is appropriate to deem that such an enterprise has a permanent establishment there. The condition in subparagraph (b), relating to the maintenance of a stock of goods, is discussed below.

23. In relation to subparagraph (a), a dependent agent causes a “permanent establishment” to be deemed to exist only if that person repeatedly concludes contracts or plays the principal role leading to the conclusion of contracts and not merely in isolated cases. The 2017 OECD Model Commentary states further:

84. For paragraph 5 to apply, all the following conditions must be met:

- a person acts in a Contracting State on behalf of an enterprise;
- in doing so, that person habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and
- these contracts are either in the name of the enterprise or for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise.

85. Even if these conditions are met, however, paragraph 5 will not apply if the activities performed by the person on behalf of the enterprise are covered by the independent agent exception of paragraph 6 or are limited to activities mentioned in paragraph 4 which, if exercised through a fixed place of business, would be deemed not to create a permanent establishment. This last exception is explained by the fact that since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for the purposes of preparatory or auxiliary activities is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes should not create a permanent establishment either. Where, for example, a person acts solely as a buying

agent for an enterprise and, in doing so, habitually concludes purchase contracts in the name of that enterprise, paragraph 5 will not apply even if that person is not independent of the enterprise as long as such activities are preparatory or auxiliary (see paragraph 68 above).

86. A person is acting in a Contracting State on behalf of an enterprise when that person involves the enterprise to a particular extent in business activities in the State concerned. This will be the case, for example, where an agent acts for a principal, where a partner acts for a partnership, where a director acts for a company or where an employee acts for an employer. A person cannot be said to be acting on behalf of an enterprise if the enterprise is not directly or indirectly affected by the action performed by that person. As indicated in paragraph 83, the person acting on behalf of an enterprise can be a company; in that case, the actions of the employees and directors of that company are considered together for the purpose of determining whether and to what extent that company acts on behalf of the enterprise.

87. The phrase “concludes contracts” focuses on situations where, under the relevant law governing contracts, a contract is considered to have been concluded by a person. A contract may be concluded without any active negotiation of the terms of that contract; this would be the case, for example, where the relevant law provides that a contract is concluded by reason of a person accepting, on behalf of an enterprise, the offer made by a third party to enter into a standard contract with that enterprise. Also, a contract may, under the relevant law, be concluded in a State even if that contract is signed outside that State; where, for example, the conclusion of a contract results from the acceptance, by a person acting on behalf of an enterprise, of an offer to enter into a contract made by a third party, it does not matter that the contract is signed outside that State. In addition, a person who negotiates in a State all elements and details of a contract in a way binding on the enterprise can be said to conclude the contract in that State even if that contract is signed by another person outside that State.

88. The phrase “or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise” is aimed at situations where the conclusion of a contract directly results from the actions that the person performs in a Contracting State on behalf of the enterprise even though, under the relevant law, the contract is not concluded by that person in that State. Whilst the phrase “concludes contracts” provides a relatively well-known test based on contract law, it was found necessary to supplement that test with a test focusing on substantive activities taking place in one State in order to address cases where the conclusion of contracts is clearly the direct result of these activities although the relevant rules of contract law provide that the conclusion of the contract takes place outside that State. The phrase must be interpreted in the light of the object and purpose of paragraph 5, which is to cover cases where the activities that a person exercises in a State are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, i.e. where that person acts as the sales force of the enterprise. The principal role leading to the conclusion of the contract will therefore typically be associated with the actions of the person who convinced the third party to enter into a contract with the enterprise. The words “contracts that are routinely concluded without material modification by the enterprise” clarify that where such principal role is performed in that State, the actions of that person will fall within the scope of paragraph 5 even if the contracts are not

formally concluded in the State, for example, where the contracts are routinely subject, outside that State, to review and approval without such review resulting in a modification of the key aspects of these contracts.

89. The phrase “habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise” therefore applies where, for example, a person solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods belonging to the enterprise are delivered and where the enterprise routinely approves these transactions. It does not apply, however, where a person merely promotes and markets goods or services of an enterprise in a way that does not directly result in the conclusion of contracts. Where, for example, representatives of a pharmaceutical enterprise actively promote drugs produced by that enterprise by contacting doctors that subsequently prescribe these drugs, that marketing activity does not directly result in the conclusion of contracts between the doctors and the enterprise so that the paragraph does not apply even though the sales of these drugs may significantly increase as a result of that marketing activity.

90. The following is another example that illustrates the application of paragraph 5. RCO, a company resident of State R, distributes various products and services worldwide through its websites. SCO, a company resident of State S, is a wholly-owned subsidiary of RCO. SCO’s employees send emails, make telephone calls to, or visit large organisations in order to convince them to buy RCO’s products and services and are therefore responsible for large accounts in State S; SCO’s employees, whose remuneration is partially based on the revenues derived by RCO from the holders of these accounts, use their relationship building skills to try to anticipate the needs of these account holders and to convince them to acquire the products and services offered by RCO. When one of these account holders is persuaded by an employee of SCO to purchase a given quantity of goods or services, the employee indicates the price that will be payable for that quantity, indicates that a contract must be concluded online with RCO before the goods or services can be provided by RCO and explains the standard terms of RCO’s contracts, including the fixed price structure used by RCO, which the employee is not authorised to modify. The account holder subsequently concludes that contract online for the quantity discussed with SCO’s employee and in accordance with the price structure presented by that employee. In this example, SCO’s employees play the principal role leading to the conclusion of the contract between the account holder and RCO and such contracts are routinely concluded without material modification by the enterprise. The fact that SCO’s employees cannot vary the terms of the contracts does not mean that the conclusion of the contracts is not the direct result of the activities that they perform on behalf of the enterprise, convincing the account holder to accept these standard terms being the crucial element leading to the conclusion of the contracts between the account holder and RCO.

91. The wording of subparagraphs a), b) and c) ensures that paragraph 5 applies not only to contracts that create rights and obligations that are legally enforceable between the enterprise on behalf of which the person is acting and the third parties with which these contracts are concluded but also to contracts that create obligations that will effectively be performed by such enterprise rather than by the person contractually obliged to do so.

92. A typical case covered by these subparagraphs is where contracts are concluded with clients by an agent, a partner or an employee of an enterprise so as to create legally enforceable rights and obligations between the enterprise and these clients. These subparagraphs also cover cases where the contracts concluded by a person who acts on behalf of an enterprise do not legally bind that enterprise to the third parties with which these contracts are concluded but are contracts for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise. A typical example would be the contracts that a “commissionnaire” would conclude with third parties under a commissionnaire arrangement with a foreign enterprise pursuant to which that commissionnaire would act on behalf of the enterprise but in doing so, would conclude in its own name contracts that do not create rights and obligations that are legally enforceable between the foreign enterprise and the third parties even though the results of the arrangement between the commissionnaire and the foreign enterprise would be such that the foreign enterprise would directly transfer to these third parties the ownership or use of property that it owns or has the right to use.

93. The reference to contracts “in the name of” in subparagraph a) does not restrict the application of the subparagraph to contracts that are literally in the name of the enterprise; it may apply, for example, to certain situations where the name of the enterprise is undisclosed in a written contract.

94. The crucial condition for the application of subparagraphs b) and c) is that the person who habitually concludes the contracts, or habitually plays the principal role leading to the conclusion of the contracts that are routinely concluded without material modification by the enterprise, is acting on behalf of an enterprise in such a way that the parts of the contracts that relate to the transfer of the ownership or use of property, or the provision of services, will be performed by the enterprise as opposed to the person that acts on the enterprise’s behalf.

95. For the purposes of subparagraph b), it does not matter whether or not the relevant property existed or was owned by the enterprise at the time of the conclusion of the contracts between the person who acts for the enterprise and the third parties. For example, a person acting on behalf of an enterprise might well sell property that the enterprise will subsequently produce before delivering it directly to the customers. Also, the reference to “property” covers any type of tangible or intangible property.

96. The cases to which paragraph 5 applies must be distinguished from situations where a person concludes contracts on its own behalf and, in order to perform the obligations deriving from these contracts, obtains goods or services from other enterprises or arranges for other enterprises to deliver such goods or services. In these cases, the person is not acting “on behalf” of these other enterprises and the contracts concluded by the person are neither in the name of these enterprises nor for the transfer to third parties of the ownership or use of property that these enterprises own or have the right to use or for the provision of services by these other enterprises. Where, for example, a company acts as a distributor of products in a particular market and, in doing so, sells to customers products that it buys from an enterprise (including an associated enterprise), it is neither acting on behalf of that enterprise nor selling property that is owned by that enterprise since the property that is sold to the customers is owned by the distributor. This would still be the case if that distributor acted as a so-called “low-risk

distributor” (and not, for example, as an agent) but only if the transfer of the title to property sold by that “low-risk” distributor passed from the enterprise to the distributor and from the distributor to the customer (regardless of how long the distributor would hold title in the product sold) so that the distributor would derive a profit from the sale as opposed to a remuneration in the form, for example, of a commission.

97. The contracts referred to in paragraph 5 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 conclude employment contracts for the enterprise to assist that person’s activity for the enterprise or if the person concluded, in the name of the enterprise, similar contracts relating to internal operations only. Moreover, whether or not a person habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise should be determined on the basis of the commercial realities of the situation. The mere fact that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has concluded contracts or played the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise.

98. The requirement that an agent must “habitually” conclude contracts or play the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise reflects the underlying principle in Article 5 that the presence which an enterprise maintains in a Contracting State should be more than merely transitory if the enterprise is to be regarded as maintaining a permanent establishment, and thus a taxable presence, in that State. The extent and frequency of activity necessary to conclude that the agent is “habitually concluding contracts or playing the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise” will depend on the nature of the contracts and the business of the principal. It is not possible to lay down a precise frequency test. Nonetheless, the same sorts of factors considered in paragraph 6 would be relevant in making that determination.

24. The Committee discussed the significance of the reference to contracts “that are routinely concluded without material modification by the enterprise.” The Committee noted that, even if the enterprise makes material modifications to some contracts (and even to the majority of contracts resulting from the activities of the local sales force) before the contracts are approved, as long as there is a person who habitually plays a principal role leading to the conclusion of other contracts that the enterprise concludes without any material modification, a dependent agent PE will still arise as a result of the activities of that person. Some Committee members still preferred to omit that phrase because they favoured a broader formulation. They also thought it would encourage enterprises to claim that the condition was not met and to artificially avoid having a PE. Countries that share this concern are free to omit the words “that are routinely concluded without material modification by the enterprise”.

25. With the addition of paragraph 5, subparagraph (b), relating to the maintenance of a stock of goods, this paragraph is broader in scope than paragraph 5 of the OECD Model Convention.

Some countries believe that a narrow formula might encourage an agent who was in fact dependent to represent himself as acting on his own behalf.

26. The former Group of Experts understood that paragraph 5, subparagraph (b) was to be interpreted such that if all the sales-related activities take place outside the host State and only delivery, by an agent, takes place there, such a situation would not lead to a permanent establishment.<sup>2</sup> The former Group of Experts noted, however, that if sales-related activities (for example, advertising or promotion) are also conducted in that State on behalf of the resident (whether or not by the enterprise itself or by its dependent agents) and have contributed to the sale of such goods or merchandise, a permanent establishment may exist.<sup>3</sup>

### ***Paragraph 6***

27. This paragraph of the United Nations Model Convention does not correspond to any provision in Article 5 of the OECD Model Convention and is included to deal with certain aspects of the insurance business. The Commentary of the OECD Model Convention nevertheless discusses the possibility of such a provision in bilateral tax treaties in the following terms:

**39114.** 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. The decision as to whether or not a provision along these lines should be included in a convention will depend on the factual and legal situation prevailing in the Contracting States concerned. Frequently, therefore, such a provision will not be contemplated. In view of this fact, it did not seem advisable to insert a provision along these lines in the Model Convention.

EXPLANATION: The above change is merely paragraph numbering change to conform to the current OECD Model Commentary.
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28. Paragraph 6 of the United Nations Model Convention, which achieves the aim quoted above, is necessary because insurance agents generally have no authority to conclude

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<sup>2</sup> See paragraph 25 of the Commentary on Article 5 of the 1999 version of the United Nations Model Convention.

<sup>3</sup> Ibid.



contracts; thus, the conditions of paragraph 5, subparagraph (a) would not be fulfilled. If an insurance agent is independent, however, the profits of the insurance company attributable to his activities are not taxable in the source State because the provisions of Article 5 paragraph 7 would be fulfilled and the enterprise would not be deemed to have a permanent establishment.

29. Some countries, however, favour extending the provision to allow taxation even where there is representation by such an independent agent. They take this approach because of the nature of the insurance business, the fact that the risks are situated within the country claiming tax jurisdiction, and the ease with which persons could, on a part-time basis, represent insurance companies on the basis of an “independent status”, making it difficult to distinguish between dependent and independent insurance agents. Other countries see no reason why the insurance business should be treated differently from activities such as the sale of tangible commodities. They also point to the difficulty of ascertaining the total amount of business done when the insurance is handled by several independent agents within the same country. In view of this difference in approach, the question how to treat independent agents is left to bilateral negotiations, which could take account of the methods used to sell insurance and other features of the insurance business in the countries concerned.

### ***Paragraph 7***

30. The first sentence of this paragraph reproduces Article 5, paragraph 6 of the OECD Model Convention, with a few minor drafting changes. The relevant portions of the Commentary on the 2017 OECD Model are as follows:

102. Where an enterprise of a Contracting State carries on business dealings through an independent agent carrying on business as such, it cannot be taxed in the other Contracting State in respect of those dealings if the agent is acting in the ordinary course of that business [...]. The activities of such an agent, represents a separate and independent enterprise should not result in the finding of a permanent establishment of the foreign enterprise.

103. The exception of paragraph 6 only applies where a person acts on behalf of an enterprise in the course of carrying on a business as an independent agent. It would therefore not apply where a person acts on behalf of an enterprise in a different capacity, such as where an employee acts on behalf of her employer or a partner acts on behalf of a partnership. As explained in paragraph 8.1 of the Commentary on Article 15, it is sometimes difficult to determine whether the services rendered by an individual constitute employment services or services rendered by a separate enterprise and the guidance in paragraphs 8.2 to 8.28 of the Commentary on Article 15 will be relevant for that purpose. Where an individual acts on behalf of an enterprise in the course of carrying on his own business and not as an employee, however, the application of paragraph 6 will still require that the individual do so as an independent agent; as explained in paragraph 111 below, this independent status is less likely if the activities of that individual are performed exclusively or almost exclusively on behalf of one enterprise or closely related enterprises.

104. Whether a person acting as an agent 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. In any event, the last sentence of paragraph 6 provides that in certain circumstances a person shall not be considered to be an independent agent (see paragraphs 119 to 121 below). The following considerations should be borne in mind when determining whether an agent to whom that last sentence does not apply may be considered to be independent.

105. It should be noted that, where the last sentence of paragraph 6 does not apply because a subsidiary does not act exclusively or almost exclusively for closely related enterprises, the control which a parent company exercises over its subsidiary in its capacity as shareholder is not relevant in a consideration of the dependence or otherwise of the subsidiary in its capacity as an agent for the parent. This is consistent with the rule in paragraph 7 of Article 5 (see also paragraph 113 below).

106. 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.

107. Limitations on the scale of business which may be conducted by the agent clearly affect the scope of the agent's authority. However, such limitations are not relevant to dependency which is determined by consideration of the extent to which the agent exercises freedom in the conduct of business on behalf of the principal within the scope of the authority conferred by the agreement.

108. It may be a feature of the operation of an agreement that an agent will provide substantial information to a principal in connection with the business conducted under the agreement. This is not in itself a sufficient criterion for determination that the agent is dependent unless the information is provided in the course of seeking approval from the principal for the manner in which the business is to be conducted. The provision of information which is simply intended to ensure the smooth running of the agreement and continued good relations with the principal is not a sign of dependence.

109. Another factor to be considered in determining independent status is the number of principals represented by the agent. As indicated in paragraph 111, 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. Where an agent acts for a number of principals in the ordinary course of his business and none of these is predominant in terms of the business carried on by the agent, dependence may exist if the principals act in concert to control the acts of the agent in the course of his business on their behalf.

110. An independent agent cannot be said to act in the ordinary course of its business as agent when it performs activities that are unrelated to that agency business. Where,

for example, a company that acts on its own account as a distributor for a number of companies also acts as an agent for another enterprise, the activities that the company undertakes as a distributor will not be considered to be part of the activities that the company carries on in the ordinary course of its business as an agent for the purposes of the application of paragraph 6). Activities that are part of the ordinary course of a business that an enterprise carries on as an agent will, however, include intermediation activities which, in line with the common practice in a particular business sector, are performed sometimes as agent and sometimes on the enterprise's own account, provided that these intermediation activities are, in substance, indistinguishable from each other. Where, for example, a broker-dealer in the financial sector performs a variety of market intermediation activities in the same way but, informed by the needs of the clients, does it sometimes as an agent for another enterprise and sometimes on its own account, the broker-dealer will be considered to be acting in the ordinary course of its business as an agent when it performs these various market intermediation activities.

111. The last sentence of paragraph 6 provides that a person is not considered to be an independent agent where the person acts exclusively or almost exclusively for one or more enterprises to which it is closely related. That last sentence does not mean, however, that paragraph 6 will apply automatically where a person acts for one or more enterprises to which that person is not closely related. Paragraph 6 requires that the person must be carrying on a business as an independent agent and be acting in the ordinary course of that business. Independent status is less likely if the activities of the person are performed wholly or almost wholly on behalf of only one enterprise (or a group of enterprises that are closely related to each other) over the lifetime of that person's business or over a long period of time. Where, however, a person is acting exclusively for one enterprise, to which it is not closely related, for a short period of time (e.g. at the beginning of that person's business operations), it is possible that paragraph 6 could apply. As indicated in paragraph 109 above, all the facts and circumstances would need to be taken into account to determine whether the person's activities constitute the carrying on of a business as an independent agent.

112. The last sentence of paragraph 6 applies only where the person acts "exclusively or almost exclusively" on behalf of closely related enterprises, as defined in paragraph [9]. This means that where the person's activities on behalf of enterprises to which it is not closely related do not represent a significant part of that person's business, that person will not qualify as an independent agent. Where, for example, the sales that an agent concludes for enterprises to which it is not closely related represent less than 10 per cent of all the sales that it concludes as an agent acting for other enterprises, that agent should be viewed as acting "exclusively or almost exclusively" on behalf of closely related enterprises.

113. The rule in the last sentence of paragraph 6 and the fact that the definition of "closely related" in paragraph 8 covers situations where one company controls or is controlled by another company do not restrict in any way the scope of paragraph 8 of Article 5. As explained in paragraph 117 below, it is possible that a subsidiary will act on behalf of its parent company in such a way that the parent will be deemed to have a permanent establishment under paragraph 5; if that is the case, a subsidiary acting exclusively or almost exclusively for its parent will be unable to benefit from the "independent agent" exception of paragraph 6. This, however, does not imply that the

parent-subsidiary relationship eliminates the requirements of paragraph 5 and that such a relationship could be sufficient in itself to conclude that any of these requirements are met.

31. In the 1999 revision of the Model, the wording was amended to clarify that the essential criterion for treating an agent as not being of “an independent status” was the absence of an arm’s length relationship.

32. In the 2017 update, the Committee decided that the lack of an arm’s length relationship should not be a deciding factor in determining that an agent does not qualify as an agent of independent status and removed this requirement from the independent agent rule. In making its decision it was noted that removal of the arm’s length condition was made because prior to the 2017 update, it was easier to qualify as “an independent agent” under the United Nations Model Convention than under the OECD Model Convention.

### ***Paragraph 8***

33. The present paragraph reproduces Article 5, paragraph 7 of the 2017 OECD Model Convention. The Commentary on the OECD text is as follows:

115. It is generally accepted that the existence of a subsidiary company does not, of itself, constitute that subsidiary company a permanent establishment of its parent company. This follows from the principle that, for the purpose of taxation, such a subsidiary company constitutes an independent legal entity. Even the fact that the trade or business carried on by the subsidiary company is managed by the parent company does not constitute the subsidiary company a permanent establishment of the parent company.

116. A parent company may, however, be found, under the rules of paragraphs 1 or 5 of the Article, to have a permanent establishment in a State where a subsidiary has a place of business. Thus, any space or premises belonging to the subsidiary that is at the disposal of the parent company [...] and that constitutes a fixed place of business through which the parent carries on its own business will constitute a permanent establishment of the parent under paragraph 1, subject to paragraphs 3 and 4 of the Article (see for instance, the example in paragraph 15 above). Also, under paragraph 5, a parent will be deemed to have a permanent establishment in a State in respect of any activities that its subsidiary undertakes for it if the conditions of that paragraph are met (see paragraphs 82-99 above), unless these activities are limited to those referred to in paragraph 4 of the Article or unless paragraph 6 of the Article applies.

117. The same principles apply to any company forming part of a multinational group so that such a company may be found to have a permanent establishment in a State where it has at its disposal [...] and uses premises belonging to another company of the group, or if the former company is deemed to have a permanent establishment under paragraph 5 of the Article [...]. The determination of the existence of a permanent establishment under the rules of paragraphs 1 or 5 of the Article must, however, be done separately for each company of the group. Thus, the existence in one State of a permanent establishment of one company of the group will not have any relevance as to whether another company of the group has itself a permanent establishment in that State.

34. The Committee notes that determining whether or not a permanent establishment exists on a separate entity basis may entail vulnerability to abusive arrangements. Depending on the domestic law of States, safeguards against purely artificial structures may be found through application of a rule according to which substance overrides form. The Commentary of the 2017 OECD Model Convention also states the following:

118. Whilst premises belonging to a company that is a member of a multinational group can be put at the disposal of another company of the group and may, subject to the other conditions of Article 5, constitute a permanent establishment of that other company if the business of that other company is carried on through that place, it is important to distinguish that case from the frequent situation where a company that is a member of a multinational group provides services (*e.g.* management services) to another company of the group as part of its own business carried on in premises that are not those of that other company and using its own personnel. In that case, the place where those services are provided is not at the disposal of the latter company and it is not the business of that company that is carried on through that place. That place cannot, therefore, be considered to be a permanent establishment of the company to which the services are provided. Indeed, the fact that a company's own activities at a given location may provide an economic benefit to the business of another company does not mean that the latter company carries on its business through that location: clearly, a company that merely purchases parts produced or services supplied by another company in a different country would not have a permanent establishment because of that, even though it may benefit from the manufacturing of these parts or the supplying of these services.

### ***Paragraph 9***

35. This paragraph reproduces Article 5, paragraph 8 of the 2017 OECD Model Convention; the relevant portions of the Commentary on the OECD text are as follows:

119. Paragraph [9] explains the meaning of the concept of a “person closely related to an enterprise” for the purposes of the Article and, in particular, of paragraphs 4.1 and 6. That concept is to be distinguished from the concept of “associated enterprises” which is used for the purposes of Article 9; although the two concepts overlap to a certain extent, they are not intended to be equivalent.

120. The first part of paragraph [9] includes the general definition of “a person closely related to an enterprise”. It provides that a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. This general rule would cover, for example, situations where a person or enterprise controls an enterprise by virtue of a special arrangement that allows that person to exercise rights that are similar to those that it would hold if it possessed directly or indirectly more than 50 per cent of the beneficial interests in the enterprise. As in most cases where the plural form is used, the reference to the “same persons or enterprises” at the end of the first sentence of paragraph [9] covers cases where there is only one such person or enterprise.

121. The second part of paragraph [9] provides that the definition of “person closely related to an enterprise” is automatically satisfied in certain circumstances. Under that second part, a person is considered to be closely related to an enterprise if either one possesses directly or indirectly more than 50 per cent of the beneficial interests in the

other or if a third person possesses directly or indirectly more than 50 per cent of the beneficial interests in both the person and the enterprise. In the case of a company, this condition is satisfied where a person holds directly or indirectly more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company.

### *Electronic commerce*

36. The Commentary of the 2017 OECD Model Convention includes the following section on "electronic commerce":

#### **Electronic commerce**

122. There has been some discussion as to whether the mere use in electronic commerce operations of computer equipment in a country could constitute a permanent establishment. That question raises a number of issues in relation to the provisions of the Article.

123. Whilst a location where automated equipment is operated by an enterprise may constitute a permanent establishment in the country where it is situated (see below), a distinction needs to be made between computer equipment, which may be set up at a location so as to constitute a permanent establishment under certain circumstances, and the data and software which is used by, or stored on, that equipment. For instance, an Internet web site, which is a combination of software and electronic data, does not in itself constitute tangible property. It therefore does not have a location that can constitute a "place of business" as there is no "facility such as premises or, in certain instances, machinery or equipment" (see paragraph 6 above) as far as the software and data constituting that web site is concerned. On the other hand, the server on which the web site is stored and through which it is accessible is a piece of equipment having a physical location and such location may thus constitute a "fixed place of business" of the enterprise that operates that server.

124. The distinction between a web site and the server on which the web site is stored and used is important since the enterprise that operates the server may be different from the enterprise that carries on business through the web site. For example, it is common for the web site through which an enterprise carries on its business to be hosted on the server of an Internet Service Provider (ISP). Although the fees paid to the ISP under such arrangements may be based on the amount of disk space used to store the software and data required by the web site, these contracts typically do not result in the server and its location being at the disposal of the enterprise (see paragraph 10 to 19 above), even if the enterprise has been able to determine that its web site should be hosted on a particular server at a particular location. In such a case, the enterprise does not even have a physical presence at that location since the web site is not tangible. In these cases, the enterprise cannot be considered to have acquired a place of business by virtue of that hosting arrangement. However, if the enterprise carrying on business through a web site has the server at its own disposal, for example it owns (or leases) and operates the server on which the web site is stored and used, the place where that server is located could constitute a permanent establishment of the enterprise if the other requirements of the Article are met.

125. Computer equipment at a given location may only constitute a permanent establishment if it meets the requirement of being fixed. In the case of a server, what is relevant is not the possibility of the server being moved, but whether it is in fact moved. In order to constitute a fixed place of business, a server will need to be located at a certain place for a sufficient period of time so as to become fixed within the meaning of paragraph 1.

126. Another issue is whether the business of an enterprise may be said to be wholly or partly carried on at a location where the enterprise has equipment such as a server at its disposal. The question of whether the business of an enterprise is wholly or partly carried on through such equipment needs to be examined on a case-by-case basis, having regard to whether it can be said that, because of such equipment, the enterprise has facilities at its disposal where business functions of the enterprise are performed.

127. Where an enterprise operates computer equipment at a particular location, a permanent establishment may exist even though no personnel of that enterprise is required at that location for the operation of the equipment. The presence of personnel is not necessary to consider that an enterprise wholly or partly carries on its business at a location when no personnel are in fact required to carry on business activities at that location. This conclusion applies to electronic commerce to the same extent that it applies with respect to other activities in which equipment operates automatically, *e.g.* automatic pumping equipment used in the exploitation of natural resources.

128. Another issue relates to the fact that no permanent establishment may be considered to exist where the electronic commerce operations carried on through computer equipment at a given location in a country are restricted to the preparatory or auxiliary activities covered by paragraph 4. The question of whether particular activities performed at such a location fall within paragraph 4 needs to be examined on a case-by-case basis having regard to the various functions performed by the enterprise through that equipment. Examples of activities which would generally be regarded as preparatory or auxiliary include:

- providing a communications link—much like a telephone line—between suppliers and customers;
- advertising of goods or services;
- relaying information through a mirror server for security and efficiency purposes;
- gathering market data for the enterprise;
- supplying information.

129. Where, however, such functions form in themselves an essential and significant part of the business activity of the enterprise as a whole, or where other core functions of the enterprise are carried on through the computer equipment, these would go beyond the activities covered by paragraph 4 and if the equipment constituted a fixed place of business of the enterprise (as discussed in paragraphs 123 to 127 above), there would be a permanent establishment.

130. What constitutes core functions for a particular enterprise clearly depends on the nature of the business carried on by that enterprise. For instance, some ISPs are in the business of operating their own servers for the purpose of hosting web sites or other applications for other enterprises. For these ISPs, the operation of their servers in order

to provide services to customers is an essential part of their commercial activity and cannot be considered preparatory or auxiliary. A different example is that of an enterprise (sometimes referred to as an “e-tailer”) that carries on the business of selling products through the Internet. In that case, the enterprise is not in the business of operating servers and the mere fact that it may do so at a given location is not enough to conclude that activities performed at that location are more than preparatory and auxiliary. What needs to be done in such a case is to examine the nature of the activities performed at that location in light of the business carried on by the enterprise. If these activities are merely preparatory or auxiliary to the business of selling products on the Internet (for example, the location is used to operate a server that hosts a web site which, as is often the case, is used exclusively for advertising, displaying a catalogue of products or providing information to potential customers), paragraph 4 will apply and the location will not constitute a permanent establishment. If, however, the typical functions related to a sale are performed at that location (for example, the conclusion of the contract with the customer, the processing of the payment and the delivery of the products are performed automatically through the equipment located there), these activities cannot be considered to be merely preparatory or auxiliary.

131. A last issue is whether paragraph 5 may apply to deem an ISP to constitute a permanent establishment. As already noted, it is common for ISPs to provide the service of hosting the web sites of other enterprises on their own servers. The issue may then arise as to whether paragraph 5 may apply to deem such ISPs to constitute permanent establishments of the enterprises that carry on electronic commerce through web sites operated through the servers owned and operated by these ISPs. Whilst this could be the case in very unusual circumstances, paragraph 5 will generally not be applicable because the ISPs will not constitute an agent of the enterprises to which the web sites belong, because they will not conclude contracts or play the principal role leading to the conclusion of contracts in the name of these enterprises, or for the transfer of property belonging to these enterprises or the provision of services by these enterprises, or because they will act in the ordinary course of a business as independent agent, as evidenced by the fact that they host the web sites of many different enterprises. It is also clear that since the web site through which an enterprise carries on its business is not itself a “person” as defined in Article 3, paragraph 5 cannot apply to deem a permanent establishment to exist by virtue of the web site being an agent of the enterprise for purposes of that paragraph.

37. The Committee of Experts notes that the OECD Commentary, in paragraph 124, draws a distinction between a contract with an Internet Service Provider and one with a place of business at the disposal of the enterprise. In this regard, the Committee recognizes that some businesses could seek to avoid creating a permanent establishment by managing the contractual terms in cases where the circumstances would justify the conclusion that a permanent establishment exists. Such abuses may fall under the application of legislative or judicial anti-avoidance rules.