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Committee of Experts on International Cooperation in Tax Matters

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Proposal for amendments to article 5 of the United Nations Model Double Taxation Convention between Developed and Developing Countries*

Summary

Based on the discussion at the third session of the Committee of Experts on International Cooperation in Tax Matters held in 2006, the subcommittee on permanent establishment prepared a proposed amended UN Model Commentary to Article 5.

*The present paper was prepared by the subcommittee on Definition of permanent establishment (Coordinator: Mr. Sollund). The views and opinions expressed are those of the authors and do not necessarily represent those of the United Nations.

Contents

I. Introduction

1. At the first session of the Committee of Experts on International Cooperation in Tax matters in December 2005, a subcommittee made up of experts and observers was appointed to propose improvements to the commentary on article 5 of the United Nations Model Double Taxation Convention between Developed and Developing Countries, taking into consideration amendments to the Organization for Economic Cooperation and Development (OECD) commentary and placing emphasis on useful examples and the specific needs of developing countries (see E/2005/45-E/C.18/2005/11, para. 85).

2. The following are the current members of the subcommittee: Stig Sollund (Coordinator), Andrew Dawson, Wolfgang Lasars, Ofir Levy, Habiba Louati, Ron van der Merwe, Hans Pijl, Erwin Silitonga, and Eduardo Zaidenzstat Capnikas.

II. Previous report

3. The subcommittee reported to the Annual Session of the Committee of Experts on Cooperation in Tax Matters in 2006 (see E/C.18/2006/4) following a presentation to the Committee by Mr Pijl on the topic at the 2005 Annual Session (see E/C.18/2005/5). In the 2006 Report of the Committee[1], the discussion was summarised as follows:

> **Definition of permanent establishment**
> 24. Stig Sollund and Hans Pijl made a presentation on the work of the subcommittee. A thorough discussion took place on that issue, which was regarded as a critical one. The discussion went further than the strict issue of the definition of "permanent establishment".
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> 25. The conclusions of the subcommittee, with regard to changes in the Commentary, were agreed.
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> 26. The main issues that arose in the discussion were as follows:
> (a) Whether article 14 ("Independent personal services") should be deleted and reliance placed on article 5, and if so, what adjustments might be needed to the Model. It was stated that any such change would need special attention, given the fact that the United Nations Model differs from the OECD Model with regard to the time test in particular;
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> (b) How to ensure proper taxation of services as a whole. The issue of technical fees — whether they should be dealt with under the royalties article — was considered as part of the broader topic, though not relating specifically to the definition of permanent establishment;
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> (c) Whether there was a need for clarification of the basis on which taxes are assessed at source, whether on a gross or net basis. It was noted that that could be a significant issue as articles 14 and 7 are not worded in the same way in regard to the basis of taxation (being income in the former case and profit in the latter), and therefore it is possible that there would be a different result between the two articles. Some expressed the views that the question is not relevant and should not be addressed any further.

[1] E/C.18/2006/10.

27. As for some other items, there was a general discussion on the relationship between the OECD and United Nations Models. The general view was that the Committee should draw upon the expertise available, including in the OECD, without being bound to the conclusions reached elsewhere. It was recognized that the two Models were not in competition and that the Committee remained free to deviate from any other Model, taking into account the situation of developing countries.

28. The subcommittee was invited to continue its work. Attention should primarily be paid to taxation of services related to articles 14 and 5 (including the possibility of deleting article 14 and adjusting article 5 to retain an appropriate balance of the taxing rights currently available under article 14) and to taxation of technical fees. As a subsidiary part of its work, the subcommittee will also address the question of taxation on a net or gross basis and the possible need for definition of the terms “business” and “enterprise”. The subcommittee was mandated to propose a draft article and Commentary, reflecting both its further work and what was agreed during the session. The Secretariat was asked to assist the subcommittee in its work of drafting the Commentary. It was decided that Erwin Silitonga and Eduardo Zaidenzstat Capnikas would join the subcommittee.

29. A number of other points, such as taxation of fisheries and electronic commerce, were also raised. The treatment of those issues was left for further consideration.

III. Purpose of this paper

4. This paper seeks to complete the work referred to in paragraph 25 of the 2006 Report of the Annual Session of the Committee. In other words it is intended to address the issues agreed at the 2006 Annual Session by updating the Commentary to Article 5. Those further matters that the subcommittee was mandated to consider by the 2006 Annual Session are addressed in a separate paper, E/C.18/2007/12.

5. The substance of the current paper is in the attached proposed version of United Nations Model Commentary on Article 5 (Annex 1 in “clean” form, and Annex 2 in a form showing the differences to the current UN Model). While it is recognised that the work of this subcommittee could result in further changes to the UN Model Commentary on Article 5, the subcommittee considered it best to first resolve text that takes account of issues raised in 2006, and then to suggest such alterations as may be necessary to deal with particular issues, such as the taxation of services, which are on the agenda for further consideration by the subcommittee and Committee.

ANNEX 1

Proposed Amended UN Model Commentary to Article 5

ARTICLE 5

PERMANENT ESTABLISHMENT

A. GENERAL CONSIDERATIONS

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

- there is a 6 months test for a building or construction site constituting a permanent establishment, rather than the 12 months test under the OECD Model, and it expressly extends to assembly projects, as well as supervisory activities in connection with building sites and construction or installation projects (paragraph 3 of the UN Model article);

- 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 6 months in a twelve month period (paragraph 3(b));

- in the paragraph 4 list of what is deemed *not* to constitute a permanent establishment (often referred to as the list of "preparatory and auxiliary activities") "delivery" is not mentioned in the UN Model, but is mentioned in the OECD Model. Therefore a delivery activity might result in a permanent establishment under the UN Model, without doing so under the OECD Model;

- 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 UN Model approach (paragraph 6); and

- an independent agent acting as such will usually not create a permanent establishment for the enterprise making use of the agent, because such an agent is effectively operating their own business providing a service. The UN Model indicates that such an agent devoting all or nearly all their time to

[1] This short form makes the text more readable and "user-friendly" in the view of the subcommittee, but the short form references to the OECD and UN Models could best be introduced once in the introduction to the UN Model as a whole. [*Subcommittee footnote – not intended to be part of the revised Commentary*].

> a particular client and not dealing with the client on an arm's length basis is not treated as having the necessary independence. (paragraph 7).

These differences are considered in more detail below.[2]

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 UN Model reaffirms the concept.

B. COMMENTARY ON THE PARAGRAPHS OF ARTICLE 5

Paragraph 1

3. This paragraph, which reproduces Article 5(1) of the OECD Model, 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 Commentary (the 2005 version of which is cited below), 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 Commentary goes on to observe:

> *3.*[3] 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

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[2] The subcommittee proposes that the next version of the UN Model should note in its introduction, words along the following lines: "In extensively quoting the Commentary to the OECD Model, it is noted that this has be to read together with the "observations" of OECD Member countries to obtain a full understanding of the acceptance or otherwise of certain parts of the Commentary by specific OECD countries in particular cases. The observations on the most recent version of the OECD Model (2005) are included at Appendix ** of this publication for convenience, along with relevant "positions" on the OECD Commentaries provided to the OECD by some non-members of the OECD". The subcommittee notes that such an introductory paragraph would render it unnecessary to include a special comment along the same lines in the Commentaries of the UN Model on each specific Article. [*Subcommittee footnote – not intended to be part of the revised Commentary*]

[3] This formatting of direct quotation of paragraphs of the OECD Model follows the suggestions of the Secretariat in a note to the Committee, to give an indication of what those changes would look like in practice. [*Subcommittee footnote – not intended to be part of the revised Commentary*] See E/C.18/2007/CRP.13.

establishment to which profits can properly be attributed for the purpose of tax in a particular territory.

4. The term "place of business" covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is immaterial whether the premises, facilities or installations are owned or rented by or are otherwise at the disposal of the 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 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.

4.2 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. These principles are illustrated by the following examples where representatives of one enterprise are present on the premises of another enterprise. 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).

4.3 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 to 6.3) and that the activities that are performed there go beyond the activities referred to in paragraph 4 of the Article.

4.4 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 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.

4.6 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

5. 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 cf. the discussion at paragraph 20 below).

5.1 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 and 20 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.

5.2 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.

5.3 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.

5.4 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.

6. 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). 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. [4]

7. 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 . . . 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. 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.

…

10. The business of an enterprise is carried on mainly by the entrepreneur or persons who are in a paid-employment relationship with the enterprise (personnel). This personnel includes employees and other persons receiving instructions from the enterprise (e.g., dependent agents). The powers of such personnel in its relationship with third parties are irrelevant. It makes no difference whether or not the dependent agent is authorised to conclude contracts if he works at the fixed place of business. But a permanent establishment may nevertheless exist if the business of the enterprise is carried on mainly through automatic equipment, the activities of the personnel being restricted to setting up, operating, controlling and maintaining such equipment.

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[4] The Committee agreed with the approach taken in paragraph 6 of the OECD Commentary, while recognizing that such 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.

> 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.
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> *11*. 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 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 lessor's; in general, the lessor's permanent establishment ceases to exist, except where he continues carrying on a business activity of his own through the fixed place of business.

Paragraph 2

4. Paragraph 2, which reproduces Article 5(2) of the OECD Model, 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 while a permanent establishment may well exist, it does not prove that one necessarily does exist. This is also the stance of the OECD 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 paragraph 4 (a) and (b) 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 at paragraph 13 that the term "place of 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:

> *15.* 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.

6. As mentioned above, the expression "any other place of extraction of natural resources" in subparagraph (f) should be interpreted broadly. Some countries believe that fishing vessels could be treated as a place of extraction of natural resources since fish, as well as minerals embedded in the earth, constitute a natural resource (albeit a renewable one). They argue that a fishing vessel can be compared to a movable oil drilling platform. Where fishing vessels are used in a State's territorial waters or its exclusive economic zone, they would, on this view, constitute a permanent establishment situated in that State. However, such an interpretation is a contentious reading of the term "permanent establishment" and of the natural language of the subparagraph, and countries who believe that a fishing vessel can be a permanent establishment should make that explicit by adopting it as a new and separate category of "deemed" permanent establishments under paragraph 3 (see paragraph 13 below).

Paragraph 3

7. This paragraph covers a broader range of activities than Article 5(3) of the OECD Model, 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, subparagraph 3(a) of the UN Model includes an "assembly project" as well as "supervisory activities" in connection with "a building site, a construction, installation or assembly project". Another difference is that while the OECD Model uses a time limit of twelve months, the UN Model 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.

8. Some developing countries support a more elaborate version of paragraph 3(a), 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 was installed by an enterprise other than the one doing the construction work.

9. Article 5(3)(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. 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.

10. A few developing countries oppose the six-month threshold in paragraph 3 (a) and (b) 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 OECD Commentary observes, with changes in parentheses to take account of the different time periods in the two Models:

> *18.* 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). The [six] month threshold has given rise to abuses; it has sometimes been found that enterprises (mainly contractors or sub-contractors 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 anti-avoidance rules, countries concerned with this issue can adopt solutions in the framework of bilateral negotiations.

The Committee points out that measures to counteract abuses would apply equally in cases under Article 5(3)(b). The Commentary of the OECD Model continues as follows:

> *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 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.

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 OECD Model continues as follows:

> *19.1* 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 month[s], 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.
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> *20.* 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 a case, the fact that the work force is not present for [six] months in one particular place 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.

12. Subparagraph (b) encompasses service activities only if they "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". The words "for the same or a connected project" are included because it is not appropriate to add together unrelated projects in view of the uncertainty which that step involves and the undesirable distinction it creates between an enterprise with, for example, one project of three months' duration and another with two unrelated projects, each of three months' duration, one following the other. However, some countries find the "project" limitation either too easy to manipulate or too narrow in that it might preclude taxation in the case of a continuous number of separate projects, each of four or five months' duration.

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 deemed 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 Commentary on the OECD Model are relevant to article 5(3)(a) of the UN Model, although the reference to an "assembly project" in the UN Model and not in the OECD Model, and the six month period in the UN Model 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 12 months. Any of those items which does 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 12 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 pipelines 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.

Paragraph 4

16. This paragraph reproduces article 5(4) of the OECD Model with one substantive amendment: the deletion of "delivery" in subparagraphs (a) and (b). In view of the similarities to the OECD Model provision and the general relevance of its Commentary, the general principles of article 5(4) under both Models are first noted below and then the practical relevance of the deletion of references to "delivery" in the UN Model are considered.

17. The deletion of the word "delivery" reflects the majority view of the Committee that a "warehouse" used for that purpose should, if at least the requirements of paragraph 1 are met, be a permanent establishment.

18. The OECD Model Commentary on paragraph 4 of the OECD Article is as follows:

21. This paragraph lists a number of business activities which are treated as exceptions to the general definition laid down in paragraph 1 and which are not permanent establishments, even if the activity is carried on through a fixed place of business. The common feature of these activities is that they are, in general, preparatory or auxiliary activities. This is laid down explicitly in the case of the exception mentioned in subparagraph *e),* which actually amounts to a general restriction of the scope of the definition contained in paragraph 1. 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, provided 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 carries on in that other State, activities of a purely preparatory or auxiliary character.

22. Subparagraph *a*) relates only to the case in which an enterprise acquires the use of facilities for storing, displaying or delivering its own goods or merchandise. Subparagraph *b*) relates to the stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery. Subparagraph *c*) covers the case in which 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. The reference to the collection of information in subparagraph *d*) is intended to include the case of the newspaper bureau which has no purpose other than to act as one of many "tentacles" of the parent body; to exempt such a bureau is to do no more than to extend the concept of "mere purchase".

23. Subparagraph *e*) provides that a fixed place of business through which the enterprise exercises solely an activity which has for the enterprise a preparatory or auxiliary character, is deemed not to be a permanent establishment. The wording of this subparagraph makes it unnecessary to produce an

exhaustive list of exceptions. Furthermore, this subparagraph provides a generalised exception to the general definition in paragraph 1 and, when read with that paragraph, provides a more selective test, by which to determine what constitutes a permanent establishment. To a considerable degree it limits that definition and excludes from its rather wide scope a number of forms of business organisations which, although they are carried on through a fixed place of business, 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. Examples are fixed places of business 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.

24. 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. Where, for example, 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 subparagraph *e).* 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 enterprises with international ramifications establish a so-called "management office" in States in which they maintain 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, a permanent establishment will normally be deemed to exist, because the management office may be regarded as an office within the meaning of paragraph 2. Where a big international concern has delegated all management functions to its regional management offices so that the functions of the head office of the concern are restricted to general supervision (so-called polycentric enterprises), the regional management offices even have to be regarded as a "place of management" within the meaning of subparagraph *a*) of paragraph 2. 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 subparagraph *e*) of paragraph 4.

25. A permanent establishment could also be constituted if an enterprise maintains a fixed place of business for the delivery of spare parts to customers for machinery supplied to those customers where, in addition, it maintains or repairs such machinery, as this goes beyond the pure delivery mentioned in subparagraph *a*) of paragraph 4. Since these after-sale organisations perform an essential and significant part of the services of an enterprise vis-à-vis its customers, their activities are not merely auxiliary ones. Subparagraph *e*) applies only if the activity of the fixed place of business is limited to a preparatory or auxiliary one. This would not be the case where, for example, the fixed place of business does not only give information but also furnishes plans etc. specially developed for the purposes of the individual customer. Nor would it be the case if a research establishment were to concern itself with manufacture.

26. Moreover, subparagraph *e*) makes it clear that the activities of the fixed place of business must be carried on for the enterprise. A fixed place of business which renders services not only to its enterprise but also directly to other enterprises, for example to other companies of a group to which the company owning the fixed place belongs, would not fall within the scope of subparagraph *e*).

26.1 Another example is that of 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 they constitute immovable property

under paragraph 2 of Article 6, the question may arise as to whether paragraph 4 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.

27. As already mentioned in paragraph 21 above, paragraph 4 is designed to provide for 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*) of paragraph 4, the fact that one fixed place of business combines any of the activities mentioned in the subparagraphs *a*) to *e*) of paragraph 4 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. The criterion "preparatory or auxiliary character" is to be interpreted in the same way as is set out for the same criterion of subparagraph *e*) (cf. paragraphs 24 and 25 above). States which want to allow any combination of the items mentioned in subparagraphs *a*) to *e*), disregarding whether or not the criterion of the preparatory or auxiliary character of such a combination is met, are free to do so by deleting the words "provided" to "character" in subparagraph *f*).

27.1 Subparagraph *f*) is of no importance in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs *a*) to *e*) provided that they are separated from each other locally and organisationally, as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists. Places of business are not "separated organisationally" where they each perform in a Contracting State complementary functions such as receiving and storing goods in one place, distributing those goods through another etc. An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity.

28. The fixed places of business mentioned in paragraph 4 cannot be deemed to constitute permanent establishments so long as their activities are restricted to the functions which are the prerequisite for assuming that the fixed place of business is not a permanent establishment. 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 employees of places of business within the meaning of paragraph 4 who are authorised to conclude such contracts should not be regarded as agents within the meaning of paragraph 5. A case in point would be a research institution the manager of which is authorised to conclude the contracts necessary for maintaining the institution and who exercises this authority within the framework of the functions of the institution. A permanent establishment, however, exists if the fixed place of business exercising any of the functions listed in paragraph 4 were to exercise them not only on behalf of the enterprise to which it belongs but also on behalf of other enterprises. If, for instance, an advertising agency maintained by an enterprise were also to engage in advertising for other enterprises, it would be regarded as a permanent establishment of the enterprise by which it is maintained.

29. If a fixed place of business under paragraph 4 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 in such installation (cf. paragraph 11 above and paragraph 2 of Article 13). Since, for example, the display of merchandise is excepted under

> subparagraphs *a*) and *b*), the sale of the merchandise at the termination of a trade fair or convention is covered by this exception. The exception does not, of course, apply to sales of merchandise not actually displayed at the trade fair or convention.
>
> *30.* A fixed place of business used both for activities which rank as exceptions (paragraph 4) and for other activities would be regarded as a single permanent establishment and taxable as regards both types of activities. This would be the case, for instance, where a store maintained for the delivery of goods also engaged in sales.

19. Subparagraph (f) was added to article 5(4) in 1999. It follows the OECD model and provides that "the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e)" is not a permanent establishment if "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 UN Model, in contrast to the OECD Model, 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 long engaged the former Group of Experts. A 1997 study revealed that almost 75 per cent of developing countries' tax treaties *included* the "delivery of goods" in the list of exceptions in paragraph 4 (a) and (b). Nevertheless, some countries regard the omission of the expression in the UN Model as an important point of departure from the OECD Model, 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 UN Model, the Committee decided to retain the existing distinction between the two Models, but it noted 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 over-attribution of income to this activity if they do not give this issue close consideration, leading to prolonged litigation and inconsistent application of tax treaties. Therefore, although the reference to "delivery" is absent from the UN Model, countries may wish to consider both points of view when entering into bilateral tax treaties, with a view to the practical results of either approach.

Paragraph 5

22. It is generally accepted that if a person acts in a State for an enterprise in a way that ties the enterprise closely into 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 dependent agent who carries out on behalf of the enterprise an activity specified in subparagraph (a) or (b). Subparagraph (a) follows the substance of the OECD Model and proceeds on the basis that a person with the authority to conclude contracts in the name of the enterprise creates for that enterprise a sufficiently close association with a State such that it would be appropriate for a deemed permanent establishment to exist 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 deemed "permanent establishment" to exist only if his authority is used repeatedly and not merely in isolated cases. The OECD Commentary states further:

> *32.1* Also, the phrase "authority to conclude contracts in the name of the enterprise" does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which

> are binding on the enterprise even if those contracts are not actually in the name of the enterprise. Lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions.
>
> *33.* The authority to conclude contracts must cover contracts relating to operations which constitute the business proper of the enterprise. It would be irrelevant, for instance, if the person had authority to engage employees for the enterprise to assist that person's activity for the enterprise or if the person were authorised to conclude, in the name of the enterprise, similar contracts relating to internal operations only. Moreover the authority has to be habitually exercised in the other State; whether or not this is the case should be determined on the basis of the commercial realities of the situation. A person who is authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority "in that State", even if the contract is signed by another person in the State in which the enterprise is situated or if the first person has not formally been given a power of representation. The mere fact, however, 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 exercised in that State an authority to conclude contracts in the name of 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. Since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either.
>
> *33.1* The requirement that an agent must "habitually" exercise an authority to conclude contracts 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 exercising" contracting authority 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.

The Committee's view is that where paragraph 33 of the OECD Commentary above refers to "all elements and details of a contract", this should be taken to include a person who has negotiated all the *essential* elements of the contract, whether or not that person's involvement in the negotiation also extends to other non-essential aspects.

24. With the addition of paragraph 5(b), relating to the maintenance of a stock of goods, this paragraph is broader in scope than paragraph 5 of the OECD Model. Some developing countries believe that a narrow formula might encourage an agent who was in fact dependent to represent himself as acting on his own behalf.

Paragraph 6

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

> *39.* 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.

26. Paragraph 6 of the UN Model achieves the aim quoted above, and is necessary because insurance agents generally have no authority to conclude contracts, so the conditions of paragraph 5(a) would not be fulfilled. If an insurance agent is independent, however, the profits attributable to his activities are not taxable in the source State because the provisions of article 5(7) are fulfilled and the enterprise would not be deemed to have a permanent establishment

27. 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 insurance business should be treated differently from activities such as the sale of tangible commodities. They would 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 of 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

28. The first sentence of this paragraph reproduces Article 5(6) of the OECD Model with a few minor drafting changes. The relevant portions of the Commentary on the OECD text are as follows:

> *36.* Where an enterprise of a Contracting State carries on business dealings through a broker, general commission agent or any other agent of an independent status, it cannot be taxed in the other Contracting State in respect of those dealings if the agent is acting in the ordinary course of his business . . . Although it stands to reason that such an agent, representing a separate enterprise, cannot constitute a permanent establishment of the foreign enterprise, paragraph [7] has been inserted in the article for the sake of clarity and emphasis.
>
> *37.* A person will come within the scope of paragraph [7]—i.e., he will not constitute a permanent establishment of the enterprise on whose behalf he acts—only if
>
> (a) he is independent of the enterprise both legally and economically,
>
> (b) he acts in the ordinary course of his business when acting on behalf of the enterprise.
>
> *38.* Whether a person is independent of the enterprise represented depends on the extent of the obligations which this person has vis-à-vis the enterprise. Where the person's commercial activities for the enterprise are subject to detailed instructions or to comprehensive control by it,

such person cannot be regarded as independent of the enterprise. Another important criterion will be whether the entrepreneurial risk has to be borne by the person or by the enterprise the person represents.

38.1 In relation to the test of legal dependence, it should be noted that 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. But, as paragraph 41 of the Commentary indicates, the subsidiary may be considered a dependent agent of its parent by application of the same tests which are applied to unrelated companies.

38.2 The following considerations should be borne in mind when determining whether an agent may be considered to be independent.

38.3 An independent agent will typically be responsible to his principal for the results of his work but not subject to significant control with respect to the manner in which that work is carried out. He will not be subject to detailed instructions from the principal as to the conduct of the work. The fact that the principal is relying on the special skill and knowledge of the agent is an indication of independence.

38.4 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.

38.5 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.

38.6 Another factor to be considered in determining independent status is the number of principals represented by the agent. Independent status is less likely if the activities of the agent are performed wholly or almost wholly on behalf of only one enterprise over the lifetime of the business or a long period of time. However, this fact is not by itself determinative. All the facts and circumstances must be taken into account to determine whether the agent's activities constitute an autonomous business conducted by him in which he bears risk and receives reward through the use of his entrepreneurial skills and knowledge. 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 legal 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.

38.7 Persons cannot be said to act in the ordinary course of their own business if, in place of the enterprise, such persons perform activities which, economically, belong to the sphere of the enterprise rather than to that of their own business operations. Where, for example, a commission agent not only sells the goods or merchandise of the enterprise in his own name but also habitually acts, in relation to that enterprise, as a permanent agent having an authority to conclude contracts, he would be deemed in respect of this particular activity to be a permanent establishment, since he is thus acting outside the ordinary course of his own trade or business (namely that of a commission agent), unless his activities are limited to those mentioned at the end of paragraph 5.

> *38.8* In deciding whether or not particular activities fall within or outside the ordinary course of business of an agent, one would examine the business activities customarily carried out within the agent's trade as a broker, commission agent or other independent agent rather than the other business activities carried out by that agent. Whilst the comparison normally should be made with the activities customary to the agent's trade, other complementary tests may in certain circumstances be used concurrently or alternatively, for example where the agent's activities do not relate to a common trade.

29. In the 1980 edition of the UN Model, the second sentence of paragraph 7 read: "However, when the activities of such an agent are devoted wholly or almost wholly on behalf of the enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph." (This sentence is an addition to the corresponding paragraph in the OECD Model Convention.)

30. It was subsequently recognized that this sentence gave rise to anomalous situations. The concern was that if the number of enterprises for which an independent agent was working fell to one, the agent would, without further examination, be treated as dependent. In the 1999 version of the Model, the wording was therefore amended as follows:

> However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered as an agent of an independent status within the meaning of this paragraph.

31. The revised version makes clear that to *automatically* treat an agent as not being of "an independent status", the essential criterion is the absence of the arm's length relationship. The mere fact that the number of enterprises for which the independent agent acts has fallen to one does not of itself change his status from independent to dependent – though it might serve as an indicator of the absence of independence of that agent.

Paragraph 8

32. This paragraph reproduces Article 5(7) of the OECD Model. The Commentary on the OECD text is as follows:

> *40.* 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.
>
> *41.* 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 4.3 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 subsidiary has, and habitually exercises, in that State an authority to conclude contracts in the name of the parent …., unless these activities are limited to those referred to in paragraph 4 of the Article or unless

the subsidiary acts in the ordinary course of its business as an independent agent to which paragraph 6 of the Article applies.

41.1 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.

33. The Committee notes that determining on a separate entity basis whether or not a permanent establishment exists may be vulnerable to abusive arrangements. Depending on the domestic law of States, safeguards against purely artificial structures may be found in applying a rule that substance overrides form. The Commentary of the OECD Model also states the following:

42. 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.

34. The Commentary of the OECD Model has been amended to include the following section on "electronic commerce":

Electronic commerce

42.1 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.

42.2 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 2 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.

42.3 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 4 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.

42.4 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.

42.5 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.

42.6 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.

42.7 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.

42.8 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 42.2 to 42.6 above), there would be a permanent establishment.

42.9 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.

42.10 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 have authority to conclude contracts in the name of these enterprises and will not regularly conclude such contracts or because they will constitute independent agents acting in the ordinary course of their business, 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.

35. The Committee of Experts notes that the OECD Commentary, in paragraph 42.3, draws a distinction between a contract with an Internet Service Provider and a place of business at the disposal of the enterprise. 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 permanent establishment conclusion instead. In such cases a rule of substance over form should apply.

ANNEX 2

Proposed Amended UN Model Commentary to Article 5 – version highlighting changes to the current (2001) Commentary[1]

ARTICLE 5

PERMANENT ESTABLISHMENT

A. GENERAL CONSIDERATIONS

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

- there is a 6 months test for a building or construction site constituting a permanent establishment, rather than the 12 months test under the OECD Model, and it expressly extends to assembly projects, as well as supervisory activities in connection with building sites and construction or installation projects (paragraph 3 of the UN Model article);

- 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 6 months in a twelve month period (paragraph 3(b));

- in the paragraph 4 list of what is deemed *not* to constitute a permanent establishment (often referred to as the list of "preparatory and auxiliary activities") "delivery" is not mentioned in the UN Model, but is mentioned in the OECD Model. Therefore a delivery activity might result in a permanent establishment under the UN Model, without doing so under the OECD Model;

- 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 UN Model approach (paragraph 6); and

- an independent agent acting as such will usually not create a permanent establishment for the enterprise making use of the agent, because such an agent is effectively operating their own business providing a service. The UN Model indicates that such an agent devoting all or nearly all their time to a particular client and not dealing with the client on an arm's length basis is not treated as having the necessary independence. (paragraph 7).

[1] Proposed new wording is underlined, proposed deletions are struck out.

These differences are considered in more detail below.[2]

2. The concept of "permanent establishment" is used in bilateral tax treaties ~~principally for the purpose of determining~~to determine the right of a ~~Contracting~~ State to tax the profits of an enterprise of the other ~~Contracting~~ State. ~~According to that concept~~Specifically, the profits of an enterprise of one ~~Contracting~~ 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 ~~to be~~ found in the early model conventions including the 1928 model conventions of the League of Nations. The UN Model ~~Convention~~ reaffirms the concept ~~and supplements it with the new concept of a "fixed base", to be used in the case of professional services or other activities of an independent character~~.

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 Commentary (the 2005 version of which is cited below), 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'~~"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." ~~[para. 2]~~

The OECD Commentary goes on to observe:

"

3.[3] 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 ~~organization~~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

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[2] The subcommittee proposes that the introduction to the new Model should note in its introduction, words along the following lines: "In extensively quoting the Commentary to the OECD Model, it is noted that it has be to read together with the "observations" of OECD Member countries to obtain a full understanding of the acceptance or otherwise of certain parts of the Commentary by specific OECD countries in particular cases. The observations on the most recent version of the OECD Model (2005) are included at Appendix ** of this publication for convenience, along with relevant "positions" on the OECD Commentaries provided to the OECD by some non-members of the OECD". The subcommittee notes that such an introductory paragraph would render it unnecessary to include a special comment along the same lines in the Commentaries of the UN Model on each specific Article. [*Subcommittee footnote – not intended to be part of the revised Commentary*]

[3] This formatting of direct quotation of paragraphs of the OECD Model follows the suggestions of the Secretariat in a note to the Committee, to give an indication of what those changes would look like in practice. [*Subcommittee footnote – not intended to be part of the revised Commentary*] See E/C.18/CRP.13.

~~organization~~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.~~" [para. 3]~~

"

4. The term ~~'~~"place of business~~'~~" covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It ~~-~~is ~~-~~immaterial whether the premises, facilities or installations are owned or rented by or are otherwise at the disposal of the 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~~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.~~" [para. 4]~~

~~"~~*4.1* 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.

4.2 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. These principles are illustrated by the following examples where representatives of one enterprise are present on the premises of another enterprise. 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).

4.3 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 to 6.3) and that the activities that are performed there go beyond the activities referred to in paragraph 4 of the Article.

4.4 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 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.

4.6 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

5. . According to the definition, the place of business has to be a ~~'fixed'~~"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~~." [para. 5]~~ (but cf. the discussion at paragraph 20 below).
"

5.1 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 and 20 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.

5.2 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.

5.3 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.

5.4 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.

6. 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. ~~If the~~ A place of business ~~was not set up merely for a temporary purpose, it can~~may, however, constitute a permanent establishment~~,~~ even though it ~~existed~~exists, in practice, only for a very short period of time because ~~of~~ the ~~special~~ nature of the ~~activity of the enterprise or because, as a consequence of special circumstances (e.g., death of the tax payer, investment failure), it was prematurely liquidated. Where a place of~~ business

~~which was, at the outset, designed for a short temporary purpose only,~~ is ~~maintained for~~ such ~~a period~~ that it ~~cannot~~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 ~~as~~ to exist in situations where a ~~temporary one, it becomes~~business had been carried on in a ~~fixed~~ country through a place of business ~~and thus retrospectively~~ that was maintained for less than six months (conversely, practice shows that there were many cases where a permanent establishment~~." [para. 6]~~ has been considered to exist where the place of business was maintained for a period longer than six months). 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. [4]

"

7. 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 . . . 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.~~" [para. 7]~~

"

8. 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.~~" [para. 8]~~

"

...

10. The business of an enterprise is carried on mainly by the entrepreneur or persons who are in a paid-employment relationship with the enterprise (personnel). This personnel includes employees and other persons receiving instructions from the enterprise (e.g., dependent agents). The powers of such personnel in its relationship with third parties are irrelevant. It makes no difference whether or not the dependent agent is ~~authorized~~authorised to conclude contracts if he works at the fixed place of business. But a permanent establishment may nevertheless exist if the

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[4] The Committee agreed with the approach taken in paragraph 6 of the OECD Commentary, while recognizing that such 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.

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.~~" [para. 10]~~

11. 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 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 lessor's; in general, the lessor's ~~-~~permanent establishment~~-~~ ceases ~~-~~to exist, except where he continues carrying on a business activity of his own through the fixed place of business.~~" [para. 11]~~

Paragraph 2

4.~~-~~ Paragraph 2, which reproduces ~~article~~Article 5~~, paragraph (~~2~~,~~)~~ of the OECD Model~~ Convention, singles out several~~, lists examples of ~~what can be regarded, prima facie, as being permanent establishments. Developing countries often wish to broaden as much as possible the scope of the term "permanent establishment" and suggest that a warehouse should be included among the specific examples.~~places that will often constitute a permanent establishment. However, the ~~Group agreed~~ provision is not ~~to expand the list of examples in view of the fact that the deletion of "delivery" from the excluded activities described in subparagraphs (a) and (b) of paragraph 4 meant that a "warehouse" used for that purpose is a permanent establishment. A "commercial warehouse", where for example space is rented to other concerns,~~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 while a permanent establishment may well exist, it does not prove that one necessarily does exist. This is ~~covered as a permanent establishment. According to~~ also the stance of the OECD Commentary, where it is assumed that ~~the Contracting~~ 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 paragraph 4 (a) and (b) 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 at paragraph 13 that the term "place of 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~~'office', there will be no need to refer to the former term in their bilateral convention". ~~[para. 13]~~

5. In connection withdiscussing 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 off-shore. Because subparagraph (f) does not mention exploration for natural resources, whether on or off-shore, paragraph 1 governs whether exploration activities are carried on through a permanent establishment. The OECD Commentary states:

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> *15.* 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." [para. 15]

6. As mentioned above, in subparagraph (f) the expression "any other place of extraction of natural resources" in subparagraph (f) should be interpreted broadly. Some members from developing countries arguedbelieve that for this purpose, "fishing vessels" could be treated as thea place of extraction or exploitation of natural resources, since "fish" constitutes natural resources. In their analysis, although it is true that all places or apparatus designated , as "permanent establishment" in subparagraphs (a) to (e) in paragraph 2 have a certain degree of permanence or constitute "immovable property", yet fishing vessels can be consideredwell as a place used for extraction of natural resources, which may not necessarily mean only minerals which are embedded in the earth. In fact, constitute a natural resource (albeit a renewable one). They argue that a fishing vessels can be compared with the to a movable oil drilling platform which is used in off-shore drilling operations for gaining access to mineral oil or petrol. Where such fishing vessels are used in thea State's territorial waters or theits exclusive economic zone of the coastal state, the activities of such vessels, they would, on this view, constitute a permanent establishment, situated in that State. However, some other members took the view that such an interpretation was open to objection that it constituted too broad a is a contentious reading of the term "permanent establishment" and of the natural language of the subparagraph, and that, accordingly, in their opinion, any treaty partner countries which sought to advance such a proposition in respect of fishing activities,who believe that a fishing vessel can be a permanent establishment should make that explicit by adopting it as a new and separate category in the list in this article. Accordingly, the interpretation on the nature of this activity would be left to negotiations between Contracting Statesof "deemed" permanent establishments under paragraph 3 (see paragraph 13 below).

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 3(a) of the United NationsUN Model Convention includes an "assembly project" as well as "supervisory

activities" in connection with "a building site, a construction, installation or assembly project". Another difference is that while the OECD Model ~~Convention provides that a site or project is a permanent establishment only if it lasts more than~~ uses a time limit of twelve months, the ~~United Nations~~ UN 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.

8.~~-~~ Some developing countries ~~have supported~~support a more elaborate version of ~~subparagraph~~ paragraph 3(a), 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 ~~members of the Group~~ countries believe that such a provision would not be appropriate, particularly if the machinery was 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, ~~which are not covered specifically~~ the performance of which does not, of itself, create a permanent establishment in the OECD Model ~~Convention in connection with the concept of permanent establishment. It is believed that~~. Many developing countries believe that management and consultancy services should be covered because the provision of ~~such~~ those services in developing countries by ~~corporations of~~ enterprises of industrialized countries ~~often involves very~~can generate large ~~sums of money.~~ profits.

10.~~—Concerning~~ A few developing countries oppose the six-month threshold in paragraph 3~~, subparagraphs~~ (a) and (b~~), of article 5 of the United Nations Model Convention, some developing countries would prefer to remove the time limit~~) altogether~~ for~~. They have two main reasons: first, ~~because~~ 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 ~~considerable~~substantial profit for the enterprise~~ carrying on those activities; and~~; second, ~~because~~and more fundamentally, they simply believe that the period during which ~~the~~ foreign personnel remain in the source country ~~was~~ is irrelevant to ~~the~~ their right ~~of developing countries~~ to tax the income (as it is in the case of artistes and sportspersons under article 17). Other ~~members from~~ developing countries ~~feel that any~~ oppose a time limit ~~should be removed~~ because it could be used by foreign enterprises ~~of capital-exporting countries~~to set up artificial arrangements to ~~evade~~avoid taxation in ~~the source country. The view has been ex~~pressed ~~that there is no reason why a construction project should not be treated in the same manner as persons covered by Article 17 of the OECD Model Convention, who are taxed at the place where~~ their ~~activities are performed irrespective~~territory. However, the purpose of ~~the duration of those activities. Nevertheless, the goal of the treaty~~bilateral treaties is to promote international trade, investment, and development, and the ~~idea behind~~reason for the time limit (indeed for the permanent establishment threshold more generally) is ~~that business enterprises of one Contracting State should be encouraged~~ to ~~initiate~~ encourage businesses to undertake preparatory or ancillary operations in ~~the other Contracting State without becoming immediately subject to the tax of the latter State, so as to~~another State that will facilitate a more permanent and ~~larger~~substantial commitment ~~at a~~ later ~~stage.~~ on, without becoming immediately subject to tax in that State.

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

> ~~"~~*18.* 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). The [six] month threshold has given rise to abuses; it has sometimes been found that enterprises (mainly contractors or sub-contractors 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 anti-avoidance rules, countries concerned with this issue can adopt solutions in the framework of bilateral negotiations.~~" [para. 18]~~

"

The Committee points out that measures to counteract abuses would apply equally in cases under Article 5(3)(b). The Commentary of the OECD Model continues as follows:

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 ~~nterruptions~~ 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 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.~~" [para. 19]~~

"

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 OECD Model continues as follows:

19.1 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 month[s], 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.

20. 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 a case, the fact that the work force is not present for [six] months in one particular place 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.~~" [para. 20]~~

12.- Subparagraph (b) encompasses service activities only if they "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". The words "for the same or a connected project" are included because it is not appropriate to add together unrelated projects in view of the uncertainty which that step involves and the undesirable distinction it creates between an enterprise with, for example, one project of three months' duration and another with two unrelated projects, each of three months' duration, one following the other. However, some ~~members~~countries find the ~~injection of a~~ "project" limitation either too easy to manipulate or too narrow in that it might preclude taxation in the case of a continuous number of separate projects, each of four or five months' duration.

13.~~ Some members from developing countries expressed the view that in bilateral negotiations a clause could be inserted in paragraph 3 stipulating that if an enterprise of one Contracting State operates fishing ships in the territorial waters of the other Contracting State, the ships could be considered permanent establishments in the latter State. This clause might apply only if the ships exceed a threshold stated in terms of fish caught or some other criterion.~~ 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 service activity is a~~ permanent establishment is deemed 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 Commentary on of the~~ OECD Model ~~Convention~~ are relevant to article 5~~, paragraph~~ (3)(a)~~,~~ of the ~~United Nations~~UN Model ~~Convention~~, although the reference to an "assembly project" in the UN Model and not in the OECD Model, and the six month period in the UN Model 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 ~~[six]~~12 months. Any of those items which does 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.~~" [para. 16]~~ 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 12 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. ~~Planning~~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 ~~this term, if carried out by the building contractor. However, planning and supervision is not included if carried out by another enterprise whose activities in connection with the construction~~

~~concerned are restricted to planning and supervising the work. If that other enterprise has an office which it uses only for planning or supervision activities relating to a site or project which does not constitute a permanent establishment, such office does not constitute a fixed place of business within the meaning of~~ paragraph ~~1, because its existence has not a certain degree of permanence." [para. 17]~~ 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.

Paragraph 4

16. ~~—~~ This paragraph reproduces article 5~~, paragraph~~ (4) of the OECD Model ~~Convention~~ with ~~two~~ one substantive amendment~~s~~: the deletion of "delivery" in subparagraphs (a) and (b). In view of the similarities to the OECD Model provision and the general relevance of its Commentary, the general principles of article 5(4) under both Models are first noted below and then the practical relevance of the deletion of references to "delivery" in the UN Model are considered.

17. ..The deletion of the word "delivery" ~~means~~reflects the majority view of the Committee that a "warehouse" used for that purpose ~~is a permanent establishment. A "commercial warehouse", where space is rented to other concerns, is also a permanent establishment under paragraph 2.~~

~~17. The word "delivery" is deleted because the presence of a stock of goods for prompt delivery facilitates sales of the product and thereby the earning of profit in the host country by the enterprise having the facility. A continuous connection and hence the existence of such a supply of goods~~ should, if at least the requirements of paragraph 1 are met, be a permanent establishment~~, leaving as a separate matter the determination of the amount of income properly attributable to the permanent establishment. Some members from developed countries disagree with this conclusion, believing that since only a small amount of income would normally be allocated to a permanent establishment whose only activity is delivery, this variance from the OECD Model Convention serves no purpose.~~ .

~~18. The question whether the use of facilities for the "delivery of goods" could be incorporated in subparagraphs 4(a) and (b) as an activity that would not give rise to a permanent establishment has engaged the attention of the Group of Experts for a long time, primarily because the phrase "delivery of goods" is included in subparagraphs 4 (a) and (b) of Article 5 of the OECD Model Convention. It has been observed that many developing countries had agreed to raise the threshold of permanent establishment and that almost 75 per cent of the bilateral tax treaties entered into by developing countries have included the "delivery of goods" in subparagraphs 4(a) and (b) in their treaties as revealed in a study in 1997. It cannot be ignored that the omission of "delivery of goods" in subparagraphs 4(a) and (b) of article 5 in the United Nations Model Convention is one of the important features which distinguish it from the OECD Model Convention. On the other hand, it is contended that even if the delivery of goods is treated as an activity which gives rise to a permanent establishment, very little income per se could be attributed to this activity. On the other hand, if such activity of "delivery of goods" is considered as giving rise to a permanent establishment, there would be a tendency on the part of tax authorities to try to attribute income to this activity, whether in reality income actually arose or not. This may lead to fruitless and prolonged litigation. The Group of Experts did not reach a consensus to amend the provisions of subparagraphs 4(a) and (b) of article 5 to include "delivery of goods" as an activity which may not constitute a permanent establishment. Hence, the Contracting States may consider both these divergent points of view while entering into bilateral tax treaties.~~

The OECD Model Commentary on paragraph 4 of the OECD Article is as follows:

~~19. Subparagraph (f) was added to paragraph 4 of article 5 in 1999. Subparagraph (f) of the OECD Model Convention provides that "the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e)" is not a permanent establishment if "the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character". The question of inclusion of subparagraph 4(f) was further re-~~

examined at the instance of a member from a developed country. Some members responded that it is administratively difficult to allocate income to the activities specified in paragraph 4 and that, since none of the activities described in subparagraphs (a) to (e) separately constitute a permanent establishment, it was difficult to see how adding them together resulted in a permanent establishment.

20. The relevant portion of the Commentary on subparagraph (f) of paragraph 4 of the OECD text is as follows:

". . . 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, provided 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 being taxed in the other State if it carries on in the other State, activities of a purely preparatory or auxiliary character." [para.

21] "As already mentioned in. This paragraph 21 above, paragraph 4 is designed to provide for exceptions to the general definition of paragraph 1 in respect of fixed placeslists a number of business which are engaged in activities having a preparatory or auxiliary character. Therefore, according to subparagraph (f) of paragraph 4, the fact that one fixed place of business combines any of the activities mentioned in subparagraphs (a) to (e) of paragraph 4 does not mean of itself that a permanent establishment exists. As long as the combined activity of such a 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 particular circumstances. The criterion 'preparatory or auxiliary character' is to be interpreted in the same way as is set out for the same criterion of subparagraph (e). Subparagraph (f) is of no importance in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs (a) to (e) provided that they are separated from each other locally and organizationally, as in such a case each place of business has to be viewed separately and in isolation for deciding the question whether or not a permanent establishment exists. States which want to allow any combination of items mentioned in subparagraphs (a) to (e) disregarding whether or not the criterion of the preparatory or auxiliary character of such a combination is met, are free to do so by deleting the words "provided" to "character" in subparagraph (f)." [para. 27]

21. The Commentary on the OECD Model Convention states that the business activities listed in paragraph 4 are "treated as exceptions to the general definition laid down in paragraph 1" and that they "which are not permanent establishments, even if the activity is carried on through a fixed place of business". The OECD Commentary stresses that "the common feature of these activities is that they are, in general, preparatory or auxiliary activities" and. This is laid down explicitly in the case of the exception mentioned in subparagraph *e)*, which actually amounts to a general restriction of the scope of the definition contained in paragraph 1. 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, provided 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 carries on in that other State activities of, activities of a purely preparatory or auxiliary character". The OECD Commentary states further: .

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22. Subparagraph (*a*) relates only to the case in which an enterprise acquires the use of facilities for storing [or], displaying ...or delivering its own goods or merchandise. Subparagraph (*b*) relates to the stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage [or], display . . .or delivery. Subparagraph (Subparagraph *c*) covers the case in which a stock of goods or merchandise belonging to one enterprise is processed by a second enterprise, on behalf of, or for the account account of, the first-mentioned enterprise. The reference to the collection of information in subparagraph (*d*) is intended to include the case of the news-paper bureau which has no purpose other than to act as one of many 'tentacles'many "tentacles" of the parent body; to exempt such a bureau is to do no more than to extend the concept of 'concept of "mere purchase'." [para. 22] ".

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23. Subparagraph (*e*) provides that a fixed place of business through which the enterprise exercises solely an activity which has for the enterprise a preparatory or auxiliary character, is deemed not to be a permanent establishment. The wording of this subparagraph makes it unnecessary to produce an exhaustive list of exceptions. Furthermore, this subparagraph provides a generalized exception generalised exception to the general definition in paragraph 1 and, when read with that paragraph, provides a more selective test, by which to determine what constitutes a permanent establishment. To a considerable degree it limits that definition and excludes from its rather wide scope a number of forms of business organizations organisations which, although they are carried on through a fixed place of business, should not be treated as permanent establishments. It is recognizedrecognised 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 realizationrealisation of profits that it is difficult to allocate any profit to the fixed place of business in question. Examples are fixed places of business solely for the purpose of advertising or for the supply of informationinformation 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.” [para. 23]

“

24. 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. Where, for example, 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 subparagraph (*e*). A fixed place of business which has the function of managing an enterprise or even only a part of 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 enterprises with international ramifications establish a so-called ‘"management office’" in States in which they maintain subsidiaries, permanent establishments, agents or licensees, such office having supervisory and coordinating functions for for all departments of the enterprise located within the region concerned, a permanent establishment will normally be deemed to exist, because the management office may be regarded as an office within the meaning of paragraph 2.paragraph 2. Where a big international concern has delegated all management functions to its regional management offices so that the functions of the head office of the concern are restricted to general supervision (so-called polycentric enterprises), the regional management offices even have to be regarded as a ‘place "place of management’" within the meaning of subparagraph (*a*) of paragraph 2. The function of managing an enterprise, even if it only covers a certain area of the the operations of the concern, constitutes an essential part of the business operations of the enterprise and thereforetherefore can in no way be regarded as an activity which has a preparatory or auxiliary character within the meaning of subparagraph (*e*) of paragraph 4.” [para. 24]

“*25.* A permanent establishment could also be constituted if an enterprise maintains a fixed place of business in order to supply for the delivery of spare parts to customers for the machinery supplied to such those customers, and to maintain or repair where, in addition, it maintains or repairs such machinery, as this goes beyond the pure delivery mentioned in subparagraph *a*) of paragraph 4. Since these after-sale organisations perform an essential and significant part of the services of an enterprise vis-à-vis its customers, their activities are not merely auxiliary ones. Sub-paragraph (Subparagraph *e*) applies only if the activity of the fixed place of business is limited to a preparatory or auxiliary one. This would not be the case where, for example, the fixed place of business does not only give information but also furnishes plans etc., specially developed for the purposes of the individual customer. Nor would it be the case if a research establishment were to concern itself with manufacture.” [para. 25]

“

26. Moreover, subparagraph (*e*) makes it clear that the activities of the fixed place of business must be carried on for the enterprise. A fixed place of business which renders services not only to its enterprise but also directly to the other enterprises, for example to other companies of a group to

which the company owning the fixed place belongs, would not fall within the scope of ~~subparagraph (e).” [para. 26]~~ subparagraph *e*).

“*26.1* Another example is that of 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 they constitute immovable property under paragraph 2 of Article 6, the question may arise as to whether paragraph 4 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.

27. As already mentioned in paragraph 21 above, paragraph 4 is designed to provide for 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*) of paragraph 4, the fact that one fixed place of business combines any of the activities mentioned in the subparagraphs *a*) to *e*) of paragraph 4 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. The criterion "preparatory or auxiliary character" is to be interpreted in the same way as is set out for the same criterion of subparagraph *e*) (cf. paragraphs 24 and 25 above). States which want to allow any combination of the items mentioned in subparagraphs *a*) to *e*), disregarding whether or not the criterion of the preparatory or auxiliary character of such a combination is met, are free to do so by deleting the words "provided" to "character" in subparagraph *f*).

27.1 Subparagraph *f*) is of no importance in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs *a*) to *e*) provided that they are separated from each other locally and organisationally, as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists. Places of business are not "separated organisationally" where they each perform in a Contracting State complementary functions such as receiving and storing goods in one place, distributing those goods through another etc. An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity.

28. The fixed places of business mentioned in paragraph 4 cannot be deemed to constitute permanent establishments so long as their activities are restricted to the functions which are the prerequisite for assuming that the fixed place of business is not a permanent establishment. 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 employees of ~~places~~ places of business within the meaning of paragraph 4 who are ~~authorized~~authorised to conclude such contracts should not be regarded as agents within the meaning of paragraph 5. A case in point would be a research institution the manager of which is ~~authorized to conclude~~authorised to conclude the contracts necessary for maintaining the institution and who exercises this authority within the framework of the functions of the institution. A ~~permanent~~permanent establishment, however, exists if the fixed place of business exercising any of the functions listed in paragraph 4 were to exercise them not only on behalf of the enterprise to which it belongs but also on behalf ~~of~~ of other enterprises. If, for instance, an advertising agency maintained by an

enterprise were also to engage in advertising for other enterprises, it would be regarded as a permanent establishment of the enterprise by which it is maintained.” [para. 28]

“

29. If a fixed place of business under paragraph 4 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 at the termination of the enterprise’senterprise's activity in such installation . . .(cf. paragraph 11 above and paragraph 2 of Article 13). Since, for example, the display of merchandise is excepted under subparagraphs (*a*) and (*b*), the sale of the merchandise at the termination of a trade fair or convention is covered by this exception. The exception does not, of course, apply to sales of merchandise not actually displayed at the trade fair or convention.” [para. 29]

“

30. A fixed place of business used both for activities which rank as exceptions (paragraph 4) and for other activities would be regarded as a single permanent establishment and taxable as regards both types of activities. This would be the case, for instance, where a store maintained for the delivery of goods also engaged engaged in sales.” [para. 30]

19. Subparagraph (f) was added to article 5(4) in 1999. It follows the OECD model and provides that “the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e)” is not a permanent establishment if “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 UN Model, in contrast to the OECD Model, 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 long engaged the former Group of Experts. A 1997 study revealed that almost 75 per cent of developing countries’ tax treaties *included* the “delivery of goods” in the list of exceptions in paragraph 4 (a) and (b). Nevertheless, some countries regard the omission of the expression in the UN Model as an important point of departure from the OECD Model, 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 UN Model, the Committee decided to retain the existing distinction between the two Models, but it noted 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 over-attribution of income to this activity if they do not give this issue close consideration, leading to prolonged litigation and inconsistent application of tax treaties. Therefore, although the reference to “delivery” is absent from the UN Model, countries may wish to consider both points of view when entering into bilateral tax treaties, with a view to the practical results of either approach.

Paragraph 5

22. — It is a generally accepted principle that an enterprise having if a person acting for it acts in a State should, under certain conditions,for an enterprise in a way that ties the enterprise closely into the economic life of that State, the enterprise should be treated as having a permanent establishment in that State, – – even if the enterprise it does not have a fixed place of business in that State within the meaning of paragraphs under paragraph 1 and 2. Paragraph 5 gives that State the right to tax if the person acting for the enterprise is a dependent agent and various other requirements are met. Dependent agents, who may be individuals or companies, generally areachieves this by deeming a permanent establishment of the enterprise if they carryto exist if the person is a dependent agent who carries out on behalf of such the enterprise one of the activities that would constitute a permanent establishment under this Model if such enterprise carried out such an activity itself.specified in subparagraph (a) or (b). Subparagraph (a) follows the substance of the OECD Model and proceeds on the basis that a person with the authority to conclude contracts in the name of the enterprise creates for that enterprise a sufficiently close association with a State such that it would be appropriate for a deemed permanent establishment

to exist there. The condition in subparagraph (b), relating to the maintenance of a stock of goods, is discussed below.

23. ~~A~~ In relation to subparagraph (a), a dependent agent ~~is~~causes ~~a~~a deemed "permanent establishment" to exist only if ~~the agent's~~his authority is used repeatedly and not merely in isolated cases. The OECD Commentary states further:

> "...
>
> *32.1* ~~'~~"authority to conclude contracts in the name of the enterprise~~'~~" does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise. Lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions.
>
> *33.* The authority to conclude contracts must cover contracts relating to operations which constitute the business proper of the enterprise. It would be irrelevant, for instance, if the person had authority to engage employees for the enterprise to assist that ~~person's~~person's activity for the enterprise or if the person were ~~authorized~~authorised to conclude, in the name of the enterprise, similar contracts relating to internal operations only. Moreover the authority has to be habitually exercised in the other State; whether or not this is the case should be determined on the basis of the commercial realities of the situation. A person who is ~~authorized~~authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority ~~'~~"in that State~~'~~", even if the contract is signed by another person in the State in which the enterprise is situated or if the first person has not formally been given a power of representation. The mere fact, however, 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 exercised in that State an authority to conclude contracts in the name of 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. Since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either." ~~[paras. 32 and 33]~~

~~24. With the addition of subparagraph 5(b), this paragraph departs substantially from and is considerably broader in scope than Article 5, paragraph 5, of the OECD Model Convention, which the Group considered to be too narrow in scope because it restricted the type of agent who would be deemed to create a permanent establishment of a non-resident enterprise, exposing it to taxation in the source country.~~

> *33.1* The requirement that an agent must "habitually" exercise an authority to conclude contracts 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 exercising" contracting authority 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.

The Committee's view is that where paragraph 33 of the OECD Commentary above refers to "all elements and details of a contract", this should be taken to include a person who has negotiated all the *essential* elements of the contract, whether or not that person's involvement in the negotiation also extends to other non-essential aspects.

24. With the addition of paragraph 5(b), relating to the maintenance of a stock of goods, this paragraph is broader in scope than paragraph 5 of the OECD Model. Some ~~members from~~ developing countries ~~pointed out~~believe that a narrow formula might encourage ~~tax evasion by permitting~~ an agent who was in fact dependent to represent himself as acting on his own behalf. ~~It was the understanding of the Group that the phrase "authority to conclude contracts on behalf of " in subparagraph 5(a) of article 5 means that the agent had legal authority to bind the enterprise for business purposes and not only for administrative purposes (e.g., conclusion of lease or electricity and manpower contracts).~~

~~25. The Group of Experts understood that the subparagraph 5(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. However, if sales related activities (e.g., 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.~~

Paragraph 6

~~26.~~

25. This paragraph does not correspond to any provision in Article 5 of the OECD Model ~~Convention. It was~~ and is included ~~because it was the common feeling of the Group that the OECD definition of permanent establishment was not adequate~~ to deal with certain aspects of the insurance business. ~~Members from developing countries pointed out that if an insurance agent was independent, the profits would not be taxable in accordance with the provisions suggested in article 5, paragraph 7, of the United Nations Model Convention (based on Article 5, paragraph 6, of the OECD Model Convention); and if the agent was dependent, no tax could be imposed because insurance agents normally had no authority to conclude contracts as would be required under the provisions suggested in subparagraph 5(a) (based on Article 5, paragraph 5, of the OECD Model Convention). Those members expressed the view that taxation of insurance profits in the country where the premiums were being paid was desirable and should take place independently of the status of the agent. However, such taxation is based on the assumption that the person (employee or representative) through whom premiums are collected and risk insured is present in the country where the risk is located.~~ The OECD Model nevertheless discusses the possibility of such a provision in bilateral tax treaties in the following terms:

~~27. Once agreement had been reached on the principle of including a special provision on insurance, the discussion in the Group focused mainly on cases involving representation through "an independent agent". Members from developing countries felt it would be desirable to provide that a permanent establishment existed in such cases~~

> 39. 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.

26. Paragraph 6 of the UN Model achieves the aim quoted above, and is necessary because insurance agents generally have no authority to conclude contracts, so the conditions of paragraph 5(a) would not be fulfilled. If an insurance agent is independent, however, the profits attributable to his activities are not taxable in the source State because the provisions of article 5(7) are fulfilled and the enterprise would not be deemed to have a permanent establishment

27. 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 ~~were~~are situated within the country claiming tax jurisdiction, and the ~~facility~~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. ~~Members from developed~~Other countries~~, on the other hand, stressed that in cases involving independent agents,~~ see no reason why insurance business should ~~not~~ be treated differently from ~~such~~ activities such as the sale of tangible commodities. ~~Those members~~ They would also ~~drew attention to the difficulties involved in~~ point to the difficulty of ascertaining the total amount of business done when the insurance ~~was~~is handled by several independent agents within the same country. In view of ~~the~~this difference in approach, the ~~Group agreed that the case~~question of ~~representation through~~how to treat independent agents ~~should be~~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

28. The first sentence of this paragraph reproduces Article 5~~, paragraph (~~6~~,~~) of the OECD Model ~~Convention in its entirety,~~ with a few minor drafting changes. The relevant portions of the Commentary on the OECD text are as follows:

> "
>
> *36.* Where an enterprise of a Contracting State carries on business dealings through a broker, general commission agent or any other agent of an independent status, it cannot be taxed in the other Contracting State in respect of those dealings if the agent is acting in the ordinary course of his business . . . Although it stands to reason that such an agent, representing a separate enterprise, cannot constitute a permanent establishment of the foreign enterprise, paragraph [7] has been inserted in the article for the sake of clarity and emphasis." ~~[para. 36]~~
>
> "
>
> *37.* A person will come within the scope of paragraph [7]—i.e., he will not constitute a permanent establishment of the enterprise on whose behalf he acts—only if
>
> (a) he is independent of the enterprise both legally and economically,
>
> (b) he acts in the ordinary course of his business when acting on behalf of the enterprise." ~~[para. 37]~~
>
> "
>
> *38.* Whether a person is independent of the enterprise represented depends on the extent of the obligations which this person has vis-à-vis the enterprise. Where the person's commercial activities for the enterprise are subject to detailed instructions or to comprehensive control by it, such person cannot be regarded as independent of the enterprise. Another important criterion will be whether the entrepreneurial risk has to be borne by the person or by the enterprise the person represents. ~~A subsidiary is not to be considered dependent on its parent company solely because of the parent's ownership of the share capital.~~
>
> *38.1* In relation to the test of legal dependence, it should be noted that 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. But, as paragraph 41 of the

Commentary indicates, the subsidiary may be considered a dependent agent of its parent by application of the same tests which are applied to unrelated companies.

38.2 The following considerations should be borne in mind when determining whether an agent may be considered to be independent.

38.3 An independent agent will typically be responsible to his principal for the results of his work but not subject to significant control with respect to the manner in which that work is carried out. He will not be subject to detailed instructions from the principal as to the conduct of the work. The fact that the principal is relying on the special skill and knowledge of the agent is an indication of independence.

38.4 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.

38.5 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.

38.6 Another factor to be considered in determining independent status is the number of principals represented by the agent. Independent status is less likely if the activities of the agent are performed wholly or almost wholly on behalf of only one enterprise over the lifetime of the business or a long period of time. However, this fact is not by itself determinative. All the facts and circumstances must be taken into account to determine whether the agent's activities constitute an autonomous business conducted by him in which he bears risk and receives reward through the use of his entrepreneurial skills and knowledge. 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 legal 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.

38.7 Persons cannot be said to act in the ordinary course of their own business if, in place of the enterprise, such persons perform activities which, economically, belong to the sphere of the enterprise rather than to that of their own business operations. Where, for example, a commission agent not only sells the goods or merchandise of the enterprise in his own name but also habitually acts, in relation to that enterprise, as a permanent agent having an authority to conclude contracts, he would be deemed in respect of this particular activity to be a permanent establishment, since he is thus acting outside the ordinary course of his own trade or business (namely that of a commission agent), unless his activities are limited to those mentioned at the end of paragraph 5." ~~[para. 38]~~

~~29.~~

38.8 In deciding whether or not particular activities fall within or outside the ordinary course of business of an agent, one would examine the business activities customarily carried out within the agent's trade as a broker, commission agent or other independent agent rather than the other business activities carried out by that agent. Whilst the comparison normally should be made with the activities customary to the agent's trade, other complementary tests may in certain circumstances be used concurrently or alternatively, for example where the agent's activities do not relate to a common trade.

29. In the 1980 edition of the ~~United Nations~~UN Model ~~Convention~~, the second sentence of paragraph 7 read ~~as under: :~~ "However, when the activities of such an agent are devoted wholly or almost wholly on behalf of the enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph." (This sentence is an addition to the corresponding paragraph in the OECD Model Convention.)

30. ~~—~~ It was ~~considered~~ subsequently recognized that this sentence~~, as worded,~~ gave rise to anomalous situations. ~~There~~The concern was ~~reason to believe~~ that~~, as worded, whenever~~ if the number of enterprises for which an ~~agent of an~~ independent ~~status~~ agent was working ~~was reduced~~fell to one, ~~such an agent's status was changed to~~ "the agent ~~of~~ would, without further examination, be treated as dependent~~ status". In 1999, it was considered necessary to remove this anomaly and doubt by rephrasing the second sentence as under~~. In the 1999 version of the Model, the wording was therefore amended as follows:

"

> However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered as an agent of an independent status within the meaning of this paragraph."~~"~~

31. ~~As redrafted, it has been made~~ The revised version makes clear that to ~~determine the status of~~ *automatically* treat an agent as not being of "an independent status", ~~it would be necessary to take into account the entirety of the commercial and financial relations between the enterprise and the agent which will show that they differ from those expected between independent enterprises at~~the essential criterion is the absence of the arm's length~~. Hence, as worded, the~~ relationship. The mere fact that the number of enterprises for which ~~an agent acted as an agent of an~~ the independent ~~status fell~~agent acts has fallen to one ~~will~~does not of itself change his status from ~~being an agent of~~ independent ~~status~~ to ~~that of a~~ dependent ~~status~~ though it might serve as an indicator of the absence of independence of that agent.

Paragraph 8

32. ~~—~~ This paragraph reproduces Article ~~5, paragraph (7,)~~ of the OECD Model ~~Convention~~. The Commentary on the OECD text is as follows:

> "
>
> *40.* 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.~~" [para. 40]~~

~~"However, a subsidiary company will constitute a permanent establishment for its parent company under the same conditions stipulated in paragraph 5 as are valid for any other unrelated company, i.e., if it cannot be regarded as an independent agent in the meaning of paragraph [7], and if it has and habitually exercises an authority to conclude contracts in the name of the parent company. And the effects would be the same as for any other unrelated company to which paragraph 5 applies." [para. 41]~~

~~"The same rules should apply to activities which one subsidiary carries on for any other subsidiary of the same company." [para.~~

> *41.* 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 4.3 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 subsidiary has, and habitually exercises, in that State an authority to conclude contracts in the name of the parent …., unless these activities are limited to those referred to in paragraph 4 of the Article or unless the subsidiary acts in the ordinary course of its business as an independent agent to which paragraph 6 of the Article applies.

41.1 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.

33. The Committee notes that determining on a separate entity basis whether or not a permanent establishment exists may be vulnerable to abusive arrangements. Depending on the domestic law of States, safeguards against purely artificial structures may be found in applying a rule that substance overrides form. The Commentary of the OECD Model also states the following:

42~~1~~. 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.

34. The Commentary of the OECD Model has been amended to include the following section on "electronic commerce":

Electronic commerce

42.1 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.

42.2 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 2 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.

42.3 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 4 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.

42.4 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.

42.5 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.

42.6 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.

42.7 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.

42.8 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 42.2 to 42.6 above), there would be a permanent establishment.

42.9 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.

42.10 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 have authority to conclude contracts in the name of these enterprises and will not regularly conclude such contracts or because they will constitute independent agents acting in the ordinary course of their business, 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.

35. The Committee of Experts notes that the OECD Commentary, in paragraph 42.3, draws a distinction between a contract with an Internet Service Provider and a place of business at the disposal of the enterprise. 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 permanent establishment conclusion instead. In such cases a rule of substance over form should apply.

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