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Definition of Permanent Establishment

Note by the Secretariat on Definition of Permanent Establishment: Proposed Amendments

Summary

This paper has been provided by the secretariat in consultation with the Coordinator of the subcommittee on Definition of Permanent Establishment, for consideration by the Committee. It represents the final stage of the mandate given to the subcommittee. The first stage of that mandate represented by paper E/C. 18/2007/3/Rev.1 (considered by the Third Annual Session of the Committee and approved with some amendments) proposed a new Commentary for the existing Article 5. The second stage of the Mandate requested the subcommittee to consider the desirability or otherwise of amending Article 5 (including its attendant Commentary) to address issues arising from the treatment of Article 14, including possible deletion of that Article; the issue of taxation of fees for technical services; and the treatment of services generally.

This paper updates E/C.18/2008/CRP.3, which was presented for consideration at the Fourth Annual Session of the Committee in 2008, and which addressed those three issues. It reflects the acceptance by the Committee at that Annual Session of the following approach for the work of the subcommittee, as outlined at paragraph 38 of the Report of that Committee, that the subcommittee should:

(a) Reconfigure the way the issue was addressed, so that Article 14 was retained in the United Nations Model Convention;
(b) Provide an alternative for those preferring to remove Article 14 and apply Articles 5 and 7 to situations previously dealt with under Article 14, without reducing the source country rights under the current Article 14;
(c) [liaise] with some of the Committee members and observers who had raised specific issues that should be addressed in the further work of the subcommittee; and
(d) Focus at present on that part of the subcommittee mandate relating to the possibility of an alternative to Article 14, with a view, as far as possible, to completing its consideration by the end of June 2009 when the terms of the current members of the Committee expired, leaving further work on fees for technical services and a possible revision of Article 14 and its commentary as matters for consideration by a future membership of the Committee.

While formally a Secretariat paper, as it takes into account the results of the written procedure put to Members of the Committee at the end of their terms (June 2009), this is in effect merely an updated version of the paper presented at that time by the Coordinator of this subcommittee, Mr Sollund, and has been prepared in consultation with Mr Sollund.

Contents

I. Introduction

1. This paper has been provided by the secretariat in consultation with the Coordinator of the subcommittee on Definition of Permanent Establishment for consideration by the Committee of Experts on International Cooperation in Tax Matters (the Committee). It represents the final stage of the mandate given to the subcommittee. The first stage of that mandate, as represented by paper E/C. 18/2007/3/Rev.1 (considered by the Third Annual Session of the Committee and approved with some amendments), proposed a new Commentary for the existing Article 5. The second stage of the Mandate requested the subcommittee to consider the desirability or otherwise of amending Article 5 (including its attendant Commentary) to address issues arising from:

- the treatment of Article 14, including possible deletion of that Article;
- the taxation of fees for technical services; and
- the treatment of services generally.

2. This paper updates E/C.18/2008/CRP.3, which was presented for consideration at the Fourth Annual Session of the Committee in 2008. It reflects the acceptance by the Committee at that Annual Session of the following approach for the work of the subcommittee, as outlined at paragraph 38 of the Committee Report[1] that the subcommittee should:

(a) Reconfigure the way the issue was addressed, so that Article 14 was retained in the United Nations Model Convention;

(b) Provide an alternative for those preferring to remove Article 14 and apply Articles 5 and 7 to situations previously dealt with under Article 14, without reducing the source country rights under the current Article 14;

(c) [liaise] with some of the Committee members and observers who had raised specific issues that should be addressed in the further work of the subcommittee; and

(d) Focus at present on that part of the subcommittee mandate relating to the possibility of an alternative to Article 14, with a view, as far as possible, to completing its consideration by the end of June 2009 when the terms of the current members of the Committee expired, leaving further work on fees for technical services and a possible revision of Article 14 and its commentary as matters for consideration by a future membership of the Committee.

3. As noted at paragraph 39 of that Report, the issue of updating and improving Article 14 was an important one that should be dealt with by a new subcommittee on Article 14 and the Tax Treatment of Services. In view of the formation of that subcommittee, the current

[1] E/2008/45; E/C.18/2008/6

paper does not repeat, or elaborate upon, this subcommittee's work on fees for technical services in particular or treatment of services more generally. The subcommittee conclusions on those topics are contained in E/C.18/2008/CRP.3.

4. In 2009, the previous membership of the Committee was asked to approve by written procedure some proposed new wording modified to address issues raised at the 2008 Annual Session. These were:

(i) **the proposed Alternative B version of Article 5 for States wishing to delete Article 14**, a**s** found at Annex 3 of this paper; and

(ii**) the proposed changes to Article 5 in the case of States retaining Article 14 (Alternative A)**, which mirror some taken in Alternative B but **do not relate to the deletion of Article 14**. These are found at Annex 2 of this Paper.

5. The preliminary proposals on the structure and content of the Commentaries at Annex 4 were left for later consideration. Consequential changes to Articles other than Articles 5 and 14, as found at Annex 5, were also *not* put for formal approval. They were left to be treated as the subcommittee's views and suggestions, provided as guidance to this Committee, and are now presented as such. This paper is effectively an updated version of the paper presented to Members during the written procedure process, updated (at paragraphs 1-8 and 84) to take into account the results of that process.

Outcome of Written Procedure

6. The text of the Article was *not* agreed by Members of the Committee in the written procedure process. The first of the two responses disagreeing with the proposed text noted as follows:

A. Definition of Permanent Establishment

(i) Proposed Text of Alternative B to Article 5 (Annex 3)

In this proposal the subcommittee proposes to eliminate Article 14 and suggest new wording for Article 5 with corresponding changes to Article 3.

For those countries that prefer to treat all types of businesses (including services under current Article 14) it may a good idea to provide an alternative text, which however should clearly state that it is an alternative text and should in my opinion only be included in the Commentary and not change the Model itself.

I have the following comments to the proposed changes.

1. Elimination of "especially" in Article 5 (2)

I do not agree with the elimination of the word “"especially”. It is a word that is in the current OECD Tax Model and I and many Committee members took the view, when this issue was discussed, that its removal is unlikely to improve clarity or certainty. On the contrary, eliminating the word may cause confusion and uncertainty as to what is intended with the change (see paragraph 80 of the Report on Issues relating to Permanent Establishment).

As an example, if we would like to clarify that paragraph 2 is not a deeming provision it could be stated in the UN Model commentary as follows (in paragraph 4 of Article 5 of the UN Model commentary):

> *“According to the OECD Commentary, 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**”. Countries who want to make this more explicit in their treaty texts could add words to such effect as follows:***
>
> ***2. The term “permanent establishment” includes the following places (subject to the requirements in paragraph 1):”***

However, and in summary, it will not make anything more clear by eliminating the word “especially”.

2. Rewording and renumbering Article 5 (3)(a) as article 5 (3)

The discussion on the issue of what constitutes a deeming provision in Article 5 is important.

In my view the wording of the UN Model is expressly establishing a deeming provision by using the words "also encompasses" in paragraph 3. I have read the complex explanation by the subcommittee arguing for a difference between 3 a) and b) but that explanation is difficult to use in practise. The subcommittee rightly points to the difficulty with the concept of “supervisory activities” in this context. The basic problem is the inconsistency in arguing that paragraph 3 (a) is not a deeming provision but accepting that paragraph 3 (b) is when both subparagraphs have the same heading. If the drafters of the UN Model intended to make this paragraph subject to paragraph 1 conditions they could have used the OECD wording but as we have seen they clearly did not. Finally, in the technical explanation by the United States with regards to the U.S. - Venezuela tax treaty which uses the UN Model language it is clearly expressed that paragraph 3 is a deeming provision. As I understand the mandate given to the group it was not to change or reduce the taxation rights given to the source state and I think this proposal does that therefore it is very difficult to accept this proposal. Perhaps the discussion is slightly academic but then again we discussed this at a very great length at both last meetings and I think the wording of the text and/or suggested commentaries should take on board that discussion.

Furthermore the problem with using the word “includes” and “also includes” in paragraph 2 and 3 is that those words with a literal understanding may be understood as a deeming provision. A literal interpretation is followed by a great deal of countries and when there is no guidance available through the OECD Model commentaries the problem may be acute. These problems are the problems which I understand the UN committee should discuss and try to clarify. The problem is illustrated in the proposed article 5 paragraph 3) text which uses the words “also includes”. The great discussion that we had on and if “also encompasses” is a deeming provision could easily be carried on with respect to the words “also includes”, especially as we do not have any guidance on this wording from the OECD. The only guidance which some countries (not all) has accepted with respect to “includes” in paragraph 2 and that it is not a deeming provision is because the OECD commentaries have such an understanding, see UN Model commentary 4 to Article 5 (above). In my view these problems are best dealt with explaining the options in the Commentary and thereby giving the Parties to a negotiation a text which is as clear and certain as possible.

My conclusion therefore is that using the words “also includes” does not solve any interpretation issue as they in any case may be understood to be a deeming provision. Therefore I am not in favor of accepting the proposal by the subcommittee.

Perhaps a way forward for countries that believe that paragraph 2 and new 3 (old 3 a) are not deeming provisions is to simply add the “content” of the new paragraph 3 to a new subparagraph under paragraph 2. This could be explained in the Commentary to the UN Model.

3. Rewording and renumbering Article 5 (3) b) as Article 5 (4) a)

The mandate for the subcommittee was to reword Article 5 (3) b) as a result of the proposed deletion of Article 14 and therefore we should have a proposed new Article 5 (4) a) but keeping the taxation threshold as in Article 14. The new paragraph should therefore fully mirror Article 14. This is not achieved by the proposed Article 5 (4) a) as the limitation “for the same or connected project” does not exist in Article 14. This wording should therefore be eliminated from the subparagraph in order to comply with the mandate given.

4. Deleting Article 14 with new Article 5 (4) b)

In my view, the new wording of new Article 5 (4) b) should be discussed in more detail in the next meeting of the UN committee. There is a fundamental issue which needs to be resolved respect to how the possible inconsistency between Article 14 and Article 5 with respect to services is resolved. In the text proposed, a permanent establishment is only created when the enterprise engages other persons (not being employees nor personnel) providing services and being present in the other country for a period of 183 days, however if the same enterprise sends employees to do the same work for the same period of time there is no permanent establishment unless the conditions of Article 5 (4) a) are met. This result is in my view inconsistent (and incorrect) and should be discussed at the next UN meeting.

Furthermore, it is advisable to change the wording in a) and b) where it uses the words “employees or other personnel”. This issue was pointed out at the last meeting; as there is no difference between employees and personnel the wording should be changed. If the negotiators would like to include persons other than employees, the wording could be changed as follows: “employees or other persons engaged by the enterprise”.

ii) Proposed text of Alternative A to Article 5 (Annex 2)

There are three changes to Article 5 proposed in Annex 2. I disagree with the first two for the reasons mentioned in part (i) above. The third change, i.e. six months to be changed to 183 days is a good suggestion and I agree with that proposal.

A second response

7. A second comment from a Member of the Committee was as follows:

My position is as follows: …

Concerning the document related to the definition of PE, I **approve of**:

- Alternative A for the maintaining of article 14 in the Model Convention;
- The harmonization of Article 5 with Articles 14 and 15 with regard to the "183 days" test instead of "six months" test.

However, I **disapprove** of the deletion of the reference to "especially" in paragraph 2 of Article 5.

A possible approach for the Fifth Annual Session

8. Perhaps an appropriate consideration at the Fifth Annual Session is to consider the text of the Article 5 proposals outlined in this document, with particular reference to the comments made by those opposing its finalisation under the written procedure, which have just been noted. The issues outlined in this paper and relating to consequential amendments and to the proposed Commentary could then be considered as time allows.

II. The Option of Deleting Article 14 and Incorporation of its Principles in Articles 5 and 7

A General

9. The subcommittee’s starting point and aim in addressing its work, including, the option for deletion of Article 14 was, in accordance with its mandate, to maintain the source

taxation principles as expressed in the current UN Model, and to retain the appropriate taxation balance between source and residence States. While one member of the subcommittee had expressed a preference for retaining Article 14 in the circumstances of his country, ultimately the subcommittee considered that the benefits of deleting Article 14 and relying in such cases on the established "permanent establishment" terminology would assist administrators, potential investors and advisors, while not disturbing the balance of source and residence country taxing rights.

10. The subcommittee was therefore in favour of deletion of Article 14, but had always recognised that there was not yet a uniform view on this, as reflected in the 2008 Committee decision noted above[2]. The deletion of Article 14 is therefore presented in this paper as an alternative to the current approach, and would need to be presented as such in the Commentary to Article 5 of the UN Model Convention. The subcommittee did not view the approach of having alternative provisions, determined by the Committee at its Fourth Annual Session, as promoting a "non-deletion" approach over a "deletion approach" but as a recognition that, amongst the 192 Members of the United Nations, some would prefer the *status quo* (though perhaps with some amendments unrelated to Article 14, as noted below) and some would prefer deletion of Article 14. As the UN Model was ultimately a recommendation of the UN Tax Committee, it was important to reflect both options, to consider why a country may choose one or the other option and the consequences that would follow, and to effectively put each country in the best possible position to make decisions in this regard in the light of its own situation and priorities.

11. **Annex 1** to this paper therefore provides the current relevant articles of the UN Model (Articles 3, 5 and 14). **Annex 2** contains the current Article 5, as amended by some changes, unrelated to the deletion of Article 14 (i.e., Alternative A), which are recommended for those retaining Article 14. **Annex 3** contains proposed amendments for those wishing to delete Article 14 (i.e., Alternative B). **Annex 4** contains a proposed indicative structure suggested by the subcommittee for a possible new version of the Commentary on Article 5. This will deal with both Alternatives A and B. The subcommittee would expect that the Commentaries would be drawn from the Commentary on the existing Article approved by the Committee in 2008, as modified by the material in this paper in relation to: 1) amendments suggested whether or not Article 14 is deleted (i.e., for Alternatives A and B) and 2) amendments relating to the deletion of Article 14 (i.e., where alternative B is preferred). The actual text of the draft Commentary is not provided in draft, as the subcommittee considered that it was better to, at this stage, describe the changes proposed in this paper, seek Committee approval of the proposed text of Articles, and leave the elaboration of the Commentary to be addressed as the Committee sees fit. **Annex 5** indicates proposed consequential changes to Commentaries on articles other than Article 5 of the UN Model, in cases where Article 14 is deleted, as the subcommittee found it important to contextualise the proposed changes. **Annex 6** gives a brief account of the "fixed base" concept relevant to this paper, in particular to the deletion or otherwise of Article 14.

[2] At paragraph 2.

B Main arguments for deletion of Article 14 – a Consideration[3]

12. The main reasons in *favour* of deleting Article 14 were, in the subcommittee's view, the following:

(i) Coverage of activities other than professional services

13. The subcommittee noted the *uncertain coverage* of Article 14. In particular, the issue of to which activities it applies, including whether it covers activities other than the performing of professional services. On one view, Article 14 deals with types of income not addressed by Article 7, so that removal would jeopardise the taxation of professional service income, for example. The subcommittee considered this view and felt that while the application of Article 14 to professional services was clear; its application to "other activities of an independent character" was ambiguous. It is not clear how extensive this formulation is intended to be, or how much overlap, if any, might be created with activities falling within Article 7 (Business Profits). Literally, it goes beyond professional services because it includes "other activities of an independent character (i.e. not merely of a "similar" character, which is a formulation that appears in some earlier treaties), but there is an issue of how far it goes beyond professional services. For example, do the activities of sub-contractors in the construction industry, which would otherwise come under Article 7, fall within this formulation?

14. In practice, many countries apply Article 14 only to professional services, thereby effectively ignoring the reference to "other activities of an independent character". This is not surprising since, if read literally, the phrase could potentially apply to any activity falling under Article 7, thereby making that Article redundant. A narrow approach is favoured by paragraph 10 of the Commentary on Article 14, which states (quoting paragraph 1 of the OECD Commentary) that the Article excludes "industrial and commercial activities", and paragraph 9 of the Commentary on Article 5 explicitly mentions "management and consultancy services" as services "it is believed … should be covered because the provision of such services in developing countries by corporations of industrialized countries often involves very large sums of money." The apparent inconsistency between the literal words of the Article and the assertion in the Commentary indicates that there is scope for debate on the point, although in practice significant difficulties do not seem to have arisen in this area.

15. The reference to "other activities of an independent character" could be completely removed when deleting Article 14 and bringing the coverage of professional services under Articles 5 and 7, but that might be perceived as altering the balance of taxing rights between source and residence countries. While doubting such an effect in practice, the subcommittee has ultimately proposed amendments to Article 3 (definition of "business") to make clear that the performance both of professional services and of other activities of an independent character would henceforward be covered by Articles 5 and 7 – this was also the

[3] The subcommittee acknowledges the 2000 OECD Report: *Issues Related to Article 14 of the Model Tax Convention*, on which this section draws. Quotation marks are dispensed with to assist the flow of the argument.

approach taken by the OECD in deleting Article 14. Some states might wish to go further than the changes proposed in Annex 3 and preserve the specific wording in Article 14(2) by a new Article 3 definition such as the following:

> The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

16. One issue that arose in the Third Annual Session of the Committee (2007) was that of whether the integration of situations now covered by Article 14 into the coverage of Articles 5 and 7 would in effect be extending the operation of the limited "force of attraction" rule included within paragraph 1 of Article 7 of the Model, and therefore enlarging the source State's potential taxing rights. While aware that differences exist as to the desirability or otherwise of the "force of attraction" approach, even as limited by the requirements of paragraph 1 of Article 7[4], the subcommittee did not consider that the existence of such differences impacted upon the issue of whether or not Article 14 should be deleted and situations currently covered by it be dealt with under Articles 5 and 7.

17. Whether or not the "force of attraction" approach is adopted in a particular treaty is a matter for consideration by the countries negotiating the agreement. The subcommittee has concluded, however (as noted above), that the situations dealt with by, and their treatment in, Article 14, are so analogous in policy and administrative terms to the coverage of Articles 5 and 7 that there is no justification for, and that there are in fact some difficulties created by, a separate Article 14. If that conclusion is accepted, the subcommittee considers that to delete Article 14 as unnecessary but then have an exclusion based upon the former (Article 14) categorisations would be contrary to its aim of seeking a consistent approach in treating situations currently dealt with by Article 14 on the one hand, and Articles 5 and 7 on the other. This would in its view potentially confuse both the reasoning for the deletion of Article 14 and also the operation of Articles 5 and 7. The subcommittee has therefore not suggested wording for countries seeking to differentiate the application of force of attraction rules on that basis, between former Article 14 cases, on the one hand, and former Article 5 and 7 cases, on the other. Of course, States regarding this as a real practical issue could retain Article 14, with no preparatory or auxiliary activities test applying.

(ii) Uncertainty about coverage of non-individuals

18. Another unclear area is the way Article 14 applies to different *persons*. The main issue is whether the Article applies to individuals only or whether it also applies to legal persons, such as companies. A further question considered below is to what extent it applies to partnerships. It might be felt that the use of the pronoun "his", in Article 14(1), indicates that the Article should apply only to individuals. However, that is not necessarily decisive. Article 4(1) applies both to individuals and to legal persons yet still uses the pronoun "his" when listing the criteria (including incorporation) that make a person liable to tax. Bringing the content of Article 14 into Article 5 would remedy this problem of interpretation.

[4] Some of these differences are noted at paragraph 8 of the Commentary to Article 7.

19. Another factor is the existence of the "183-day rule" in both Articles 5 and 14, with only the former provision being drafted in a way that makes it readily applicable to a legal person (i.e., a non-individual). Moreover, paragraph 9 of the Commentary on Article 14 notes that the former Ad Hoc Experts Group on Cooperation in International Tax Matters generally agreed that a payment for services made to an individual would fall under Article 14 whereas "payments made to an enterprise in respect of the furnishing by that enterprise of the activities of employees or other personnel are subject to Articles 5 and 7." Nevertheless, uncertainty remains and the Commentary provides for States believing that the relationship between Articles 5 and 14 needs to be clarified in the course of negotiations to do so.

(iii) Unnecessarily differentiated treatment of professionals

20. It is notable that professionals incorporate more commonly now than they did when Article 14 was devised, so that applying different rules to services depending on whether they are provided by an individual or a legal person, or having different articles if the rules are the same, would seem increasingly difficult to justify. That would therefore be another reason to eliminate Article 14.

21. The subcommittee recognised that some countries may apply separate rules as between (a) the taxation of professional services and (b) other business profits – for example, where cash accounting applies to professional services but not to other activities. However, the elimination of Article 14 would not prevent countries from continuing to apply such a distinction, provided they did it in a way that did not constitute discrimination in favour of nationals of that country and against nationals of the treaty partner or non-residents of both countries contrary to the provisions of Article 24. In the same way, the obligation in Article 7 to allow expenses when determining the profits attributable to a permanent establishment does not mean that States must allow *all* expenses. It remains permissible to specify that certain expenses (e.g. entertainment expenses) are not deductible as provided by domestic law.

(iv) Application to partnerships?

22. The application of Article 14 to partnerships presents other problems. Countries that treat partnerships as fiscally transparent generally recognise that Article 14 applies to the individuals who are members of that partnership. But must the partners personally perform services in the source country to be taxable there on their share of the partnership's income attributable to a fixed base in that country?

23. In the case of countries that treat partnerships as non-fiscally transparent, the result would probably be different since, in that case, the problem of the application of Article 14 to legal persons would arise. Mixed partnerships (where some partners are individuals - natural persons - and some are legal persons) would create a problem if Article 14 were found to apply only to individuals. In that case, those partners which are legal persons would be covered by Article 7 and those partners who are individuals would be covered by

Article 14, or else, alternatively, Article 14 would not apply to *any* partner where at least one partner was a legal person. Neither approach would be satisfactory. Eliminating Article 14 would remove these questions and uncertainties.

(v) Differences in time thresholds

24. There is also an issue relating to the differences in time thresholds between the two Articles. The UN Model permits source State taxation under Articles 7 and 14 not only where a permanent establishment (Article 5) or a fixed base (Article 14) exists under the basic rules provided in those Articles, but also where a time condition is fulfilled in respect of particular activities. The conditions are slightly differently expressed between the two Articles. Article 5(3)(b) provides that a permanent establishment exists in the case of the furnishing of services where the *activities continue* in the source State "for a period or periods aggregating more than six months within any twelve-month period".

25. The parallel Article 14 condition, dealing with cases of the provision of professional services or other activities of an independent character, is a little different. The period is expressed in days, and it is also not necessary for the *activities* in the source State to continue for the full period: rather, the *individual's presence alone* is sufficient to give that State taxing rights "if his stay is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period…". The elimination of Article 14 would present the opportunity of rationalising and improving these time tests. Adoption of the "days" test will also avoid any difficulties of interpretation which may have arisen from the use of months rather than days as the measuring unit in the "six months" test.

(vi) Application to performers of services only, or those earning income from those services?

26. Another issue that could be resolved by the suggested changes is that of whether the application of source taxation under Article 14 is restricted to the person who provides the services or whether it also applies to anyone who derives income from these services. For example, assume A, B and C, three lawyers who are residents of State R, form a partnership. The partnership opens an office in State S, where only D, a new partner resident of State S, will provide services. It is agreed that the partnership's income will be divided equally among the four partners so that each partner will derive a share of the income from services rendered in State R as well as in State S. Under Article 14, can State S tax that part of the income related to the services performed in State S that accrues to the partners resident in State R, even though these partners have not, themselves, rendered any services in State S?

27. A first possible approach is to say that Article 14, like Article 7, applies to any person who derives income from the services performed through a fixed base so that partners A, B and C are taxable in State S although the services were provided by D alone. Under that approach, it is argued that since Article 14(1) refers to "income derived by a resident ... in respect of ... services" rather than to "income derived by a resident... in respect of... *his*

services", the paragraph may be applied to someone who *is not* performing the services referred to in the paragraph but who *is deriving income* from these services. That approach reduces the possible scope for differences between Article 14 and Article 7 but would also indirectly seem to support the view that Article 14 also applies to companies, rather than being limited to applying to individuals.

28. The second approach is to consider that Article 14 only allows State S to tax income attributable to a fixed base that is used by a non-resident to provide his personal services so that A, B and C are not taxable in State S as long as they do not personally provide any services there. Under that approach, the words in Article 14(1)(a): "for the purpose of performing his activities" are interpreted so that the office in State S is not considered to be a fixed base regularly available to A, B and C for the purposes of performing their activities, since they do not perform any activities in that office. On this approach it may also be relevant that in Article 14(1)(b) the reference is to "*his* stay" and "derived from *his* activities performed in that other State" – reflecting the individual's presence and provision of services in State S although as noted above[5], the use of the term "his" cannot be seen as necessarily excluding the application to companies and other "legal persons" in the view of the subcommittee.

29. This second approach narrows considerably the scope of source taxation under Article 14. It would seem to create tax avoidance opportunities since it might allow all the profits related to professional services rendered through a fixed base to escape source taxation as long as they are allocated to non-resident partners. Similarly, that approach would prevent the State where the fixed base is located from taxing any of the partnership's profits attributable to that fixed base if the partnership's activities in that State were exclusively carried out by employees.

30. The second approach, clearly, would therefore produce a result that would be at odds with that under Article 7, particularly when taking into account the implications of Article 5(5) (the "agency permanent establishment" rule) in the legal context of a partnership.

31. To properly judge as between these two approaches one has to take into account the administrative difficulties that would result from the first approach, which would require each of the partners of a partnership that has offices in many countries to comply with the tax requirements of all these countries (e.g. possibly having to file a great number of tax returns). Under this approach, taxpayers and tax authorities would have to distinguish between the attribution of income to fixed bases and the distribution of the income to partners in different countries. However, even if the first approach produces the correct result and is preferred; eliminating Article 14 would ensure that the second approach was no longer capable of being argued.

[5] At paragraph 18.

C Main Arguments for Retaining Article 14

32. The main arguments expressed in favour of *retaining* Article 14 from the UN Model, and the subcommittee's response to them, are as follows:

(i) "Fixed base" and "permanent establishment" – are they synonymous?

33. Those objecting to the deletion of Article 14 often note that it is not clear that the notion of "fixed base" and "permanent establishment" are synonymous, and that the latter may be a narrower term, so that there may be some loss of source country taxing rights as a result of the change. On one such view, the degree of permanence required of a fixed base is lower than that required of a permanent establishment, based on the fact that a business must be carried on through a permanent establishment, while a fixed base need only be "regularly" available.[6]

34. The subcommittee ultimately took the view that there was no intended difference between the two concepts and that any differences in practical application were not only not justified by a reading of the provisions, but also inimical to the purpose of tax treaties of encouraging investment. The subcommittee considered that the reasoning of the OECD in deleting Article 14 was equally relevant to the UN Model and did not represent a distinction between the two Models in terms of source and residence taxation balances. Paragraph 1.1 of the OECD Commentary on Article 5 says in this respect:

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

35. The OECD Report on Article 14[7] had earlier noted at paragraph 28:

> Notwithstanding any such theoretical differences, the Committee [of Fiscal Affairs] could not, in practice, find examples of fixed bases that would not be permanent establishments or vice-versa. The examples of 'fixed bases' found in paragraph 4 of

[6] E. Michaux. "An analysis of the notion 'fixed base' and its relation to the notion 'permanent establishment' in the OECD Model". *Intertax* 1987 ("Michaux") at 70.

[7] OECD, *Issues Related to Article 14 of the OECD Model Tax Convention*, 2000

> the Commentary on Article 14, i.e. a physician's consulting room or the office of a lawyer or architect, would, for instance, equally constitute permanent establishments.

36. The subcommittee considered that the same view could be taken in relation to the UN Model. It was noted in this respect that paragraph 10 of the 2001 UN Model Commentary on Article 14 quotes with apparent approval the OECD Commentary on Article 14, which was still part of the OECD Model as it then existed. Paragraph 2 of that OECD Commentary noted that "[t]he provisions of the Article are similar to those for business profits and rest in fact on the same principles as those of Article 7". Furthermore, the changes suggested by the subcommittee at Annexes 2 and 3 to this paper would, in the subcommittee's view, not introduce into the UN Model a change in the balance of taxing rights to that existing under the OECD Model, but would rather retain the balance of taxing rights existing under the UN Model.

37. With this in mind, the subcommittee suggests that a similar paragraph be included in the UN Commentary to Article 7, possibly following current paragraph 6. The proposed paragraph would read:

> Paragraph 8 of the OECD Model Commentary on Article 7 (formerly paragraph 2.1) notes the following:
>
> Before 2000, income from professional services and other activities of an independent character was dealt under a separate article, i.e. Article 14. The provisions of that article were similar to those applicable to business profits but it used the concept of fixed base rather than that of permanent establishment since it had originally been thought that the latter concept should be reserved to commercial and industrial activities. However, it was not always clear which activities fell within Article 14 as opposed to Article 7. The elimination of Article 14 in 2000 reflected the fact that there were no intended differences between the concepts of permanent establishment, as used in Article 7, and fixed base, as used in Article 14, or between how profits were computed and tax was calculated according to which of Article 7 or 14 applied. The effect of the deletion of Article 14 is that income derived from professional services or other activities of an independent character is now dealt with under Article 7 as business profits. This was confirmed by the addition of a definition of the term "business" which expressly provides that this term includes professional services or other activities of an independent character.

The Committee considers that the reasoning of this OECD text holds equally true for the United Nations Model, and does not represent a difference between the two Models in terms of source and residence taxation balances.

38. A short note at Annex 6 to this paper outlines the history of the "fixed base" concept, though it is noted that none of the more recent Models, including the UN Model, have sought to define what the term "fixed base" means in any detail.

39. Often the distinction has been made between industrial and commercial activities (to which the permanent establishment test applies) on the one hand, and professional activities (to which the "fixed base" test applies) on the other. While noting that some authors defend

the appropriateness of making this sort of distinction between professional and commercial activities,[8] the subcommittee considers that the distinction is increasingly irrelevant in the light of modern ways of conducting both the professions and business generally, and that in any case the distinction would not justify differing tax treatment under bilateral tax treaties. Both case law[9] and commentators' views on the matter[10] lend support to the subcommittee's conclusion.

40. The subcommittee noted the changes to the OECD Commentary in 2003 addressing the issue of time thresholds for the existence of a permanent establishment. In its 2007 paper on updating the Commentary to Article 5 (E/C.18/2007/3), the subcommittee recommended, and the Committee accepted,[11] that these Commentary changes should be incorporated into the UN Model, since they were essentially consistent with the terms of that Model. This would further reduce the need to maintain the separate concept of the fixed base. The difference between the leniently interpreted "at the disposal" (see paragraphs 4 to 4.5 of the Commentary to Article 5 of the OECD Model) and "regularly available" of Article 14(1)(a) in the UN Model, seems to be illusory in practice.

41. The 2003 revision to paragraph 6 of the OECD Commentary to Article 5 (which, again, the Committee agreed to adopt for the UN Model in 2007) was also noted by the subcommittee. Indeed, the "regularly available" test of Article 14 is now fully covered by paragraph 6 of the OECD Commentary to Article 5 (see, e.g., "recurrent activities"), which could be argued (though the subcommittee does not necessarily accept this) to go even further in relation to "short duration" permanent establishments. In conclusion, the subcommittee believes that the source State principle is neither reduced nor extended by the merger of the fixed base concept into the permanent establishment concept.

42. The subcommittee believes that the proposed UN Model changes, which would in effect confirm that the fixed base concept and the permanent establishment concept mean the same thing, would have a harmonising global effect, including in relation to decisions of judiciaries in States, without changing the taxation balance between residence and source States.

(ii) Is there a distinction in the *type* of income covered as between Articles 7 and 14?

43. As noted above, one view is that Article 14 deals with types of income not addressed by Article 7, so that removal would jeopardise the taxation of professional service income, for example. The subcommittee decided that this should not prevent deletion of Article 14 if it was otherwise justified (as the subcommittee ultimately considered it was) but that the application of Article 7 to professional services should be ensured by appropriate changes to

[8] E.g. Michaux, supra fn 4.

[9] See e.g., Netherlands Supreme Court 25 March 1992, BNB 1992/245 (photo model), Dutch Supreme Court, 24 June 1981, BNB 1981/236 (accountant).

[10] See e.g. Huston, *Intertax* 1988, 282; Vollebregt WFR 1992, 831.

[11] The final form of the amendments agreed by the Committee is represented by E/C.18/2008/CRP.10, found at http://www.un.org/esa/ffd/tax/fourthsession/index.htm

the definitions in Article 3. The more uncertain application to "other activities of an independent character" would also be preserved by explicitly making those activities part of the definition of "business" in Article 3. This latter definition is not exhaustive. However, since all the Article 14 activities would now fall within Article 7, together with all other business income, it would not matter in practice. Nor would there be any alteration of the balance of taxing rights resulting from such a change.

(iii) Article 5 has deemed exclusions which mean that source States are not able to tax "preparatory and auxiliary" activities. Article 14 does not – will this mean a loss of source State taxing rights if Article 14 is deleted?

44. The Commentary on Article 14 states that the provisions of Article 7 and its Commentary could guide the interpretation and application of Article 14, and it expressly confirms the application to Article 14 of the provisions of Article 7 paragraphs (2) and (3). However, the text of Article 14 itself contains no explicit authority for such an approach. Many countries appear to consider that paragraphs 2 to 5 of Article 7 *are* applicable to income currently falling within Article 14. However, the elimination of Article 14 would make it unnecessary to clarify that position. An issue that is currently less clear, and which would also be helpfully resolved by the elimination of Article 14, would be whether the priority rule in Article 7(6) (i.e. that other articles take precedence) applies in relation to Article 14.

45. That raises a key question: would moving the coverage of independent personal services from Article 14 (which has no explicit exception for "preparatory and auxiliary" activities) to Article 5 (which *has* such an exception) change the balance of taxation rights? The subcommittee considers that this is a theoretical, rather than a practical possibility, as it considers that, with the proposed special provisions for the taxation of the performing of services under proposed Article 5(4), any reduced source tax coverage could relate only to the provision of independent personal services through a fixed place of business but which were "preparatory and auxiliary" under the existing Article 5(4).

46. The subcommittee reviewed the matter, as noted below, and ultimately did not consider that cases of preparatory and auxiliary activities to non-fixed place of business permanent establishments are likely to actually arise in practice, and was of the view that any such cases would be so rare (if they occurred at all) as to not have a practical impact on the balance of taxing rights. Further the Committee noted that the personal services referred to in existing Article 14 and proposed Article 5(4) are services provided to others, which reduces the possibility that any "preparatory or auxiliary activities" exception could apply to them. It is unlikely that there would be any significant fee charged for, or income attributable to, the provision of such preparatory or auxiliary services, in any case.

47. The subcommittee noted that paragraph 4 of Article 5, which excluded certain activities from the concept of "permanent" establishment" would only apply to "independent personal services" cases in a few instances. Subparagraphs (a) to (c) would not apply in such a case, subparagraph (d) would not seem to apply, as purchasing of goods or collection of

information for the enterprise would not also represent the provision of a service to another person. Subparagraph (f) merely addresses "combinations of activity", so that subparagraph (e) is the only potentially relevant provision in its own right: "[t]he maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character".

48. The question is, then, whether the application of this extra requirement (that it not be a subparagraph (e) activity) to what were formerly "fixed base" cases under Article 14 results, in any real sense, in a diminution of source State taxing rights, and it can be immediately observed that subparagraph (e) is a general provision referring to other instances of preparatory or auxiliary activities, and that what constitutes such activities naturally takes meaning from the examples given in the other subparagraphs.

49. In the proposed redrafted Article paragraph 5, which deals with preparatory and auxiliary activities, applies "[n]otwithstanding the preceding provisions of this article" so that it applies to both aspects of proposed paragraph 4 dealing with the performing of services. In providing for this, the subcommittee nevertheless considers that there is little or no scope for the provision of a service, meeting the test of either subparagraphs (a) or (b) of proposed paragraph 4, to be regarded as merely preparatory or auxiliary. In any case, only the amount attributable to the provision of services could generally (depending to some extent upon the wording of paragraph 1 of Article 7 in a particular treaty) be taxed in the host state, not amounts attributable to other activities. The subcommittee therefore does not consider that there is in any practical sense, a diminution of source State taxing rights by making proposed paragraph 4 subject to the preparatory and auxiliary activities exception in proposed paragraph 5.

50. The subcommittee notes that the 2008 changes to the OECD Model[12] provide the following option ("the OECD alternative provision") at paragraph 42.23 of the new OECD Commentary on Article 5:

> Notwithstanding the provisions of paragraphs 1, 2 and 3, where an enterprise of a Contracting State performs services in the other Contracting State
>
> a) through an individual who is present in that other State for a period or periods exceeding in the aggregate 183 days in any twelve month period, and more than 50 per cent of the gross revenues attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State through that individual, or
>
> b) for a period or periods exceeding in the aggregate 183 days in any twelve month period, and these services are performed for the same project or for connected projects through one or more individuals who are present and performing such services in that other State

[12] "The 2008 Update to the Model Tax Convention", OECD, 18 July 2008.

the activities carried on in that other State in performing these services shall be deemed to be carried on through a permanent establishment of the enterprise situated in that other State, unless these services are limited to those mentioned in paragraph 4 which, if performed through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph. For the purposes of this paragraph, services performed by an individual on behalf of one enterprise shall not be considered to be performed by another enterprise through that individual unless that other enterprise supervises, directs or controls the manner in which these services are performed by the individual.

51. The subcommittee notes that in this formulation, there is a preparatory and auxiliary test which in effect applies subparagraphs (d), (e) and (f), (subparagraphs which in their terms address the use of a fixed place of business) but applies the test in a way that "switches off" the "fixed place of business" requirements. In other words the provisions apply subparagraphs (d) (e) and (f) to the extent of enquiring, in a services provision case, whether the services are merely those of collecting information for the enterprise, or carrying on other preparatory or auxiliary activities. The preparatory or auxiliary tests drawn from Article 5 situations ultimately do not give much guidance in the area of services and there might also be difficulties conceptually and practically in hypothesising a fixed place of business but then attributing a real purpose to that hypothesised fixed place, since subparagraphs (d) and (e) look to the *purpose* of the maintenance of the fixed place of business, and paragraph (f) implicitly does the same.

52. The subcommittee does not consider that the preparatory or auxiliary activity tests as formulated in current Article 5(4) are likely to apply in practice to the provision of services, and while it does not regard it as necessary to recommend the inclusion of an additional test in this paragraph (paragraph 5 in the proposed amended Article) that is better adapted to cases of service provision, it also recognises that some treaty partners may choose to include one.

53. Other countries may consider that the concept of preparatory and auxiliary activities is inherently not well adapted to cases of service provision and would prefer to avoid any difficulties of identification and treatment of these activities. Such countries may wish to have paragraph 4 (deemed permanent establishments), as proposed by the subcommittee for cases where Article 14 is deleted, re-numbered as paragraph 5 in their treaties, while re-numbering paragraph 5 (preparatory and auxiliary activities) as paragraph 4. Paragraph 4 in those treaties would therefore read "Notwithstanding the preceding provisions of this article, the term "permanent establishment" shall be deemed not to include: …" and would not affect the deeming provisions found at paragraph 5 of those treaties and dealing with "services permanent establishments". This would address the issue of the difficulty in applying those tests in the context of provision of services without a fixed place of business by not applying them.

(iv) Does Article 14 permit the taxation of gross income, with Articles 5 and 7 only allowing taxation of net income, so that there is a loss of source State taxing rights?

54. The argument has been made that to delete Article 14 and bring independent personal services into the "net income concept" of Articles 5 and 7 from their previous home of the "gross income concept" of Article 14 represents a loss of source country taxing rights, and imposes extra burdens upon the administrations of developing countries.

55. Article 7 allows the source State to tax *profits* attributable to a permanent establishment. Article 14, however, allows the source State to tax *income* attributable to a fixed base. The concept of profits clearly means "net" income, i.e. after the deduction of those expenses permitted by domestic law[13], as confirmed by Article 7(3). The concept of income in Article 14 has sometimes been interpreted more broadly so as to allow taxation on *either* a gross or net basis. The proponents of such interpretation point to the fact that the phrase "income derived" is also found in Article 6 (Income from Immovable Property) and Article 17 (Artistes and Sportsmen), where the Commentary explicitly contemplates taxation of the gross amount. Arguably, a further confirmation of that interpretation is the fact that paragraph 3 of Article 24 (Non-discrimination), which has a direct effect on the deduction of expenses related to a permanent establishment, is not expressed as applicable to fixed bases.

56. On the other hand, the existing Commentary on Article 14 clearly states at paragraph 10 that countries should tax only the net amount:

> …expenses incurred for the purposes of a fixed base… should be allowed as a deduction in determining the income attributable to a fixed base in the same way as such expenses incurred for the purposes of a permanent establishment.

57. In addition, the fact that Articles 10 to 12 clearly specify that the source State may levy tax on the "gross" amount of the dividends, interest, etc, might be argued to imply that in cases where there is no such specific provision, only the net amount should be taxed under Article 14.

58. The subcommittee considered this issue and concluded that the only issue for its current consideration was whether the taxation of some providers of services who were previously dealt with under Article 14 and not Article 7 would be affected so that the State where the services are performed would no longer be able to tax the gross receipts from that provision of services, but would instead now be able only to tax the net receipts, by virtue of the limited taxing right under Article 7 as compared with Article 14. An example might be the

[13] The subcommittee notes that the requirement that the host State should allow deductions in calculating the profits of a permanent establishment only means that it must allow those deductions that are provided for under its domestic law. Most countries will have rules about the sort of deductions that are generally permitted, and they are not required to give a deduction for items not on that list. Entertainment expenditure is an example of an item that is frequently disallowed. Accounting depreciation is another, where capital allowances are given instead. In such cases, a State could tax a permanent establishment on its gross income without allowing such deductions and yet the State would not thereby be offending the principles of Article 7 (or of course Article 14).

taxation of a lawyer or an architect providing services through a fixed base under Article 14 and (following the proposed removal of Article 14) through a permanent establishment under paragraphs 5 and 7, or else not having a fixed base/ permanent establishment but staying in the host country for over 183 days in a year. Would such a person be taxable only on net receipts when previously he or she was taxable under Article 14 on gross receipts?

59. The subcommittee noted that such an issue would in any case only arise in cases where a final taxation on gross receipts was applied to such service providers under the domestic law of the host country. In most cases, even if the treaty allowed for taxation on gross, that treaty right could not be exercised, because domestic law would only allow taxation on a net basis, and any loss of taxing rights to a source country would be theoretical, or would at most merely operate to restrict options for legislative change in future.

60. Differing views have been expressed about whether paragraph 3 of Article 24 addresses discriminatory treatment of fixed bases (not specifically referred to) as well as permanent establishments (specifically referred to), a matter considered in more detail in the following subsection. However, the subcommittee noted that if Article 24 *did* apply to fixed bases at present, taxation on the fixed base could not be less favourably levied than for domestic enterprises carrying on the same sort of service provision. This would in practice render taxation on gross receipts even less likely.

61. The subcommittee considered that in any case there was no policy justification for taxing professional services under Article 14 on a different basis from commercial services under Article 7, and noted that, in practice, it appears most countries recognise this and only tax the net amount under Article 14, consistent with this approach. The subcommittee ultimately considered that the proposed replacement of Article 14 would, in practice, not lead to any significant reduction of source country taxing rights, and that any conceivable effects were heavily outweighed by the benefits of a consistent approach between providers of professional services and other service providers – benefits that would extend to tax administrations as well as taxpayers and their advisers.

(v) Will the non-discrimination provision of Article 24(3) apply to cases formerly covered by Article 14 because they would now be dealt with by Article 7

62. Another question (adverted to in the previous subsection) is whether the migration of the coverage of independent services from Article 14 (with the fixed base test) to Articles 5 and 7 (with the permanent establishment test) means that the non-discrimination obligation in Article 24(3) would apply where it did not previously, thus affecting the balance of taxing rights between source and residence States.

63. Article 24(3) provides as follows:

> The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the

> same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

64. The non-discrimination test of Article 24(3) will, for example, affect a State's ability to limit deductibility of costs. This rule disallows a system where e.g. the permanent establishment is subject to more burdensome cost deduction rules than enterprises of the host State. Also, where, e.g., the permanent establishment would be subject to taxation in the host State at a lower tax rate on gross income (no costs deductible), whereas enterprises of that host State would be taxable at the normal domestic tax rate on net income (costs deductible), Article 24(3) could (depending on the parameters chosen for such a taxation rule) be an impediment to States imposing that rule for permanent establishments. The subcommittee notes, however, that it is ultimately the *effect* of the rules that counts. Different rules *as such* applied to permanent establishments and to domestic enterprises are not forbidden.

65. While Article 24(3) strictly only refers to permanent establishments, some consider that the provision implicitly applies in Article 14 cases also. The subcommittee concluded that, whichever view was correct, the non-discrimination provision is an important part of the object and purpose of tax treaties of encouraging investment and that the application of the provision is best viewed as an issue of consistency of application in similar circumstances rather than an issue of the balance of source and residence State taxation rights. The subcommittee does not consider that this is an issue likely to arise often in practice, in any case.

(vi) Should there be a provision, even if Article 14 is deleted, reflecting in Article 5 the former Article 14(1)(c)?

66. There used to be a provision, Article 14(1)(c), that (as noted by paragraph 7 of the current Commentary):

> ... provided a further criterion for source country tax when neither of the two conditions specified in subparagraphs (a) and (b) is met. It was provided that if the remuneration for the services performed in the source country exceeds a certain amount (to be determined in bilateral negotiations), the source country may tax, but only if the remuneration is received from a resident of the source country or from a permanent establishment or fixed base of a resident of any other country which is situated in that country.

67. The view has been advanced that a small number of countries still use that provision in their modern treaty practice, and they would lose this source taxation right if Article 14 was deleted.

68. The subcommittee notes that Article 14(1)(c) was deleted, as indicated by paragraph 8 of the UN Commentary on that Article, because monetary thresholds tended to become

meaningless over time and would potentially only limit the import of services, and because it was little used. The subcommittee considers that countries wishing to preserve such a rule in relation to the performing of services could still do so if they wanted, even if included under the head of Article 5, rather than under Article 14. Existing treaties with the former 14(1)(c) would, of course, be unaffected by the proposed change.

D Subcommittee Conclusions on Article 14

(i) General conclusions

69. After considering the arguments for and against deletion of Article 14, the subcommittee concluded that retaining the combination of Article 14 and Articles 5 and 7 would continue to cause difficulties, ambiguities and uncertainty in application that benefit neither administrations nor taxpayers. These difficulties include: the uncertainties over the personal scope of Article 14; the scope of activities that fall under Article 14; the possible interpretation of a difference between the concepts of permanent establishment and fixed base that serves no policy or administrative purpose; and difficulties over the taxation of partnerships under Article 14 (especially those of a mixed individual/company character) and in relation to the taxation of large worldwide partnerships of lawyers etc. The subcommittee notes that the OECD, for these and other reasons, deleted Article 14 from the OECD Model in 2000, and merged this Article into Articles 5 and 7 of the OECD Model.

70. The subcommittee considered that the UN Model should do the same, while recognising that this will only be one option provided in the Model, in accordance with its mandate. It believes that this can be done without raising the threshold for taxation in source countries. The draft wording at Annex 3 of this paper for the various provisions affected by the deletion of Article 14 seeks to achieve this. The structure of those proposed amendments is considered below.

(ii) The structure of the suggested changes

71. The integration of Article 14 concepts into Articles 5 and 7 is reflected in the subcommittee's proposed text for Article 5 of the UN Model, which can be found at Annex 3 of this paper. Structurally, the proposal is as follows:

- the existing Article 5(3)(a) (building sites) is mirrored in the proposed Article 5(3);

- the existing Article 5(3)(b) (furnishing of services)is proposed to become Article 5(4)(a);

- the content of existing Article 14(1)(b) (stays of 183 days or more) is expressed in the proposed Article 5(4)(b) as complemented by Article 7; and

- changes to Article 3 (Definitions) ensure that all situations previously covered by Article 14 would now be covered by Articles 5 and 7.

72. Finally, the subcommittee also proposes some changes of a logical and stylistic nature, to assist in the clarity and readability of the relevant provisions.

73. The existing Article 14(1)(a) (taxation on the basis of a "fixed base") does not explicitly find a place in the proposed articles. However, its contents are covered by the existing Article 5(1) in combination with Article 7, Article 3(1)(c) and Article 3(1)(h). The concept of a "fixed base" is therefore replaced by the concept of "permanent establishment", with alterations to clarify that all cases previously dealt with in Article 14 are now dealt with by Articles 5 and 7.

(iii) Transition to a Model with Article 14 and non-Article 14 alternatives.

74. Without departing from its view in favour of removing Article 14, the subcommittee had always recognised that some States may wish, for administrative or other reasons, to retain Article 14 as it was in the 2001 UN Model, whether as a shorter or longer term measure. The subcommittee also recognised that a consideration of Article 14 will be relevant to existing treaties for some time to come. It had therefore proposed that the existing Article 14, as well as its Commentaries and the 2001 versions of those provisions in other articles which the subcommittee suggests need consequential amendments, should be preserved, in their 2001 state as an Annex to the next version of the Model. A draft Annex addressing such changes was attached to the 2008 version of this paper (E/C.18/2008/CRP.3) as Annex 3.

75. This approach was discussed in the 2008 Annual Session of the UN Tax Committee and, as outlined at paragraph 38 of the Report of that Committee (E/2008/45; E/C.18/2008/6) the subcommittee was asked to:

(a) Reconfigure the way the issue was addressed, so that Article 14 was retained in the United Nations Model Convention;

(b) Provide an alternative for those preferring to remove Article 14 and apply Articles 5 and 7 to situations previously dealt with under Article 14, without reducing the source country rights under the current Article 14;

(c) [Liaise] with some of the Committee members and observers who had raised specific issues that should be addressed in the further work of the subcommittee (which has been done with secretariat assistance); and

(d) Focus at present on that part of the subcommittee mandate relating to the possibility of an alternative to Article 14, with a view, as far as possible, to completing its consideration by the end of June 2009 when the terms of the current members of the Committee expired, leaving further work on fees for technical services and a possible revision of Article 14 and its commentary as matters for consideration by a future membership of the Committee.

76. As noted at paragraph 39 of that Report, the issue of updating and improving Article 14 was an important one that should be dealt with by a new subcommittee on Article 14 and the Tax Treatment of Services, coordinated by Ms. Liselott Kana.

77. The existence of two quite distinct options for addressing the treatment of independent services represents some technical and logistical challenges for the subcommittee's work and for this paper. The subcommittee has addressed these by developing an Alternative B for Article 5 (at Annex 3), as well as by providing the possible structure for a new version of the Commentary which is based on the amended Commentary for Article 5 proposed by this subcommittee and agreed by the Committee as an explanation of the current wording of Article 5[14]. Finally, the subcommittee has addressed the direct and indirect issues related to the deletion of Article 14. In doing so, the subcommittee has remained true to its deliberations on that issue, while recognising that not all States will wish to adopt the proposed changes. Therefore this paper remains focussed on the reasons for deletion of Article 14, and assisting those States which find the reasons for deletion compelling, while acknowledging the different views and some of the grounds for them.

78. It is therefore proposed that there will be alternatives A and B in relation to Article 5, with Annex 4 representing a possible structure for a new version of the Commentary that deals with common issues and then comments on the similarities of, and differences between, the two alternatives. The Commentary on Alternative A (non deletion of Article 14) would preserve the structure currently existing under the Model and therefore effectively be the Commentary agreed by the Committee in 2007[15], together with some additions to deal with issues unrelated to the deletion of Article 14 and which are therefore addressed in this paper as relevant to both Commentaries. As paragraphs 1 and 2 are identical in the two alternative Article 5 texts, there will be a common Commentary for those paragraphs, and the Commentaries would be identical, or nearly so, for all paragraphs other than paragraphs 3 and 4. A general introduction to the Article 5 Commentary, preceding the separate Commentaries, would address differences from the OECD Article 5 and also the policy and administrative reasons why negotiating States might prefer one or the other of the UN Model alternatives, in their particular circumstances.

79. The subcommittee has taken that approach of having two alternatives in this paper, consistent with its mandate. It notes that the current UN Model has other Alternatives A and B at Articles 8, 18 and 23 and considers that having essentially distinct Commentaries on the two alternatives, to the extent of their differences, gives greater clarity for those interpreting and applying treaties representing a choice on whether or not to delete Article 14. The consequential amendments to other Articles upon the deletion of Article 14 should be noted in the Commentary on Alternative B, but would then be addressed in greater detail in the Commentary on the relevant article. Ultimately, however, the way in which the two alternatives are presented is a matter for the Committee to decide.

[14] See E/C.18/2008/CRP.10 for the Commentary on that paragraph as it currently stands, a Commentary approved by the Committee in 2007.

[15] E/C.18/2008/CRP.10.

(iv) Personal scope not addressed

80. The proposed changes do not attempt to resolve the debate on the "personal scope" of Article 14; that is, the issue of whether the current Article 14 only covers individuals (see discussion at paragraphs 18-19 above). This issue is currently unresolved under the UN Model, just as it was not resolved under the OECD Model before the Article was removed. In view of the conclusions of the subcommittee in favour of removing Article 14, which solves the problem, the subcommittee has taken the question no further. Any further work on this aspect would need to be dealt with by the new subcommittee on Article 14 and the Tax Treatment of Services.

(v) Rewording of Article 5(2)

81. It has occasionally been suggested that the current text of Article 5(2) ("The term 'permanent establishment' includes especially…") means that the paragraph deems each of the items to *automatically* be a permanent establishment. The subcommittee rejects this view.

82. Paragraph 4 of the UN Model Commentary to Article 5 says:

> Paragraph 2 … singles out several examples of what can be regarded, *prima facie*, as being permanent establishments… According to the OECD Commentary, 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".

83. The subcommittee agrees with this statement, and notes that such an approach is widely accepted[16]. Issues such as the geographical and temporal "permanence" of the presence will, for example, still need to be considered. The point was made in the subcommittee's suggested Commentary changes at Annex 1 to its 2007 paper on draft proposals to the Commentary (E/C. 18/2007/3 – at paragraph 4 and following of the proposed revised Commentary). The subcommittee contemplated putting the matter beyond argument by changes to the provision itself. It considered in particular, the formulation: "Subject to the conditions of paragraph 1, the term 'permanent establishment' includes: …" It ultimately decided against this approach, however, because it might be construed as an attempt to alter the existing position and the distribution of taxing rights. Further, the subcommittee thought it so improbable that any court could find, for example, that an office occupied for just one day constituted a permanent establishment, that no clarification was necessary. The subcommittee did decide that the removal of the word "especially" was warranted, as it serves no real purpose and could obscure the relationship between paragraphs 1 and 2 of the Article. The subcommittee recommended its removal, *whether or not* Article 14 was deleted.

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[16] See e.g. Vogel, *Double Taxation Conventions* (Art. 5, m.nr. 47). Various writings have noted this issue of uncertainty. Skaar e.g. writes: "In spite of its own wording, the 'positive list' consists mainly of places of business, or, one might say, *prima facie* PE": A.A. Skaar. *Permanent Establishment; Erosion of a Tax Treaty Principle*. Kluwer 1992, at 113.

84. The list in paragraph 2 is clearly not intended to be an exhaustive list of places capable of meeting the test of paragraph 1 and the proposed removal of the word "especially" should not be read as seeking to make such a change. In the subcommittee's view, Article 5(2) should be interpreted in the same way whether or not the change suggested, removing the word "especially", is adopted in a treaty or not. Some members of the subcommittee nevertheless preferred retaining the word "especially" on the basis that its removal was not likely to appreciably improve clarity or certainty. That view was shared by two Members of the Committee in the written procedure of this year, as noted above, and if the Committee decides on balance to retain the word "especially", so long as the same approach is taken whether or not countries are deleting Article 14 in their treaties, such a retention would be compatible with the other recommendations suggested by this subcommittee.

85. Another option would be to remove Article 5(2) on the basis that it has no substantial meaning. On this approach, the examples would be better positioned in a separate paragraph of the UN Commentaries to Article 5(1). The subcommittee, however, feels that this understates the meaning of Article 5(2), which helpfully suggests what are *prima facie* likely to be permanent establishments, without reaching a definitive view in a particular case – because that requires a reference to paragraph 1 and an application of that paragraph to the facts of the case. The provision may also have evidential value in court or tribunal cases, which could be reduced or even lost by shifting the provision to the Commentary.

(vi) Rewording and renumbering Article 5(3)(a) as Article 5(3)

86. The subcommittee concluded that Article 5(3)(a) of the UN Model dealing with construction projects and related supervisory activities, is *not* intended to be a stand-alone deeming provision, distinct and separate from the basic rule in paragraphs 1 as further explained by paragraph 2, although it recognises that there are differences of opinion on this point. The subcommittee believes that its view is not just consistent with the wording of that provision, ("[t]he term "permanent establishment" also encompasses)" but is also evident from the history of that paragraph, since the coverage of construction activities etc. originates from Article 5(2) of the 1963 OECD Model, where it was one of the examples given of a PE (at subparagraph (g)) which were to be read in the context of paragraph 1. In 1977 the construction activities provision was moved from Article 5(2) to Article 5(3) of the OECD Model, but clearly not with any intention of altering this position and making it a stand-alone provision. This is evident from the Commentary to paragraph 3 of the OECD 1977 Commentary referring back to paragraphs 1 and 2 in dealing with paragraph 3.

87. The OECD Commentaries (since 2003, which post-dates the current UN Model) accept Article 5(3) as a specific case of the application of Article 5(1) rules (see paragraphs 4.5, 4.6 and 5.1 of the OECD Commentary on Article 5 OECD Model) rather than as being an independent test for a PE.[17] The subcommittee believes this is the correct view as far as the OECD Model is concerned: a construction site etc. is only a permanent establishment if the conditions of Article 5(1) are met (place of business, carry on business, at the disposal of

[17] See generally on this, H Pijl, "The relationship between Article 5, Paragraphs 1 and 3 of the OECD Model Convention", *Intertax*, 2005, 189-193.

the enterprise), apart from the time requirement which is replaced by the more than 12 months criterion in that Model.

88. The UN Model provision, however, is differently worded, so the question must be addressed of whether that difference is significant. The UN Model provides that "[t]he term 'permanent establishment' also encompasses" the specified situations, rather than saying, as in the OECD Model, that it "includes especially". The UN Model also provides at paragraph 3(b) a second type of permanent establishment, the so-called "services permanent establishment" as well as the construction site or project related permanent establishment in both Models. The subcommittee considered that each of these elements of paragraph 3 needed separate consideration.

89. In the changes to the Commentary agreed by the Committee in 2007[18] and which address the current text of the Article, it was noted at paragraph 7 that:

> The Committee notes that there are differing views about whether paragraph 3(a) is a "self-standing" provision (so that no resort to paragraph 1 is required) or whether (in contrast) only building sites and the like that meet the criteria of paragraph 1 would constitute permanent establishments, subject to there being a specific six months time test. However, the Committee considers that where a building site exists for six months, it will in practice almost invariably also meet the requirements of paragraph 1. Indeed, an enterprise having a building site etc at its disposal through which its activities are wholly or partly carried on will also meet the criteria of paragraph 1.

90. The subcommittee considered this issue further and noted that paragraph 3(a), like paragraph 2, did not address all the elements of the PE requirement in that, while it addresses which activities might constitute a permanent establishment and also gives a specific test of the time during which such activities must continue for there to be a permanent establishment, it does not deal with the question of *whose* permanent establishment it is in relation to the activities. That question is only informed by the reference in paragraph 1 to the "enterprise". The subcommittee considers that the *whole* of paragraph 3(a) is so informed by the basic rule at paragraph 1. Structurally, paragraph 3(a) cannot be a stand-alone provision as it answers the "what activities" and "how long" questions relating to permanent establishments, but not the "who" question, recalling that a permanent establishment as a concept is helpful only in the context of identifying an enterprise *of which* it is the permanent establishment.

91. Paragraph 3(b) is different: it is truly self-contained and self-standing in that it addresses those activities that constitute the permanent establishment (the "what activities" question), the relevant period of time (the "how long" question), and the link between the enterprise and the activities that is required – performance of services by the enterprise through others (the "who" question). No reference back to Articles 1 or 2 is required.

[18] E/C.18/2008/CRP.10..

92. The subcommittee, however, recognises the distinct differences of interpretation between States treating paragraph 3(a) as a deeming provision, and others viewing it as a provision to be read in conjunction with the basic rule at paragraph 1. The subcommittee did not consider that sufficient agreement could be reached on this point, so it did not seek to clarify the point by amended wording.

93. In this respect, the subcommittee was also particularly taking into consideration its view that the question of whether or not paragraph 3(a) is self-standing was a more theoretical than practical issue. As the conditions of Article 5(1) are almost automatically met in construction site cases: a building contractor has the factual disposal of the place of business (this is inherent in the building contract with his principal), and carries on his business there. The word *encompasses* (or its synonym *includes*) expresses this relationship of Article 5(3) to Article 5(1), if the same approach as taken by the OECD Model is taken in respect of the UN Model. Article 5(3) could thus read:

> "The term 'permanent establishment' also includes a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months."

94. However, there is an issue here, which is already inherent in the current text of Article 5(3)(a): "supervisory activities in connection therewith" are not necessarily connected with a place of business referred to in Article 5(1). It may be (though in practice this is probably unlikely) that these activities are done elsewhere in a place that does not qualify as a "place of business" at the disposal of the supervisory enterprise.

95. One solution might thus be to make that part of the current Article 5(3)(a) a deemed permanent establishment, which detaches the qualification as a permanent establishment from the issue of a place of business.

96. The subcommittee considers, however, that, in the proper maintenance of the source State's taxing rights, that step is not necessary. Indeed, even if – in an unlikely situation – the supervisory enterprise could be considered not to have at its disposal a place of business at the site of the construction, or elsewhere in the country where these activities are performed, the current Article 5(3)(b) would trigger, subject to the remarks below, this permanent establishment.

97. Therefore, the subcommittee proposes the text noted at paragraph 93 above as the new Article 5(3), reflecting current Article 5(3)(a):

> **The term "permanent establishment" also includes a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months.**

98. In the proposed re-wording, the term "includes" is used because the current difference in terminology between the terms "includes especially" in paragraph (2) and "also encompasses" in paragraph (3) is, in the subcommittee's view, not justified by any intended

difference in meaning, and could confuse those who would expect different phrases used in the same article to have some intended differentiation in meaning. The subcommittee therefore suggests that the same terminology should be used in the two paragraphs – ("includes in paragraph (2) and "also includes" in paragraph (3)). The word "also" has been retained simply to clarify that no attempt is being made to change the balance of this provision, and because it is the second such instance of an "includes" paragraph in the Article. The subcommittee considers that even States retaining Article 14 might wish to alter the words "also encompasses" in Paragraph 3 to "also includes" where convenient.

99. For States agreeing that a more specific provision is needed to clarify that paragraph 3 must be read in the context of paragraph 1: the following wording is a possible solution:

> A building site, construction, assembly or installation project or any supervisory activity in connection therewith, constitutes a permanent establishment only if such site, project or activity lasts more than six months.

100. For States agreeing that a more specific "deeming provision" is needed to clarify the self-standing aspect of paragraph 3, the following wording is a possible solution:

> The term "permanent establishment" shall be deemed to include–a building site, a construction, assembly or installation project or any supervisory activity in connection therewith, but only if such site, project or activity lasts more than six months.

101. For the reasons expressed in the following part of the paper, the subcommittee proposes including the current Article 5(3)(b) in a separate, reworded Article 5(4)(a).

(vii) Rewording and renumbering Article 5(3)(b) as Article 5(4)(a)

102. The "furnishing" or "performing" of services often takes place without the physical place of business of Article 5(1), which is Article 5(3)(b)'s reason for existence. The provision should be understood as providing for a "deemed" permanent establishment: in other words, if the activities of this provision are met a permanent establishment exists, even though the terms of Article 5(1) may not be met. This analysis can therefore be done without needing to consider the terms of Article 5(1).

103. This is a different situation to that of a construction permanent establishment, where the terms of Article 5(1) are relevant, subject to a special "time test" replacing the normal paragraph 1 time tests. The subcommittee therefore proposes, in cases where Article 14 is deleted, separating the construction permanent establishment paragraph from the services permanent establishment paragraph to reflect these differences.

104. The proposed text, without altering the current substance of Article 5(3)(b), reads:

4. A permanent establishment shall be deemed to exist:

(a) where an enterprise performs services through employees or other personnel engaged by the enterprise for such purpose:

if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned;

105. Note that the reference to "more than six months" in the current article is proposed to be changed to the Article 14 terminology, reintroduced to proposed Article 5(4)(b) ("more than 183 days") to avoid any differences as to how to deal with parts of a month, and to avoid any inference of different tests between the two subparagraphs of Article 5(4). This change is proposed *whether or not* Article 14 is deleted, and therefore will appear in both Alternative A and B, as it contributes to greater clarity of the Model whatever view is taken on Article 14.

106. Note also that the formulation used in the proposed draft is "more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned." This requires some connection with the relevant fiscal year, but does not require activities/ presence to exist for more than half of that *fiscal* year. To draw upon an example in paragraph 4 of the OECD Commentary to Article 15, if an employee is present in a State during 150 days between 1 April 07 and 31 March 08, (the fiscal year in that State) but is present there during 210 days between 1 August 07 and 31 July 08, the employee will have been present for a period exceeding 183 days during the second 12 month period identified above even though he did not meet the minimum presence test during the first period considered and though the first period partly overlaps the second. This change is designed to discourage abuse, rather than to alter the balance of taxing rights.

107. It should also be noted that the draft refers to the "performing" of services, in language taken from Article 14(1) rather than referring to the "furnishing" of services, as in Article 5(3)(b). The subcommittee saw no difference in meaning between the two terms, but regarded "performing" as a slightly more common and current usage which contributed to the clarity of the paragraph.

(viii) Taxation based on duration of stay – proposed Article 5(4)(b)

108. The subcommittee considered whether Article 5 could be rewritten in a more condensed form. It ultimately decided against attempting that under its mandate, as such a rewrite was likely to trigger new interpretational questions, issues about existing treaties using the older wording and extensive "threshold" discussions. Focus on the key issues for decision might also be lost. It has therefore transposed, to the extent possible, the existing paragraphs from Article 14 into the proposed Article 5. This "soft" approach also makes

clear the subcommittee's intention of streamlining the operation of Article 5, by fully covering Article 14 situations, while not altering the balance of taxing rights.

109. The subcommittee considered it unnecessary to provide for an explicit reflection of Article 14(1)(a) (taxation based on existence of a "fixed base") in Article 5, as that provision is fully covered by existing Article 5(1). This is because the "permanent establishment" concept fully covers "fixed base" situations in the subcommittee's view, as noted above, and Alternative B will clarify that.

110. In the view of the subcommittee, however, the current Article 14(1)(b) (taxation based on duration of stay, even without a fixed base) must be explicitly referred to in order to preserve the current balance of taxing rights in the UN Model, as the current Article 5(3) does not contain a similar "presence", as opposed to "activities" based, time test.

111. Whereas current Article 5(3)(a) requires a project of 6 months, and whereas Article 5(3)(b) has specific requirements related to the performing of services, the triggering condition for Article 14(1)(b) is merely the *physical presence* of a person during 183 days in the working State (compare this requirement to the similar condition in article 15(2)(a) dealing with dependent personal services). Therefore, the deletion of Article 14 also needs to be accompanied by an addition to Article 5, in the absence of which source taxation rights would be reduced. As the OECD Model did not have an equivalent to Article 14(1)(b), the same issue did not arise in the removal of Article 14 from the OECD Model.

112. As the 183 day activities test of Article 14 is best classified as a "deemed permanent establishment" when viewed in the context of Article 5 (such as under paragraph 5 of that article[19]), and not as a permanent establishment that is a special expression of the general tests referred to in Article 5(1) and therefore based on general principles (as in the Article 5(2) examples), the subcommittee proposes including this provision as Article 5(4)(b). The new provision would read:

4. A permanent establishment shall be deemed to exist: [...]

(b) where an enterprise performs services other than through employees or other personnel engaged by the enterprise for such purpose;

if the services are performed through an individual and the individual's stay in the Contracting State where the services are performed is for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned.

113. The proposed wording attempts to reflect the view, evident in the current Commentary on Article 14[20], that Articles 5 and 14 are intended to complement each other, rather than overlap with each other. Thus, paragraph 4(b) will only apply, in

[19] See E/C.18/2008/CRP.10 for the Commentary on that paragraph as it currently stands, a Commentary approved by the Committee in 2007.

[20] For example, at paragraph 9.

effect, where there is not an employment or the like situation as covered by paragraph 4 (a). This is a way of reflecting the difference under the current Model between "dependent personal services" and "independent personal services" without using those largely outmoded terms, and while ensuring that between them, paragraphs 4(a) and (b) give the same coverage as Article 5(3)(b) and Article 14(1)(b) of the current Model.

114. In part because of the uncertainty about what constitutes "professional services", despite the partial definition at Article 14(2), and also because of the increasingly tenuous distinctions between "professional" and "commercial" activities, proposed new paragraph 4(b) has avoided references to that term, or to independent personal services, and has been made applicable to "services" generally.

115. In doing so, it might be argued that source country taxing rights are being extended, however the subcommittee considered that as the current Article 14 extends not just to professional services, but to other activities of "an independent character", this is not the case. Any services performed by an individual under paragraph 4(b), that is - in a non-employment situation, would in the subcommittee's view, come within the definition of professional services or would be "other activities of an independent character". Again, the way in which paragraphs 4(a) and (b) complement each other, rather than overlap, reflects the intended complementary relationship between Articles 14 and 5 under the current Model, as reflected in the Commentary on Article 14.

116. The proposal also deletes the Article 14(1)(b) requirement that the individual referred to must be a resident of one Contracting State staying in the other Contracting State . It replaces it by a reference to "the enterprise" to conform to the structure of Article 5 and ensure that the operation of the provision could not be avoided by the enterprise of the first State simply utilising residents of the State where performance of services occurs, or by an individual changing the State of his or her residence.

117. Article 7 will then address the "profits of an enterprise of a contracting State", so that in effect the focus has shifted from the State of residence of the individual performing the services to whether the enterprise connected to such performance is an enterprise of a Contracting State. This is consistent with the way Article 5 operates and interacts with Article 7.

118. The subcommittee did not regard this change as altering the balance of taxing rights, as the enterprise will, in the actual operation of subparagraph (b), generally be synonymous with the State of residence of the individual, and in other cases either paragraph 5(4)(a) is likely to apply or else the matter would be treated as a purely domestic situation unaffected by the treaty.

119. Finally, the combination of Articles 5 and 7 renders it unnecessary to repeat the last words of paragraph 14(1)(b): "in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State". This idea is already structurally part of the approach taken by Articles 5 and 7, in the subcommittee's view.

120. Some States will prefer to delete Article 14, but retain more of its current language in the Article 5 text. There are various ways in which this could be done, such as by preserving current Article 5(3) of the UN Model (preferably with the suggested change to a 183 day test in the replacement for current Article 5(3)(b)) but adding a third subparagraph along the following lines (with changes from the current provision highlighted):

> 3. The term "permanent establishment" also **includes**:
>
> *(a)* A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;
>
> *(b)* The **performing** of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than **183 days** within any twelve-month period **commencing or ending in the fiscal year concerned;**
>
> ***(c)* the performing of professional services or other activities of an independent character by an individual , but only where the individual's stay in the Contracting State where the services are performed is for a period or periods aggregating more than 183 days within any twelve-month period commencing or ending in the fiscal year concerned.**

120. Although intended to be a "minimalist" approach for those wishing to delete Article 14, the 183 days test expressed in a single consistent formulation is preferred for consistency, for the reasons noted at paragraph 105. Likewise the term "performing" is preferred over "furnishing" for the sake of consistency, as noted at paragraph 107 above. The term "includes" is preferred over "encompasses" for the same reason, as noted in paragraph 98 above. States taking such an approach might wish to preserve in Article 5 or Article 3 an inclusive definition of "professional services", such as exists at Article 14(2) noting that:

> The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Relationship between Article 5(3) and Article 5(4)

121. As noted above, the wording proposed for Article 5(3) of the UN Model, where 14 is deleted, is:

3. The term "permanent establishment" also includes a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months.

122. The proposed wording for paragraph 4, if Article 14 is deleted, is:

4. A permanent establishment shall be deemed to exist:

(a) where an enterprise performs services through employees or other personnel engaged by the enterprise for such purpose:

if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned;

(b) where an enterprise performs services *other than* through employees or other personnel engaged by the enterprise for such purpose;

if the services are performed through an individual and the individual's stay in the Contracting State where the services are performed is for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned.

123. The question has arisen of which of paragraphs 5(3) or 5(4) would take precedence under the proposed amended Article. Both of these provisions have determinative force. Paragraph 4 is a deeming provision, while the relevant aspect of paragraph 3 for current purposes is that if the site, activities etc last for 6 months or less they are *not* a permanent establishment under this provision, and resort could not be had to paragraphs 1 and 2 to render them a permanent establishment on general grounds where they have been ruled out as such by the specific provision at paragraph 3. The issue therefore does not depend on whether paragraph 3 is viewed as a deeming provision or not (an issue left open in the proposed paragraph), because in either case, it has this impact on the time requirement for a permanent establishment to exist.

124. Take, for example, the case of an engineer, Z, who carries on the engineering business of an enterprise for a total period of 8 months in a State, but at two different and unrelated construction sites (4 months at each site). Are Z's activities deemed to constitute a PE of the enterprise under 5(4) when 5(3) states that a construction site is a PE ***only if*** it lasts more than six months? *Prima facie*, because the engineer spends less than six months at each construction site, paragraph 5(3) prevents the site from being a PE. But *prima facie* , paragraph 4 deems there to be a PE of the enterprise because of the *presence* of the employee there for over 183 days, or where the *activities* of a self-employed person exceed that time test.

125. The analysis of such a situation most in keeping with the wording of the Article would seem to be as follows: the sites do not each constitute a permanent establishment, since they are unrelated and cannot be treated as a single site under paragraph 5(4). Whatever would be the case under paragraph 1 of the Article, and whether or not one regards paragraph 3 as a "deeming provision" as to what is a permanent establishment, a construction, assembly or installation project or (perhaps most importantly here) supervisory activities in connection therewith, are protected from being permanent establishments by Article 5(3) when they do not meet the more than 6 months time threshold,

126. Article 5(4) can, however, deem there to be a permanent establishment where the time test has been met in relation to either the provision of services or the presence of an employee in the State where services are performed. If the services provided are not covered by paragraph 3 then there is no difficulty, Article 5(3) is not relevant and Article 5(4) has full effect.

127. However, if the services performed are covered by paragraph 3, the most relevant legal analysis would be that this is a case where the well accepted principle of "lex specialis" applies: ***Lex specialis derogat legi generali***. The doctrine states that a provision governing a specific subject matter (*lex specialis*) is not overridden by a provision which only governs general matters (*lex generalis*). In the context of services contemplated in paragraph 3, the *lex specialis* is at paragraph 3, and paragraph 4 would be overridden and inapplicable to the extent of the conflict.

128. The OECD "alternative" services provision appears on first examination, however, to provide just the opposite result. In providing that: "[n]otwithstanding the provisions of paragraphs 1, 2 and 3, where an enterprise of a Contracting State performs services in the other Contracting State" ... the "services permanent establishment" rule is therefore prima facie overriding paragraph 3, the "construction permanent establishment" rule: "A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months". Note however, that the OECD paragraph 3 does not refer to "supervisory activities" so that there is less possibility for a conflict in practice.[21]

129. The outcome under the analysis of the UN Model wording could be clarified by amending the beginning of subparagraph 4 to provide a special "rule of precedence" such as:

> 4. Subject to the operation of paragraph 3, a permanent establishment shall be deemed to exist where:.....

130. It follows from the analysis above that this would only clarify what the subcommittee considers to be the position without the extra words anyway.

[21] Note, however, paragraph 17 of the OECD Commentary on Article 5, which states: "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."

131. An alternative policy approach would be to reverse the position suggested above and reduce the special position of construction–related permanent establishments under the Model, and therefore allow paragraph 4 to operate without hindrance from paragraph 3, by wording such as:

> 4. Notwithstanding the provisions of paragraphs 1, 2 and 3, a permanent establishment shall be deemed to exist where:

132. Another wording for this same approach would be:

> 4. Notwithstanding the preceding provisions of this article, a permanent establishment shall be deemed to exist where:

133. Perhaps most accurately, since only paragraph 3 *excludes* activities from being permanent establishments, and since only that paragraph provides the risk of a conflict with the function of paragraph 4 in deeming activities to *constitute* a PE, the wording should be:

> 4. Notwithstanding the provisions of paragraph 3, a permanent establishment shall be deemed to exist where:

134. In choosing between preserving, or confirming, the precedence of paragraph 3 on the one hand, and giving precedence to paragraph 4 on the other, the subcommittee had reference to its objective of not seeking to alter the balance of taxing rights as between source and residence States. That means that there is a need to consider what the situation would be under the current (2001) UN Model, looking at both Articles 5 and 14.

135. Under the 2001 Model or where the proposed Alternative A in a revised Model is followed, so that Article 14 is retained, the legal analysis seems to be as follows:

i. Articles 5 and 14 do not contemplate a dual operation, and therefore do not have any rules of precedence as between them;

ii. The Article 14 Commentary (drawing upon paragraph 4 of the former OECD Commentary) is expressed to cover situations where the term “permanent establishment” is not relevant because of its “commercial and industrial connotations”.

iii. Provision of supervisory services is explicitly contemplated as capable of constituting a permanent establishment under Article 5.

iv. This again can also be seen as an instance of a specific provision overriding a more general one in the same instrument.

v. Therefore it follows that the limitations imposed in defining a permanent establishment (that such activities exist for more than 6 months) should

not, in the scheme of the two Articles, be circumvented by reference to Article 14.

136. A specific "rule of precedence" of the type noted above is ultimately not proposed by the subcommittee, as there appears to be a clear "safe harbour" in paragraph 3 for building sites and supervisory activities, and while the policy underpinnings of such a rule might be the subject of different views, where that rule *is* relied on, it could be confusing to have the specific rule also subject to a general exception at paragraph 4. This is consistent with the analysis above of the situation where Article 14 is retained, but appears stronger in interpretational terms where the specific rule is found in the same article as the general rule

(ix) Adaptation of the references in Article 5(5) and consequent renumbering of current paragraphs 5 to 8

137. Consequent upon what is currently paragraph 3 being split into paragraphs 3 and 4 where Article 14 is deleted, paragraphs 4 to 8 of the current Model would need to be renumbered as paragraphs 5 to 9.

138. Article 5(1) and (2) are closely linked paragraphs, being a definition at paragraph 1 and then examples assisting in the practical application of that definition at paragraph 2. The current Article 5(5) reference to paragraph 2 ("Notwithstanding the provisions of paragraphs 1 and 2") therefore creates the wrong impression that Article 5(2) is detached from Article 5(1) and is somehow a stand-alone test for the existence of a permanent establishment. In addition, if Article 5(3)(b) (and perhaps also Article 5(3)(a)) is indeed intended as a special deemed permanent establishment, it is not clear why Article 5(5) does not make reference to paragraph 3 as well as paragraphs 1 and 2.

139. The subcommittee therefore suggests ensuring that the Article reads more logically by bringing the references into conformity with the structure of Article 5. The proposed Article 5(5), after renumbering it as Article5(6), replacing the reference to paragraph 2 with a reference to paragraph 4, and replacing the reference to paragraph 7 with a reference to paragraph 8, would read:

> 6. Notwithstanding the provisions of paragraphs 1 and 4, where a person - other than an agent of an independent status to whom paragraph 8 applies - is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person: …

140. The subcommittee has proposed that what now becomes paragraph 8 should begin with the phrase "Notwithstanding the preceding provisions of this article, an enterprise", rather than with "An enterprise". The subcommittee considered it useful to make it as clear as possible that the "independent agent" provision takes precedence over other paragraphs when its terms are met. While that is clearly the case under the current Model, it was felt

useful to put that beyond doubt now that independent personal services previously covered by Article 14 had been introduced into the scheme of Article 5.

(x) Ensuring full coverage of professional services – amending the Article 3 definitions of "business" and "enterprise"

141. The subcommittee's proposed Article 3(1)(c) reads:

> (c) The term "enterprise" applies to the carrying on of any business;

142. The proposed Article 3(1)(h) reads:

> (h) The term "business" includes the performance of professional services and of other activities of an independent character.

143. These changes, whether or not they are regarded as strictly necessary, ensure that the full range of activities that currently come within Article 14, including the rendering of professional services, would now come within Articles 5 and 7.

144. Guidance in achieving this is provided by the OECD Model, which brought Article 14 situations under the scope of Article 5 and Article 7 in its year 2000 revision - see paragraph 4 and paragraph 10.2 of the OECD Commentaries to Article 3 on this point. The OECD changes to the text of Article 3 are the same as are now proposed for the UN Model.

145. Paragraph 4 of the OECD Commentary on Article 3 (dealing with the term "enterprise") reads as follows:

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

146. Paragraph 10.2 of the OECD Commentary on Article 3 (dealing with the term "business") reads as follows:

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

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

147. The subcommittee also suggests building upon the OECD Commentary changes relating to Article 3 by incorporating part of paragraph 4 of the OECD Commentary into paragraph 5 of the UN Commentary to Article 3 along the following general lines. Note that that the drafting will, of course, have to be integrated with any other changes to the Commentary to Article 14 in future, and that the phrase "are free" as used in the last sentence of paragraph 10.2 of the OECD Commentary is changed to "may wish", to better reflect the UN Model's role and application:

(c) The term "enterprise"

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

148. The second sentence of current paragraph 5 of the UN Model Commentary on Article 3, which reads: "It does not define …laws of the Contracting States", may then be deleted.

149. Similarly, the subcommittee suggests a new paragraph after the current paragraph 11 of the Commentary to Article 3 (renumbering the subsequent paragraphs) to explain the new Article 3(1)(g). This proposed paragraph is derived from paragraph 10.2 of the OECD Commentary noted above:

(b) The term "business"

The Convention does not contain an exhaustive definition of the term "business", which, under paragraph 2, should generally have the meaning which it has under the domestic law of the State that applies the Convention. Subparagraph (h), however, provides expressly that the term includes the performance of professional services and of other activities of an independent character. This provision was added in […] at the same time as the option was introduced into the Convention of deleting Article 14, dealing with independent personal services. This addition for States deleting Article 14, which ensures that the term "business" includes the performance of activities which were previously covered

by Article 14, was intended to prevent that term "business" from being interpreted in a restricted way so as to exclude the performance of professional services, or other activities of an independent character, in States where the domestic law does not consider that the performance of such services or activities can constitute a business. Contracting States for which this is not the case may wish to agree bilaterally to omit the definition.

150. For the proposed redrafted Article 5(3) and Article 5(4)(a), the proposed changes to Article 3 have no significance. Article 5(3) currently covers the situations that would be covered by suggested Article 5(3) and Article 5(4)(a) without the extra wording, and that would be the same with the proposed changes.

(xi) Adaptation of other articles that use the term "fixed base"

151. Annex 3 includes the proposed Amendments for those wishing to delete Article 14 and deal with cases previously dealt with by it under Articles 5 and 7. The proposed consequential changes are to Articles 3, 6, 10, 11, 12, 13, 15, 17, 21 and 22. They flow on naturally from the other changes proposed, with matters now dealt with by Article 5 that were previously dealt with under Article 14. The suggested change to the title of Article 15 from "Dependent Personal Services" to "Income from Employment" is not strictly consequential, but is useful to clarify Article 15's purpose and operation after the deletion of Article 14, and follows more ordinary and current usage. None of these changes involves any change in the balance of taxing rights between source and residence countries.

(xii) Renumbering of Articles 15 and following?

152. The subcommittee does not propose the renumbering of Articles 15 and following articles upon the proposed deletion of Article 14. This avoids further consequential changes to the Articles and Commentaries, and is not justified where the deletion of Article 14 is just one option under the UN Model, although States may prefer to do so in their bilateral treaties.

Annex 1:
Current Relevant Articles of the UN Model[22]

Article 3

1. For the purposes of this Convention, unless the context otherwise requires:

(a) The term "person" includes an individual, a company and any other body of persons;

(b) The term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes;

(c) The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

(d) The term "international traffic" means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State;

(e) The term "competent authority" means:

(i) (In State A): .....

(ii) (In State B): .....

(f) The term "national" means:

(i) Any individual possessing the nationality of a Contracting State

(ii) Any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State.

2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

Article 5

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

[22] This Annex contains Article 3, 5 and 14, the consideration of which formed the main part of the subcommittee's work. Annex 2 also contains some suggested consequential changes to other provisions where Article 14 is deleted.

2. the term “permanent establishment” includes especially:

(a) A place of management;

(b) A branch;

(c) An office;

(d) A factory;

(e) A workshop;

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

3. The term “permanent establishment” also encompasses:

(a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;

(b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (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.

4. Notwithstanding the preceding provisions of this article, the term “permanent establishment” shall be deemed not to include:

(a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;

(b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;

(c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

(e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.

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

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 7 applies — is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:

(a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or

(b) Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.

6. Notwithstanding the preceding provisions of this article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.

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

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

Article 14

1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:

(a) If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or

(b) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

2. The term “professional services” includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Annex 2:

Article 5 of the UN Model – Proposed Amendments for those Wishing to Retain Article 14 (Alternative A)

Article 5

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

2. the term "permanent establishment" includes ~~especially~~:

(a) A place of management;

(b) A branch;

(c) An office;

(d) A factory;

(e) A workshop;

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

3. The term "permanent establishment" also ~~encompasses~~ **includes**:

(a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;

(b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (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~~**183 days** in any twelve-month period commencing or ending in the fiscal year concerned.

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

(a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;

(b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;

(c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

(e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.

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

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 7 applies — is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:

(a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or

(b) Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.

6. Notwithstanding the preceding provisions of this article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.

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

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

Annex 3:

Relevant Articles of the UN Model – Proposed Amendments for those Wishing to Delete Article 14 (Alternative B)

Article 3

1. For the purposes of this Convention, unless the context otherwise requires:

(a) The term "person" includes an individual, a company and any other body of persons;

(b) The term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes;

(c) The term "enterprise" applies to the carrying on of any business;

(d) The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

(e) The term "international traffic" means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State;

(f) The term "competent authority" means:

(i) (In State A): .....

(ii) (In State B): .....

(g) The term "national" means:

(i) Any individual possessing the nationality of a Contracting State

(ii) Any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State.

(h) The term "business" includes the performance of professional services and of other activities of an independent character.

2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

Article 5

1. For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term “permanent establishment” includes ~~**especially**~~:

(a) A place of management;

(b) A branch;

(c) An office;

(d) A factory;

(e) A workshop;

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

3. The term “permanent establishment” also includes a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months.

4. A permanent establishment shall be deemed to exist:

(a) where an enterprise performs services through employees or other personnel engaged by the enterprise for such purpose:

if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned;

(b) where an enterprise performs services *other than* through employees or other personnel engaged by the enterprise for such purpose;

if the services are performed through an individual and the individual’s stay in the Contracting State where the services are performed is for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned.

5. Notwithstanding the preceding provisions of this article, the term “permanent establishment” shall be deemed not to include:

(a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;

(b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;

(c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

(e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

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

6. Notwithstanding the provisions of paragraphs **1 and ~~2~~ 4,** where a person — other than an agent of an independent status to whom paragraph ~~7~~ **8** applies — is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:

(a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or

(b) Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.

7. Notwithstanding the preceding provisions of this article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph ~~7~~ **8** applies.

8. **Notwithstanding the preceding provisions of this article,** an enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. 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 an agent of an independent status within the meaning of this paragraph.

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

Article 6

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

Article 10

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

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

Article 11

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

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

Article 12

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

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

Article 13

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

Article 14: *Deleted*

Article 15

Title "Dependent Personal Services" replaced by "Income from Employment"

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(a) The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and

(b) The remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and

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

Article 17

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

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

Article 21

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

Article 22

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

Annex 4:
Proposed (Indicative) Structure of UN Model Commentary on Article 5

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 the two alternative versions of the UN Model each contain several significant differences from the OECD Model. In relation to this version of the UN Model Article 5, this includes amendments consequent on the deletion of Article 14, for those States wising to delete that Article. 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(a) of Alternative A of the UN Model Article, paragraph 3 of Alternative B);

- the performing of services by an enterprise through employees or other personnel results in a permanent establishment where such *activities* continue for a total of more than 183 days in any twelve month period commencing or ending in the relevant fiscal year (paragraph 3(b) of Alternative A of the UN Model Article, paragraph 4(a) of Alternative B);

- the performing of services by an enterprise, through an individual resident of one Contracting State but present in the other Contracting State, results in a permanent establishment where such presence continues for a total of more than 183 days in any twelve month period commencing or ending in the relevant fiscal year (paragraph 4(b) of Alternative B of the UN Model Article, addressed by Article 14 under Alternative A)

- in the paragraph 5 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) of Alternative A of the UN Model Article, paragraph 6(b) of Alternative 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 of Alternative A of the UN Model Article, paragraph 7 of Alternative B); 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 of Alternative A of the UN Model Article, paragraph 8 of Alternative B).

These differences are considered in more detail below.

B. COMMENTARY ON THE PARAGRAPHS OF ARTICLE 5

Paragraph 1

[Common Commentary, reflecting that accepted by Committee in 2007]

Paragraph 2

[Common Commentary, reflecting that accepted by Committee in 2007, except for also noting that "includes especially" was changed to "includes" to help clarify that Paragraph 2 should be read in the context of paragraph 1 and was not a free standing provision. Will note that this was intended to help confirm this change, but was not regarded as making any substantive change to the meaning of the Article.**]**

Paragraph 3

[Alternative A version, reflecting, for subparagraph (a), Commentary accepted by Committee in 2007. Reflecting, for subparagraph (b), that Commentary and the change from a six months to a 183 days test]

[Alternative B version, reflecting the discussion in this paper of the "construction permanent establishment" and noting that what was previously subparagraph (b) is now found at paragraph 4]

Paragraph 4

[Alternative A version, reflecting, Commentary accepted by Committee in 2007.]

[Alternative B version, reflecting the discussion in this paper of the "services permanent establishment" drawing upon current Article 5(3)(b) and Article 14(1)(b) and their current commentaries]

Paragraph 5 of Alternative A/ *Paragraph 6* of Alternative B

[Common Commentary, reflecting that accepted by Committee in 2007, except for consequential renumbering of paragraphs referred to.]

Paragraph 6 of Alternative A/ *Paragraph 7* of Alternative B

[Common Commentary, reflecting that accepted by Committee in 2007]

Paragraph 7 of Alternative A/ *Paragraph 8*of Alternative B

[Common Commentary, reflecting that accepted by Committee in 2007]

Paragraph 8 of Alternative A/ *Paragraph 9* of Alternative B

[Common Commentary, reflecting that accepted by Committee in 2007]

C. CONSEQUENTIAL CHANGES WHERE ALTERNATIVE B IS ADOPTED

For those States deleting Article 14, and relying on this alternative version of Article 5 (Alternative B), certain consequential changes are suggested to ensure that former Article 14 cases are all now dealt with under a combination of Article 5 and Article 7.

The suggested consequential changes are to Articles 3, 6, 10, 11, 12, 13, 15, 17, 21 and 22. They flow on naturally from the changes proposed in this alternative Article 5. A proposed change to the title of Article 15 from "Dependent Personal Services" to "Income from Employment" is not strictly consequential, but is useful to clarify its operation after the proposed deletion of Article 14, and follows more ordinary usage.

The renumbering of Articles 15 and following Articles upon the proposed deletion of Article 14 is not proposed in Alternative B, especially as the removal of Article 14 is only one option provided in this Model, although States may prefer to do so in their bilateral treaties.

The consequential changes in more detail

Changes to other articles

Article 3

1. For the purposes of this Convention, unless the context otherwise requires:

(a) The term “person” includes an individual, a company and any other body of persons;

(b) The term “company” means any body corporate or any entity that is treated as a body corporate for tax purposes;

(c) The term “enterprise” applies to the carrying on of any business;

(d) The terms “enterprise of a Contracting State” and “enterprise of the other Contracting State” mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

(e) The term “international traffic” means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State;

(f) The term “competent authority” means:

(i) (In State A): .....

(ii) (In State B): .....

(g) The term “national” means:

(i) Any individual possessing the nationality of a Contracting State

(ii) Any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State.

(h) The term “business” includes the performance of professional services and of other activities of an independent character.

2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

Article 6

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

Article 10

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

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

Article 11

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

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

Article 12

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

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

Article 13

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

Article 14: ***Deleted***

Article 15

Title "Dependent Personal Services" replaced by "Income from Employment"

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(a) The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and

(b) The remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and

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

Article 17

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

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

Article 21

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

Article 22

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

Annex 5:

Consequential Changes to the Commentaries on Other Articles

*[**Secretariat note:** Proposed changes to the Commentary on Article 5 are to the Commentary as agreed at the third Session of the committee and noted in paper E/C.18/2008/CRP.10[23].It is likely that the following list is will be further refined, which could be achieved as the revised Commentary to Article 5 is developed.]*

A new **Paragraph 5 of the Commentary on Article 3** (dealing with the term "enterprise") deletion of Article 14 should read as follows:

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

The second sentence of current paragraph 5 of the Commentary on Article 3: "It does not define …laws of the Contracting States" should be expressed as inapplicable for countries optionally deleting Article 14:

There will also need to be consequential renumbering to existing paragraphs and a new **Paragraph 13 of the Commentary on Article 3** would address new paragraph 1(*h*) (dealing with the term "business"). The new paragraph of the Commentary should read as follows:

> *(h) The term "business"*
>
> The Convention does not contain an exhaustive definition of the term "business", which, under paragraph 2, should generally have the meaning which it has under the domestic law of the State that applies the Convention. Subparagraph (*h*) of paragraph 1, however, provides expressly that the term includes the performance of professional services and of other activities of an independent character. This provision was added in [20**] as part of an option to delete Article 14, which dealt with Independent Personal Services, from the Convention. This addition, which ensures that the term "business" includes the performance of the activities which were previously covered by Article 14, was intended to prevent the term "business" being interpreted in a restricted way so as to exclude the performance of professional services, or other activities of an independent character, in States where the domestic law does not consider that the

[23] Found at http://www.un.org/esa/ffd/tax/fourthsession/index.htm

performance of such services or activities can constitute a business. Contracting States for which this is not the case may wish to agree bilaterally to omit the definition.

There should be a new **Paragraph 6A of the Commentary to Article 7** as follows for countries optionally deleting Article 14:

"Paragraph 8 of the OECD Model Commentary on Article 7 (formerly paragraph 2.1) notes the following:

Before 2000, income from professional services and other activities of an independent character was dealt with under a separate Article, i.e. Article 14. The provisions of that Article were similar to those applicable to business profits but it used the concept of fixed base rather than that of permanent establishment since it had originally been thought that the latter concept should be reserved to commercial and industrial activities. However, it was not always clear which activities fell within Article 14 as opposed to Article 7. The elimination of Article 14 in 2000 reflected the fact that there were no intended differences between the concepts of permanent establishment, as used in Article 7, and fixed base, as used in Article 14, or between how profits were computed and tax was calculated according to which of Article 7 or 14 applied. The effect of the deletion of Article 14 is that income derived from professional services or other activities of an independent character is now dealt with under Article 7 as business profits. This was confirmed by the addition of a definition of the term "business" which expressly provides that this term includes professional services or other activities of an independent character.

The Committee considers that the reasoning of this OECD text holds equally true for the United Nations Model for countries taking the option of deleting Article 14, dealing with Independent Personal Services, from the Convention."

Paragraph 16 of the Commentary on Article 10 should be amended as follows for countries optionally deleting Article 14: (deletions and additions highlighted):

This paragraph, which makes paragraphs 1 and 2 inapplicable to dividends on shares that are effectively connected with a permanent establishment **(or a fixed base, in cases where Article 14 is retained)**~~or fixed base~~ of the recipient in the source country, reproduces Article 10, paragraph 4, of the OECD Model Convention. The OECD Commentary notes that paragraph 4 does not adopt a force of attraction rule, allowing dividends to be taxed as business profits if the recipient has a permanent establishment **(or a fixed base, in cases where Article 14 is retained)** ~~or fixed base~~ in the source country, regardless of whether the shareholding is connected with the permanent establishment. Rather, the paragraph only permits dividends to be taxed as business profits "if they are paid in respect of holdings forming part of the assets of the permanent establishment or otherwise effectively connected with that establishment". [Para. 31]

Paragraph 21 of the Commentary on Article 11 should be amended as follows for countries optionally deleting Article 14:

This paragraph, which provides that paragraphs 1 and 2 do not apply to some interest if the recipient has a permanent establishment **(or a fixed base, in cases where Article 14 is retained)** ~~or fixed base~~ in the source country, reproduces Article 11, paragraph 4, of the OECD Model Convention, with one modification. The OECD version only applies if the obligation on which the interest is paid is effectively connected with the permanent establishment **(or a fixed base, in cases where Article 14 is retained)**~~or fixed base~~. Since the United Nations Model

Convention, unlike the OECD Model Convention, adopts a limited force of attraction rule in Article 7, defining the income that may be taxed as business profits, a conforming change is made in Article 11, paragraph 4, of the United Nations Model Convention. This modification makes paragraphs 1 and 2 of Article 11 inapplicable if the debt claim is effectively connected with the permanent establishment **(or fixed base, where applicable)** ~~or fixed base~~ or with business activities in the source country of the same or similar kind as those effected through the permanent establishment.

Paragraph 18 of the Commentary on Article 12 should be amended as follows in cases of deletion of Article 14:

This paragraph reproduces with modifications Article 12, paragraph 3, of the OECD Model Convention, which states that paragraph 1 does not apply to royalties beneficially owned by a person having a permanent establishment or permanent base in the source country if the right or property from which the royalties derive is effectively connected with the permanent establishment **(or a fixed base, in cases where Article 14 is retained)** ~~**or fixed base**~~**.** The Group decided to modify paragraph 3 of the OECD Model Convention by introducing a limited force of attraction principle. In addition to royalties excluded from the application of paragraph 1 by paragraph 3 of the OECD Article, paragraph 4 of the United Nations Model Convention excludes royalties which are received in connection with business activities described in subparagraph (*c*) of paragraph 1 of Article 7 (business activities of the same or similar kind as those of a permanent establishment in the source country), even if the business activities are not carried on through a permanent establishment ~~or a fixed base~~ **(or fixed base, where applicable)**. The United Nations Model Convention also modifies the paragraph to refer to paragraph 2 as well as paragraph 1.

Paragraph 2 of the Commentary on Article 13 should be amended as follows in cases of deletion of Article 14:

The text of this article resulted from a compromise which the Group felt would be most acceptable to both developed and developing countries. Some members from developed countries advocated the use of Article 13 of the OECD Model Convention, which (1) allows the source country to tax capital gains from the alienation of immovable property and from movable property that is a part of a permanent establishment (or pertains to **a fixed base for performing independent personal services, in cases where Article 14 is retained)** ~~or pertains to a fixed base~~ (2) permits gains from the alienation of ships and aircraft to be taxed only in the State of effective management of the relevant enterprises, and (3) reserves to the residence country the right to tax gains on other forms of alienable property. Most members from developing countries advocated the right of the source country to levy a tax in situations in which the OECD reserves that right to the country of residence.

The Commentary on Article 15 should be amended by adding a new paragraph 3, reading:

3. While the title of Article 15 refers to “Dependent Personal Services” by contrast to the title of Article 14, which refers to “Independent Personal Services”, States deleting Article 14 and using the optional Article 5 provision (Alternative B) may choose to change the title of Article 15 to refer to ‘Income from Employment’, a phrase that is commonly used to describe the activities to which the Article applies, and is now used in the OECD Model. This change is not intended to affect the scope or substance of the Article in any way.”

There should be a change to **paragraph 2 of the Commentary on Article 15** (Dependent Personal Services) so that the first sentence reads (deletions and additions highlighted): "Although Articles 14 **(or 7, in cases where Article 14 has been deleted)**, 15, 19 and 23 may generally be adequate to prevent double taxation of visiting teachers, some countries may wish to include a visiting teachers article in their treaties."

While the **Commentary on Article 20** includes a discussion on the application of Article 14 to teachers, the discussion is essentially historical. To avoid confusion, the references to Article 14 could be footnoted as follows in paragraph 11 of that Commentary:

> During the course of discussions in the Seventh Meeting of the Ad Hoc Group of Experts, several participants argued for the addition to the Model Convention of an article dealing with visiting teachers. Currently, under the Model Convention visiting teachers were subject to Article 14[24], if the teaching services were performed in an independent capacity; Article 15, if the services were dependent; or Article 19, if the remuneration was paid by a Contracting State. Many treaties have an additional article or paragraph dealing specifically with teachers and, sometimes, researchers, which typically exempted them from taxation in the source country if their stay did not exceed a prescribed length. It was noted that Articles 14[25], and 15 commonly did not exempt a visiting teacher's compensation from taxation at source because they generally allowed source taxation of service performers who were present in the host country for more than 183 days, and many teaching assignments exceeded that period of time.

In the subcommittee's view, there is no need to footnote the reference to the Article in the report cited at **paragraph 13 of the Commentary on Article 20**, just as it has not recommended altering the quoted extracts from earlier versions of the OECD Model – that can be addressed as the Committee considers revised Commentary for other Articles of the UN Model.

The **Commentaries on Articles 17, 20 and 21** should be amended by adding new sentences, probably at the end of paragraph 1 of each Commentary along the following lines: "The Article should be amended to remove references to the "fixed base" concept where the option to delete Article 14, dealing with Independent Personal Services, has been taken."

[24] Article 7, in cases of the deletion of Article 14.

[25] Article 7, in cases of the deletion of Article 14.

Annex 6:

A Short History of the "Fixed Base" Concept

Historically, the "fixed base" concept goes back to the work of the Organisation for European Economic Cooperation (OEEC – the predecessor to the OECD) in its Reports of 1959. The London (1946) and Mexico (1943) Drafts had used the concept of permanent establishment in the context of independent personal services without reference to a "fixed base".

Article VII(4) of the Mexico Draft read:

> "Income derived by an accountant, an architect, a doctor, an engineer, a lawyer or other person engaged in the practice of a liberal profession shall be taxable only in the contracting State in which the person has a permanent establishment at, or from, which he renders services."

Article VI(4) of the London Draft read:

> "Income derived by an accountant, an architect, an engineer, a lawyer, a physician or other person engaged on his own account in the practice of a profession shall be taxable in the contracting State in which the person has a permanent establishment at, or from, which he renders services."

Prior to that, the Report presented by the Committee of Technical Experts on Double Taxation and Tax Evasion (League of Nations) (April 1927) Model Article 5 read:

> "Income from any industrial, commercial or agricultural undertaking and from any other trades or professions shall be taxable in the State in which the persons controlling the undertaking or engaged in the trade or profession possess permanent establishments."

Also the 1928 report presented by the General Meeting of Governmental Experts on Double Taxation and Tax Evasion (C.562.M.178.1928.II), Text of Draft Convention Ia, made no difference in Article 5[26] [27]:

> "Income, not referred to in Article 7, from any industrial, commercial or agricultural undertaking and from any other trades or professions shall be taxable in the State in which the permanent establishments are situated".

In 1931 a distinction was made in the Fiscal Committee Report to the Council on the Work of the Third Session of the Committee (C.415.M.171.1931.II.A). For industrial, commercial or agricultural enterprises the permanent establishment concept was used (Article 5 of the Draft Plurilateral Convention "A" for the Prevention of the Double Taxation of Certain Categories of Income), whereas Article 7 provided:

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[26] Article 7, to which Article 5 refers, deals with dependent personal income: salaries, wages etc.

[27] Nor did the other Models Ib (Article 2) and Ic (Article 3).

> "The income of the liberal professions shall be taxable only in the States in which they are regularly exercised."

The 2nd OEEC Report (July 1959) dealt with personal services by including the concept of fixed base (Annex B, Article VI):

> "Income derived by a resident of a Contracting State in respect of professional services or other independent activities of a similar character shall be taxable only in that State unless he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities. If he has such a fixed base, such part of that income as is attributable to that base may be taxed in that other State."

Paragraph 2 of the Commentary (Annex F) to this Article did not explain the need to make a difference, apart from rather vague "thoughts":

> "The provisions of Article VI are similar to those customarily adopted for income from industrial or commercial activities. Nevertheless it was thought that the concept of permanent establishment should be reserved for commercial and industrial activities."

The same remark was made in paragraph 3 of the 1963 OECD Commentaries (and paragraph 4 of the 1977 OECD Commentaries). Unfortunately, the paragraph also contemplated that "it has not been thought appropriate to try to define it".

The UN Commentaries cite paragraph 4 of the 1977 OECD Model after noting the relevance of that Commentary. (UN Commentary to Article 14, paragraph 10).

As noted in the body of this paper, Article 14 and the concept of fixed base were deleted from the OECD Model in the year 2000 and consequential amendments made, following a report produced earlier that year[28].

[28] OECD, *Issues Related to Article 14 of the Model Tax Convention*, 2000.