



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT



INTERPRETATION AND APPLICATION OF ARTICLE 5 (PERMANENT ESTABLISHMENT) OF THE OECD MODEL TAX CONVENTION

12 October 2011 to 10 February 2012



CENTRE FOR TAX POLICY AND ADMINISTRATION

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**INTERPRETATION AND APPLICATION OF ARTICLE 5 (PERMANENT ESTABLISHMENT)
OF THE OECD MODEL TAX CONVENTION**

Public discussion draft

Article 5 (Permanent Establishment) of the OECD Model Tax Convention includes the definition of the treaty concept of permanent establishment, which is primarily used for the purpose of the allocation of taxing rights when an enterprise of one State derives business profits from another State.

Despite the long history of the concept of permanent establishment, its practical application raises a number of issues. The Committee on Fiscal Affairs, through a subgroup of its Working Party 1 on Tax Conventions and Related Questions, has examined various questions related to the interpretation and application of the definition of permanent establishment. This public discussion draft includes proposals for additions and changes to the Commentary on the OECD Model Tax Convention resulting from the work of that subgroup that have recently been presented to the Working Party for discussion. Given the practical importance of these proposals, the Committee has decided to invite public comments on the proposed changes to the Commentary before they are thoroughly discussed by the Working Party.

The proposed changes appear in the order of the paragraphs of the current Commentary on Article 5 to which they relate. The Annex includes a consolidated version of paragraphs 1 to 35 of the Commentary on Article 5 that includes all the proposed changes.

The Committee intends to ask the Working Party to examine these proposed additions and changes to the OECD Model Tax Convention for possible inclusion through the next update, which is currently scheduled for 2014. It therefore invites interested parties to send their comments on this discussion draft **before 10 February 2012**. These comments will be examined at the next meeting of the Working Party.

Comments on this discussion draft should be sent electronically (in Word format) to:

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Unless otherwise requested at the time of submission, comments submitted to the OECD in response to this invitation will be posted on the OECD website.

This document is a discussion draft released for the purpose of inviting comments from interested parties on the proposals prepared by a working group. It reflects the majority views in the group on some issues on which there was no consensus. Given the preliminary nature of the proposals, this document does not necessarily reflect the final views of the OECD and its member countries.

TABLE OF CONTENTS

INTRODUCTION	6
1. Can a farm be a permanent establishment? (proposed paragraph 3.1 of the Commentary)	7
Description of the issue	7
Recommendation of the Working Group	7
Background	7
2. Meaning of “at the disposal of” (paragraph 4.2 of the Commentary)	8
Description of the issue	8
Recommendation of the Working Group	9
Background	10
3. Can the premises of a (converted) local entity constitute a permanent establishment of a foreign enterprise under paragraph 1? (paragraph 4.2 of the Commentary)	11
Description of the issue	11
Recommendation of the Working Group	11
Background	11
4. Home office as a PE (proposed new paragraphs 4.8 and 4.9)	12
Description of the issue	12
Recommendation of the Working Group	12
Background	13
5. Shops on ships operated in international traffic (proposed paragraph 5.5 of the Commentary)	14
Description of the issue	14
Recommendation of the Working Group	14
Background	14
6. Time requirement for the existence of a permanent establishment (paragraph 6 of the Commentary)	14
Description of the issue	14
Recommendation of the Working Group	16
Background	17
7. Presence of foreign enterprise’s personnel in the host country (paragraphs 10 of the Commentary)	18
Description of the issue	18
Recommendation of the Working Group	18
Background	19
8. Main contractor who subcontracts all aspects of a contract (paragraphs 10 and 19 of the Commentary)	20
Description of the issue	20
Recommendation of the Working Group	21
Background	21
9. Application of paragraph 3 to joint venture and partnership activities (paragraphs 10 and 19 of the Commentary)	22
Description of the issue	22
Recommendation of the Working Group	22
Background	23

10. Meaning of “place of management” (paragraph 12 of the Commentary)	24
Description of the issue	24
Recommendation of the Working Group	24
Background	25
11. Additional work on a construction site (proposed new paragraph 19.1 of the Commentary)	25
Description of the issue	25
Recommendation of the Working Group	26
Background	26
12. Must the activities referred to in paragraph 4 be of a preparatory or auxiliary nature? (paragraphs 21 and 23 of the Commentary)	26
Description of the issue	26
Recommendation of the Working Group	27
Background	28
13. Relationship between delivery and the sale of goods in subparagraph 4 <i>a</i>) (paragraphs 22 and 27.1 of the Commentary)	28
Description of the issue	28
Recommendation of the Working Group	28
Background	29
14. Does a development property constitute a PE? (paragraph 22 of the Commentary)	30
Description of the issue	30
Recommendation of the Working Group	30
Background	30
15. Do “goods or merchandise” cover digital products or data? (paragraph 22 of the Commentary)....	31
Description of the issue	31
Recommendation of the Working Group	31
Background	31
16. Carrying on various activities listed alternatively in subparagraphs 4 <i>a</i>) and <i>b</i>) (paragraph 22 of the Commentary)	32
Description of the issue	32
Recommendation of the Working Group	32
Background	32
17. Negotiation of import contracts as an activity of a preparatory or auxiliary activity (paragraphs 24 and 25 of the Commentary)	33
Description of the issue	33
Recommendation of the Working Group	33
Background	34
18. Fragmentation of activities (paragraphs 27.1 of the Commentary)	34
Description of the issue	34
Recommendation of the Working Group	35
Background	35
19. Meaning of “to conclude contracts in the name of the enterprise” (paragraph 32.1 of the Commentary)	35
Description of the issue	35
Recommendation of the Working Group	36
Background	36

20.	Is paragraph 5 restricted to situations where sales are concluded? (paragraph 33 of the Commentary)	37
	Description of the issue	37
	Recommendation of the Working Group	38
	Background	38
21.	Does paragraph 6 apply only to agents who do not conclude contracts in the name of their principal?	38
	Description of the issue	38
	Recommendation of the Working Group	39
22.	Assumption of entrepreneurial risk as a factor indicating independence	39
	Description of the issue	39
	Recommendation of the Working Group	39
23.	Activities of fund managers.....	40
	Description of the issue	40
	Recommendation of the Working Group	40
	Background	41
24.	Clarification of paragraph 8 of the Commentary on Article 5.....	43
	Description of the issue	43
	Recommendation of the Working Group	43
25.	Activities of insurance agents.....	43
	Description of the issue	43
	Recommendation of the Working Group	43
ANNEX -	Consolidated version of paragraphs 1 to 35 of the Commentary on Article 5 as amended by the proposals included in this note	44

INTERPRETATION AND APPLICATION OF ARTICLE 5 (PERMANENT ESTABLISHMENT) OF THE OECD MODEL TAX CONVENTION

INTRODUCTION

1. This note includes the recommendations on the interpretation and application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention made by a Working Group composed of delegates to Working Party 1 on Tax Conventions and Related Questions of the OECD Committee on Fiscal Affairs. The Working Group was set up to examine various issues related to the definition of permanent establishment that had been identified in previous work of the Committee, such as the work on business restructurings¹ and on the application to electronic commerce of the current treaty rules for the taxation of business profits,² in comments from delegates and in comments from the OECD Business and Industry Advisory Committee (BIAC).

2. In discussing these issues, the Working Group used a number of examples that were developed in the course of the preparation of the branch reports and general report on the topic “Is there a Permanent Establishment?” for the 2009 Congress of the International Fiscal Association (IFA).³ These examples are included in the relevant parts of this note.

3. The recommendations of the Working Group appear in the order of the paragraphs of the Commentary to which these recommendations relate. For each recommendation, this note includes:

- the description of the issue that led to the recommendation;
- the recommendation of the Working Group, which in most cases includes proposed changes to the Commentary on Article 5 (in these proposed changes, suggested additions to the existing

1. In 2005, the Committee on Fiscal Affairs created a Joint Working Group of delegates from Working Party 1 (which deals with tax treaty issues) and Working Party 6 (which deals with transfer pricing issues) to initiate work on treaty and transfer pricing issues related to business restructurings (see http://www.oecd.org/document/11/0,3343,en_2649_37989760_38087051_1_1_1_1,00.html). At the end of 2007, having taken stock of the progress made to that point, the Committee referred the work on the transfer pricing aspects of business restructurings to Working Party 6 and the work related to the definition of permanent establishment to Working Party 1.

2. In 1999, the Committee on Fiscal Affairs set up a Technical Advisory Group (TAG) on Monitoring the Application of Existing Treaty Norms for Taxing Business Profits with the general mandate to “examine how the current treaty rules for the taxation of business profits apply in the context of electronic commerce and examine proposals for alternative rules”. The final report of the TAG “Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce?” (available at <http://www.oecd.org/dataoecd/58/53/35869032.pdf>) included some suggestions for clarification of the definition of permanent establishment.

3. These reports are available in *Is there a Permanent Establishment?*, Cahiers de droit fiscal international, vol. 94a, Sdu Uitgevers, The Hague, 2009.

text of the Commentary appear in ***bold italics*** and suggested deletions appear in ~~strikethrough~~);

- background explanations on the recommendation (except for a few recommendations that do not include proposed changes to the Commentary).

4. The Annex includes a consolidated version of paragraphs 1 to 35 of the Commentary on Article 5 as these paragraphs would read if the proposals included in this note were adopted (unless indicated otherwise, all references to the Commentary included in this note are references to the Commentary on Article 5 of the OECD Model Tax Convention as it read after 22 July 2010).

1. Can a farm be a permanent establishment? (proposed paragraph 3.1 of the Commentary)

Description of the issue

5. Does the fact that income from agriculture is covered by Article 6 prevent a farm from being a permanent establishment?

6. This issue arose from the views expressed by some countries (see the position from India in paragraph 3 of the Positions on Article 5 included in the OECD Model Tax Convention).

Recommendation of the Working Group

7. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Add the following paragraph 3.1 to the Commentary on Article 5:

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

Background

8. Whilst Article 6 applies to income from a farm, nothing seems to prevent a farm from being a permanent establishment under the definition of Article 5. This may be relevant for other provisions of the OECD Model Tax Convention that refer to permanent establishments for purposes unrelated to the taxation of the profits derived therefrom.

9. The Group concluded that although there was little doubt that a farm could constitute a permanent establishment even though the income thereof would be covered by Article 6, the issue should be clarified in the Commentary to avoid any negative inference from the fact that the treaties concluded by some countries expressly refer to farms in Article 5.

2. Meaning of “at the disposal of” (paragraph 4.2 of the Commentary)

Description of the issue

10. Paragraphs 4 to 4.2 of the Commentary on Article 5 explain that a place of business may constitute a permanent establishment of an enterprise if that place is “at the disposal” of the enterprise. Business representatives have expressed concerns about the perceived lack of clarity of the phrase “at the disposal of the enterprise”. In a note prepared for its meeting with WP1 Delegates in February 2005, BIAC expressed concerns about the uncertainty of the concept of “at the disposal” and expressed the view that, at a minimum, a non-exclusive list of criteria should be provided as to what constitutes “at the disposal”:

WP1 stated in its letter to BIAC of 12 April 2004 that, since the words “at the disposal of an enterprise” are not found in the language of Art. 5, MTC but are only included in the Commentary (since 1977), it “sees no benefit in defining that term”. WP1 further stated that “the issue of when a particular location constitutes ‘a place of business through which the business of an enterprise is wholly or partly carried on’, is inherently related to the **nature of the business** under consideration. An abstract definition....would therefore not be possible.”

Too heavy a reliance on an exclusively facts and circumstances approach will inevitably lead to situations where neither tax authorities nor taxpayers will be in a position to determine in advance whether a PE exists. This complete lack of precision is not helpful in interpreting Art. 5 correctly, and arguably, is not a definition per se. At the very minimum, a **non-exclusive list of criteria** should be provided as to what constitutes “at the disposal”. Similarly, safe harbour exceptions could be included.

While BIAC understands the principle which justifies the finding of no PE in the OECD example of a **salesman visiting a customer** at its premises on a regular basis, we do not understand the rationale for finding of a possible PE in the examples of a painter working at the premises of a customer or a farmer repeatedly attending a market for a short period of time; BIAC would have thought under a facts and circumstances analysis that the painter is operating at the premises for the convenience of the customer, a factor that would lead against determining that a PE exists.⁴

The main purpose of the PE concept of Art. 5, MTC is to grant taxation rights to the source state with respect to a foreign enterprise which is performing substantive activities and functions requiring a permanent physical presence. Art. 5, par. 1, MTC has always properly been interpreted to require some degree of **physical presence**, some type of **fixed place** of business at its disposal. For example, a **general contractor subcontracting** all of its work never has this kind of physical presence at its disposal; such a situation would thus never be similar to the painter example. To reiterate, the main purpose of the permanent establishment concept is to give taxation rights to the source state if an enterprise is performing activities and functions which require a permanent physical presence. If a mere **civil law responsibility**⁵ would be sufficient to create a permanent establishment, the concept would become so diluted as to be virtually useless. The case of a company buying goods under a toll manufacturing agreement or contracting services, for example, could become problematical because the definition of “at disposal of” seems to have been broadened

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4. BIAC would think the more relevant inquiry is whether the painter operates at customer premises on a nearly exclusive basis within the host jurisdiction over an extended period of time. Thus the “fixed place of business” standard may have to be read less literally for this professional based on the facts and circumstances surrounding his/her occupation.
 5. For example, the standard for being subjected to a long-arm statute for product liability purposes should not become the standard for a PE.

to include “**at the direction of**”. Heretofore, nobody would have assumed a permanent establishment of the enterprise in question at the place of the producer’s or service provider’s residence. If this were the rule, the existence of a permanent establishment would, in most business arrangements, become the rule instead of the exception. We suggest that “at the disposal of” requires that an enterprise **can make use of a place** to the extent and for the duration it chooses to pursue its own business plan and activities and at the exclusion of the resident enterprise if necessary; the mere use of unutilized capacity of the resident operation should not be viewed as satisfying the requirement of “at the disposal of”.

Accordingly, we urge the OECD to reconsider the proposals made by BIAC on page 4 in the paper dated September 15, 2003 relating to the issue of “at the disposal of”.

Recommendation of the Working Group

11. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 4.2 of the Commentary on Article 5 by the following new paragraphs 4.2 to 4.4, renumber existing paragraphs 4.3 to 4.5 as paragraphs 4.5 to 4.7, add new paragraphs 4.8 and 4.9 as recommended under section 4 below and renumber existing paragraph 4.6 as paragraph 4.10:

4.2 Whilst no formal legal right to use a particular place is required for that place to constitute a permanent establishment, the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise. ***Whether a location may be considered to be at the disposal of an enterprise in such a way that it may constitute a “place of business through which the business of [that] enterprise is wholly or partly carried on” will depend on the extent of the presence of an enterprise at that location and the activities that it performs there. Where an enterprise has an exclusive legal right to use a particular location which is used only for carrying on that enterprise’s own business activities, that location is clearly at the disposal of the enterprise. This will also be the case where an enterprise performs business activities on a continuous and regular basis during an extended period of time at a location that belongs to another enterprise or that is used by a number of enterprises. This will not be the case, however, where the enterprise’s presence at a location is so intermittent or incidental that the location cannot be considered a place of business of the enterprise. Where an enterprise does not have a right to be present at a location and, in fact, does not use that location itself, that location is clearly not at the disposal of the enterprise; thus, for instance, it cannot be considered that a plant that is owned and used exclusively by a supplier or contract-manufacturer is at the disposal of an enterprise that will receive the goods produced at that plant merely because all these goods will be used in the business of that enterprise (see also paragraph 4.2 below). It is also important to remember that even if a place is a place of business through which the activities of an enterprise are partly carried on, that place will be deemed not to be a permanent establishment if the only business activities carried on at that place are those listed in paragraph 4. [the rest of existing paragraph 4.2 is moved to new paragraphs 4.3 and 4.4]***

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

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

constitute a ~~fixed~~ place of business through which the business of that enterprise is carried on (depending on the circumstances, however, paragraph 5 could apply to deem a permanent establishment to exist).

Background

12. The concept of “at the disposal” is not found in the definition of permanent establishment but is a test put forward in paragraph 4 of the Commentary in order to explain the concept of “place of business”. Whilst the Group examined the suggestion that it should not try to clarify a concept that is not included in the definition found in Article 5(1) and should focus instead on the meaning of “through which the business of the enterprise is wholly or partly carried on”, it concluded that discarding the concept of “at the disposal” would create a number of problems and that it should therefore provide clarification regarding the meaning of that concept.

13. The Group discussed the meaning of that concept in light of the following example, which was developed in the course of the preparation of the branch reports and general report for the IFA 2009 Congress, of a consultant working at a client’s premises for a long period of time:

Consultant working at the client’s premises

Peter, a resident of State R, is an independent consultant who provides computer training services on the use of specialized software.

CLIENTCO, a resident of State S, has concluded a contract with Peter under which Peter provides training to CLIENTCO’s staff in State S over a 20 month-long period. During that period, the work is undertaken at CLIENTCO’s headquarters located in a series of office buildings located in a large estate in State S. In these buildings, Peter meets employees in their respective offices and is allowed to use 10 various training rooms, located throughout the complex, where group training sessions take place. When these rooms are not in use, Peter is allowed to use them for preparing his courses (the rooms have internet connection). Peter is given a security card allowing him unrestricted access to the buildings located in the estate during business hours. His contract requires him to use CLIENTCO’s facilities exclusively for the purposes of the contract.

14. Members of the Group who expressed a view on the example concluded that the consultant should be viewed as having a permanent establishment in that case. For some, the fact that the room was available to the consultant for the preparation of his training activities was crucial. Others thought that since training was the core part of the consultant’s business, a place where he did that training was a place through which that business was carried on.

15. During the discussion of the example, the painter’s example included in paragraph 4.5 of the Commentary on Article 5 was also discussed.

16. The Group agreed that its conclusion on the CARCO example (see section 3 below) should be included in the proposed paragraph that resulted from its work on this issue. It was also agreed to add a cross-reference to paragraph 42 of the Commentary in order to clarify that the principle put forward in the sentence dealing with the CARCO example applied not only to the supplier or contract-manufacturer referred to in the penultimate sentence of the proposed paragraph but also to a service provider such as the one mentioned in paragraph 42.

3. Can the premises of a (converted) local entity constitute a permanent establishment of a foreign enterprise under paragraph 1? (paragraph 4.2 of the Commentary)

Description of the issue

17. Business restructurings may lead to assets being held, risks being managed or activities being performed by a converted local entity for the account of a foreign enterprise. The issue was raised of whether, and if so in which circumstances, the premises of the converted local entity in which these activities take place may constitute a fixed place of business of the foreign enterprise. Two relevant questions are whether these premises are *at the disposal of* the foreign enterprise and whether it is the *business of the foreign enterprise* (and not only the business of the local entity) that is wholly or partly carried on in these premises. This issue was discussed by the Joint Working Group on Business Restructurings before it was referred to Working Party 1. A broader issue that is raised by these questions is to what extent the activities of a supplier of goods or services, such as contract manufacturer, can create a permanent establishment for the client. The following example, which was developed in the course of the preparation of the branch reports and general report for the IFA 2009 Congress, illustrates this issue:

Contract manufacturing

CARCO, a company resident in State R, manufactures and sells automobiles worldwide. It sets up a subsidiary, SUBCAR, in State S, a developing country. SUBCAR will assemble cars from parts owned and supplied by CARCO. The parts will be provisionally imported from State R to State S and the finished cars shipped back from State S to State R. The parts necessary for the assembly will remain the property of CARCO. The industrial plant has been built by CARCO but will be sold to SUBCAR. SUBCAR will also pay royalties for the use of manufacturing processes developed and owned by CARCO. SUBCAR will invoice CARCO for its costs plus the usual margin for this type of activity in State S; the parts and automobiles will be the property of CARCO throughout the entire process.

Recommendation of the Working Group

18. The Working Group agreed that, in the above example, CARCO did not have a permanent establishment in State S and that this conclusion should be reflected in the changes to paragraph 4.2 (see the penultimate sentence of the proposed new paragraph 4.2 included in section 2 above).

19. In line with the approach already adopted with respect to the transfer pricing aspects of business restructurings,⁶ the Group also agreed that no distinction should be made in the application and interpretation of Article 5 based on whether or not the facts and arrangements relevant to the determination of a permanent establishment resulted from a business restructuring.

Background

20. When the Group discussed the above CARCO example, which deals with a subsidiary that performs contract manufacturing for its parent, the conclusion of the Group was that there was no permanent establishment in the situation described. A key factor was that the premises of SUBCAR were not used by CARCO itself and could not be viewed as being at the disposal of CARCO. It was also agreed that there could be no agency-PE issue in such a case because the subsidiary clearly did not exercise any authority to conclude contracts in the name of its parent.

6. See paragraph 9.9 of Chapter IX “Transfer Pricing Aspects of Business Restructurings” of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

21. The question was then asked whether the same conclusion would be reached if the subsidiary was previously a supplier who was converted into a contract manufacturer. Delegates agreed that the result should be the same; more generally, it concluded that in line with the approach already adopted with regard to the transfer pricing aspects of business restructurings, no distinction should be made in the application and interpretation of Article 5 based on whether or not the facts and arrangements relevant to the determination of a permanent establishment resulted from a business restructuring.

4. Home office as a PE (proposed new paragraphs 4.8 and 4.9)

Description of the issue

22. This issue is whether an individual's home office (*i.e.* an office located in an individual's own home) would constitute a permanent establishment of the enterprise for which the individual works.

Recommendation of the Working Group

23. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Add the following paragraphs immediately after new paragraph 4.7 of the Commentary on Article 5 (see Issue A):

4.8 *Even though part of the business of an enterprise may be carried on at a location such as an individual's home office, that should not lead to the automatic conclusion that that location is at the disposal of that enterprise simply because that location is at the disposal of an individual (e.g. an employee) who works for the enterprise. Whether or not a home office constitutes a location at the disposal of the enterprise will depend on the facts and circumstances of each case. In many cases, the carrying on of business activities at the home of an individual (e.g. an employee) will be so intermittent or incidental that the home will not be considered to be a location at the disposal of the enterprise (see paragraph 4.2 above). Where, however, a home office is used on a regular and continuous basis for carrying on business activities for an enterprise and it is clear from the facts and circumstances that the enterprise has required the individual to work from home (e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office), the home office may be considered to be at the disposal of the enterprise.*

4.9 *A clear example is that of a non-resident consultant who is present for an extended period in a given State where she carries on most of the business activities of her own consulting enterprise from an office set up in her home in that State; in that case, that home office constitutes a location at the disposal of the enterprise. Where, however, a cross-frontier worker performs most of his work from his home situated in one State rather than from the office made available to him in the other State, one should not consider that the home is at the disposal of the enterprise. It should be noted, however, that since the vast majority of employees reside in a State where their employer has at its disposal one or more places of business to which these employees report, the question of whether or not a home office constitutes a location at the disposal of an enterprise will rarely be a practical issue. Also, the activities carried on at a home office will often be merely auxiliary and will therefore fall within the exception of subparagraph e) of paragraph 4.*

Background

24. This issue was raised by a delegate who asked the Working Group whether and in which circumstances the home office of a resident employee of a foreign company could be considered to be a permanent establishment of the foreign company. After discussion, the Group concluded that this question was related to the meaning of “at the disposal” and that it required further analysis and should be clarified in the Commentary.

25. Some delegates, however, questioned whether the issue had practical relevance, noting that employees would normally reside in the State where their employer had business premises and that in the vast majority of cases, work done at a home office would be preparatory or auxiliary. It was explained that the issue would typically arise in the case of expatriate employees, cross-frontier workers and travelling consultants and it was agreed that this should be reflected in the proposed clarification.

26. The Group discussed this issue in light of the following four examples with a view to reaching a conclusion as to when a home office of an employee should be considered to be a place of business at the disposal of his/her employer:

1. A large multinational insurance company has employees in various countries who sell insurance policies on the local market. These employees are expected to maintain a home office but are not reimbursed for the costs of doing so. The direct supervisors of these employees know the address of the employees but cannot go to their homes without being invited.
2. An engineering company sends one of its employees to work on a number of unrelated building projects in a foreign country. The employee is not present on any construction site for more than 3 months but lives and work in that country for two years. As part of its usual expatriation package, the company pays the rental costs of the house in which the employee will live. The employee uses part of that home as an office where he works one or two hours each day. The direct supervisor of the employee does not know that he does part of his work from home.
3. An engineering company sends one of its employees to work on a number of unrelated building projects in a foreign country. The employee is not present on any construction site for more than 3 months but lives and works in that country for two years. As part of its usual expatriation package, the company pays the rental costs of the house in which the employee will live. The employee uses part of that home as an office where he performs about 50% of his work (the rest is spent on the various construction sites). The company initially intended to rent a separate office for the employee but he convinced his direct supervisor that it was more efficient for him to work from home.
4. A company, resident of one State, has only two employees who are also its shareholders. One employee is a resident of another State who carries on a large part of the activities of the enterprise at her home office, the costs of which are neither paid for nor reimbursed by the company.

27. During the discussion of the issue, the question was asked whether these examples raised any issue that had not been previously discussed by the Group or addressed in the Commentary. It was explained that whilst it was clear that the home office of an employee was at the disposal of the employee and was a place where the business activities of the employer were partly carried on, the crucial issue that had not been previously addressed was whether this was sufficient to consider that that place was at the disposal of the employer.

5. Shops on ships operated in international traffic (proposed paragraph 5.5 of the Commentary)

Description of the issue

28. If an enterprise of State A owns a shop on a ship registered in State B and the ship travels between several countries including States A and B, in which country may the income from the shop be taxed? In the example, it may be assumed that enterprise is not associated to the enterprise operating the ship. Could it be argued that there is a PE on the ship (and if so in which country would the PE be situated)?

Recommendation of the Working Group

29. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Add the following paragraph 5.5 to the Commentary on Article 5 (and renumber existing paragraph 5.5 as 5.6):

5.5 Similarly, a ship or boat that navigates within territorial waters or in inland waterways is not fixed and does not, therefore, constitute a fixed place of business (unless the operation of the ship or boat is restricted to a particular area that has commercial and geographic coherence). Business activities carried on aboard such a ship or boat, such as a shop or restaurant, must be treated the same way.

Background

30. The Group concluded that a moving ship would typically not constitute a fixed place and a shop aboard such a ship would not, therefore, constitute a permanent establishment. It was noted, however, that a specific area to which the operation of the ship would be restricted could itself have commercial and geographic coherence and therefore, could constitute a fixed place of business depending on the circumstances.

31. It was also noted that, in any event, the enterprise operating a restaurant or shop aboard a ship would probably have a deemed permanent establishment under Article 5(5) to the extent that contracts would normally be concluded with customers by the personnel of such a restaurant or shop.

6. Time requirement for the existence of a permanent establishment (paragraph 6 of the Commentary)

Description of the issue

32. Business has expressed concerns about the uncertainty concerning the period of time required for a location to be considered a permanent establishment. In a note prepared for its 2005 meeting with WP1, BIAC presented its concerns as follows:

We also remain concerned over the uncertainties arising out of the lack of any rules relating to the duration of an activity to be judged a PE.

In its letter to us of 12 April, 2004, the OECD wrote “We read the second sentence of Paragraph 6 of the Commentary to refer to a business which exists for a short period of time by reason of its very nature and to indicate that a place set up for such business would not be set up merely for a

temporary purpose **even if it exists for a very short period** of time because of the nature of that activity.” The response merely rearranges the words that we found unintelligible in the revised Commentary without providing any clarification. We still do not understand how the nature of the activity can transform a place that is intended to exist for a short period into a place of business that is not set up for a temporary purpose. By way of example, a non-US resident food vendor that provided food services to its country’s athletes during the Atlantic Olympic games appears to be a PE under the newly evolving definition merely because the duration activity overlaps significantly with the short term nature of the Olympic games. This not the definition many treaty negotiators had in mind when most current double tax treaties were signed. Apparently the definition of “permanency” is a function of the underlying business activity that it relates to. If so, one can posit the creation of a new business enterprise in a host jurisdiction of an indefinite nature and which takes 3 to 5 years to make fully operation. Under the evolving PE definition, one can argue that an entity that provides a subset of services to this entity with a duration of less than 3 years would not be deemed to have a PE.

We understood the former requirement that “the place of business [must be] not set up merely for a temporary purpose” to involve a required and demonstrable intention of the taxpayer. The recent revisions have removed this condition. The elimination of this condition **creates uncertainty** that did not previously exist and introduces greater pressure for clarification. Specifically, what aspect of the nature of the business that will be carried on for only a short period of time distinguishes between a place of business that exists for a very short period of time that constitutes a PE and a place of business that exists for a very short period of time that does not constitute a PE?

The revised Commentary essentially acknowledges that it fails to answer this question. It merely points out, “It is sometimes difficult to determine whether this [a place of business constitutes a PE even though it exists, in practice, only for a very short period of time because the nature of the business is such that it will only be carried on for a very short period of time] is the case.”

The **meaning of the Commentary must become more clear** and the language used must be understandable to the typical reader versed in international tax principles, both tax administrations and taxpayers. The existing Commentary is not serving its purpose if the States that must enforce the treaties and the multinational enterprises that are trying to remain in compliance with the requirements of the treaties cannot determine what the treaties mean. The goal of voluntary compliance would best be served by a presumption that a fixed place of business can exist only if business is **conducted at such place for a minimum period of time**. Let the commentary note that the minimum period is not meant to be illustrative of the definition of a PE but that it serves for the administrative convenience of all member States; some States will win in some cases and lose in others but that is the nature of a double tax treaty.

We, therefore, suggest that the OECD seriously consider using a **minimum time period** for which an activity has to be performed in a continuous manner before a PE is created. The 183 day rule of Art. 15, MTC uses the concept of a time frame with great success and, notably, with a minimum amount of controversy associated in defining the scope of this definition. Art. 5, par. 3, MTC could be used as a precedent to establish a **twelve month period** as the minimum duration for a foreign enterprise’s activities to rise to the level of PE. This can be derived from the fact that the construction and installation projects often require a substantial physical presence so that other businesses with less physical presence should, at the very least, also enjoy a twelve-month de minimus rule.

A **prescribed time frame** allows businesses and tax authorities to assess, in advance, whether or not a PE will emerge. Except for extraordinary circumstances, for example, when a PE which is initially

created to accomplish a long term agenda is closed down after a short period due to unforeseen events, there is little, if any, justification for defining a short term activity as being permanent even if it were of recurrent nature. Such an approach would only result in uncertainty whether or not a PE exists, which is unwarranted because these activities create no substantial permanent presence. In this context, the term “**nature of the business**” used by the OECD is generally not helpful for getting advance guidance.

The Commentary could suggest a minimum period of time as a general rule, even if paragraph 1 does not specify a minimum period of time. The Commentary could conclude that a place of business that does not exist for twelve months should “generally” or “except in the case of changed or unusual circumstances” be viewed as not fixed and, therefore, not constituting a PE. While such an objective standard is clearly preferred, **clarification of the more subjective standard** in the current Commentary is still necessary, especially if the Commentary is not revised to include this more objective standard.

Recommendation of the Working Group

33. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 6 of the Commentary on Article 5 by the following (and renumber the existing paragraphs 6.1 to 6.3 as paragraphs 6.4 to 6.6):

6. Since the place of business must be fixed, it also follows that a permanent establishment can be deemed to exist only if the place of business has a certain degree of permanency, *i.e.* if it is not of a purely temporary nature. A place of business may, however, constitute a permanent establishment even though it exists, in practice, only for a very short period of time because the nature of the business is such that it will only be carried on for that short period of time. It is sometimes difficult to determine whether this is the case. Whilst the practices followed by Member countries have not been consistent in so far as time requirements are concerned, experience has shown that permanent establishments normally have not been considered to exist in situations where a business had been carried on in a country through a place of business that was maintained for less than six months (conversely, practice shows that there were many cases where a permanent establishment has been considered to exist where the place of business was maintained for a period longer than six months). *[the rest of the paragraph is moved to new paragraphs 6.1 to 6.3]*

6.1 One exception to *this general practice* has been where the activities were of a recurrent nature; in such cases, each period of time during which the place is used needs to be considered in combination with the number of times during which that place is used (which may extend over a number of years). *That exception is illustrated by the following example. An individual resident of State R rents a stand at a commercial fair in State S for 15 consecutive years where he sells sculptures during a period of five weeks each year. In that case, it could be considered that the time requirement for a permanent establishment is met due to the recurring nature of the activity regardless of the fact that any consecutive presence lasts less than 6 months.*

6.2 Another exception to this *general practice* has been ~~made~~ where activities constituted a business that was carried on exclusively in that country; in this situation, the business may have short duration because of its nature but since it is wholly carried on in that country, its connection with that country is stronger. *That exception is illustrated by the following example. An individual resident of State R has learned that a television documentary will be shot in a*

remote village in State S where her parents still own a large house. Since the documentary will require the presence of a number of actors and technicians in that village during a period of four months, she decides to transform the house of her parents into a small restaurant which she will operate as sole proprietor during that period. These are the only business activities that she has carried on and she does not intend to carry on such activities in the future; the restaurant will therefore be the location where the business of that enterprise will be wholly carried on. In that case, it could be considered that the time requirement for a permanent establishment is met since the restaurant is operated during the whole existence of that particular business. This would not be the situation, however, where a company resident of State R which operates various catering facilities in State R would operate a cafeteria in State S during a four week international sports event. In that case, the company's business, which is permanently carried on in State R, is only temporarily carried on in State S.

6.3 For ease of administration, countries may want to consider these practices *reflected in paragraphs 6 to 6.2* when they address disagreements as to whether a particular place of business that exists only for a short period of time constitutes a permanent establishment.

Background

34. After discussion of BIAC's comments on this issue, the Group expressed its support for the conclusions currently reflected in paragraph 6 and concluded that whilst examples could be provided to clarify the exceptions included at the end of the paragraph, no other changes should be made to the guidance on the issue of the time requirement.

35. In its discussion of examples that could be added to paragraph 6 to illustrate the situations envisaged by the two exceptions mentioned at the end of existing paragraph 6 of the Commentary, the Group discussed the following two examples developed in the course of the preparation of the branch reports and general report for the IFA 2009 Congress:

Short duration business

Claudia, an individual resident of State R who recently retired from her job as a school teacher, has learned that a movie will be made in a remote village in State S where her parents still own a large house. Since the movie will require the presence of a number of actors and technicians in that village during a period of four months, Claudia decides to transform the house of her parents into a small restaurant during that period. Throughout the first month following her arrival in State S, Claudia obtains all the necessary permits, equipment and furniture, redecorates the house and, after that month, operates that restaurant as a sole proprietor on a full-time basis during the period of four months. These are the only business activities that Claudia will carry on in the foreseeable future.

Recurrent activities

Frans, a fireman resident of State R, produces small glass sculptures in his spare time. For the last 11 years, he has rented a small kiosk at the same Christmas market in State S where he sells his sculptures during a period of five weeks each year. This is the only time and place where Frans sells his sculptures but he makes a small profit out of this business activity.

7. Presence of foreign enterprise's personnel in the host country (paragraphs 10 of the Commentary)

Description of the issue

36. In which circumstances can the presence in a country of personnel of a foreign enterprise constitute a permanent establishment for the foreign enterprise?

37. This question was raised in the context of the work of the Joint Working Group on Business Restructurings.

Recommendation of the Working Group

38. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 10 of the Commentary on Article 5 by the following:

10. *There are different ways in which an enterprise may carry on its business. In most cases, the business of an enterprise is carried on mainly by the entrepreneur or persons who are in a paid-employment relationship with the enterprise (personnel). This personnel includes employees and other persons receiving instructions from the enterprise (e.g. dependent agents). The powers of such personnel in its relationship with third parties are irrelevant. It makes no difference whether or not the dependent agent is authorised to conclude contracts if he works at the fixed place of business of the enterprise (see paragraph 35 below). [the rest of the existing paragraph 10 is moved to new paragraph 10.2] As explained in paragraph 8.11 of the Commentary on Article 15, however, there may be cases where individuals who are formally employed by an enterprise will actually be carrying on the business of another enterprise and where, therefore, the first enterprise should not be considered to be carrying on its own business at the location where these individuals will perform that work. Within a multinational group, it is relatively frequent for employees of one company to be temporarily seconded to another company of the group and to perform business activities that clearly belong to the business of that other company. In such cases, administrative reasons (e.g. the need to preserve seniority or pension rights) often prevent a change in the employment contract. The analysis described in paragraph 8.13 to 8.15 of the Commentary on Article 15 will be relevant for the purposes of distinguishing these cases from other cases where employees of a foreign enterprise perform that enterprise's own business activities.*

[10.1 See section 8 below]

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

Background

39. Whilst the issue was discussed by the Joint Working Group on Business Restructurings in relation to associated enterprises, similar issues may arise with respect to independent entities, as shown by the following example developed in the course of the preparation of the branch reports and general report for the IFA 2009 Congress:

Presence of employees of a foreign company

SCO is a company resident of State S that owns a small hotel. The hotel will be operated as a franchise.

SCO has contracted with RCO, a manpower company resident of State R, to provide the services of a hotel manager. During 2008 and 2009, RCO sends successively 3 different persons to perform that role in the hotel for periods of 5, 15 and 4 months respectively. RCO is paid a management fee equal to the total remuneration of the persons that it sends plus 25%.

40. When the Group discussed that example, it was suggested that it was ambiguous and it was therefore decided to discuss the following two versions of the example:

1. Manager employed by the hotel owner

SCO is a company resident of State S that owns a small hotel. The hotel will be operated as a franchise.

SCO has contracted with RCO, a manpower company resident of State R, to obtain the services of hotel managers. RCO will find the managers and will negotiate employment contracts between each of them and SCO; RCO will not be the legal employer of these managers. During 2008 and 2009, RCO finds successively 3 different persons to perform the hotel manager functions for periods of 5, 15 and 4 months respectively. RCO is paid a “management fee” equal to the total remuneration paid to these persons by SCO plus 25%.

2. Manager employed by the manpower company

SCO is a company resident of State S that owns a small hotel. The hotel will be operated as a franchise.

SCO has contracted with RCO, a manpower company resident of State R, to obtain the services of hotel managers. RCO will be the legal employer of the managers and will provide their services to SCO under that contract for services. During 2008 and 2009, RCO sends successively 3 different persons to perform the hotel manager functions for periods of 5, 15 and 4 months respectively. RCO is paid a “service fee” equal to the total remuneration of the persons that it sends plus 25%.

41. The Group concluded that the manpower company would not have a permanent establishment in the first example of managers who would become employees of the company that owned and operated the hotel.

42. As regards the second example, reference was made to the last sentence of paragraph 8.11 of the Commentary on Article 15, according to which if the State of source considered the hotel managers to be in an employment relationship with SCO, which operated the hotel, the conclusion should be reached that RCO does not have a permanent establishment. It was noted, however, that if the State of source treated the managers as employees of RCO and RCO as a provider of hotel management services to SCO, the

Commentary on Article 15 would not directly address the issue of whether or not RCO had a permanent establishment in that State.

43. The view was expressed that since paragraph 10 of the Commentary on Article 5 provides that an enterprise carries on its business through its employees, it would be difficult to consider that RCO did not have a PE in the situation where the managers were formally employed by RCO unless it was found that the managers were in fact “economically” employed by SCO under the criteria put forward in paragraphs 8.13 to 8.15 of the new Commentary on Article 15.

44. It was suggested that the practical situation in which this issue was most likely to occur was the case where an employee of a company that belonged to a multinational group was temporarily seconded to work for another company of the group. In many cases, the secondment would be done without a formal contract between the two enterprises but, to avoid transfer pricing issues, a cost-plus charge might be paid to the first company. This could have the unfortunate consequence that the services rendered by the employee might be considered to be provided by the first company to the second company, which would create the risk that the first company would be found to have a PE in the premises of the second company where the employee would work. The Group concluded that the analysis in paragraph 8.13 to 8.15 of the Commentary on Article 15 would be relevant for the purpose of distinguishing these cases from other cases where employees of a foreign enterprise perform that enterprise’s own business activities.

8. Main contractor who subcontracts all aspects of a contract (paragraphs 10 and 19 of the Commentary)

Description of the issue

45. Does an enterprise (contractor) that has undertaken the performance of a comprehensive project have a permanent establishment if it subcontracts all aspects of that contract to other enterprises (subcontractors)?

46. This issue was discussed some years ago by the Working Party. Whilst changes to paragraph 19 of the Commentary were then tentatively agreed to by the Working Party, it was subsequently decided that these and other changes related to the definition of permanent establishment should be re-examined after the conclusion of the work on other issues, including the work on attribution of profits to permanent establishments.

47. As was noted when the issue was discussed by the Working Party, the issue goes beyond the scope of Article 5(3) and raises questions concerning the interpretation of paragraph 10 of the Commentary, which discusses how the business of enterprise is carried on for the purposes of the application of Article 5(1). This is illustrated by the following example developed in the course of the preparation of the branch reports and general report for the IFA 2009 Congress:

Subcontractor

KCO is a company resident of State R that provides services to the oil industry. KCO has concluded a contract with an independent oil company, OCO, which is resident of State S. Under the contract, KCO is to conduct certain engineering services in addition to providing certain other services related to the managing of the accommodation facilities (“catering”) on an offshore oil platform in State S. KCO subcontracts the catering to an independent company, FCO, which is a resident of State S. KCO is fully responsible for the work done by FCO in relation to OCO. Hence, FCO does not have any obligations towards OCO. FCO is paid on a cost plus basis. KCO itself does not have any physical presence in State S, and performs the engineering services from its offices in State R.

Recommendation of the Working Group

48. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Add the following paragraph 10.1 immediately after new paragraph 10 of the Commentary on Article 5 (see section 7 above):

10.1 An enterprise may also carry on its business through subcontractors, acting alone or together with employees of the enterprise. In that case, a permanent establishment will only exist for the enterprise if the other conditions of Article 5 are met. In the context of paragraph 1, that will require that these subcontractors perform the work of the enterprise at a fixed place of business that is at the disposal of the enterprise for reasons other than the mere fact that these subcontractors perform such work at that location (see paragraph 4.2 above). An example would be where an enterprise that owns a small hotel and rents out the hotel's rooms through the internet has subcontracted the on-site operation of the hotel to a company that is remunerated on a cost-plus basis.

Replace paragraph 19 of the Commentary on Article 5 by the following (and renumber existing paragraph 19.1 as paragraph 19.2):

19. A site exists from the date on which the contractor begins his work, including any preparatory work, in the country where the construction is to be established, *e.g.* if he installs a planning office for the construction. *[the six subsequent sentences have been moved to new paragraph 19.1]* If an enterprise (general contractor) which has undertaken the performance of a comprehensive project subcontracts ***all or*** parts of such a project to other enterprises (subcontractors), the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor on the building project. ***In that case, the site should be considered to be at the disposal of the general contractor during the time spent on that site by any subcontractor where the general contractor has overall responsibility for the site and the site is made available to that general contractor for the purposes of carrying on its construction business.*** The subcontractor himself has a permanent establishment at the site if his activities there last more than twelve months.

[19.1 See section 11 below]

Background

49. The Group concluded that the implication of paragraph 19 was that the activities of the subcontractors were allocated to the main contractor. It was also noted that it would be fairly unlikely that a main contractor would not have some employees on a construction site and that it would seem strange to have a different result if the main contractor's employees spent only one day on the site.

50. The Group also concluded that the issue was not restricted to construction sites and to paragraph 19 of the Commentary but was in effect related to the more general issue of whether an enterprise can carry on its business through subcontractors and, therefore, to paragraph 10 of the Commentary.

51. The application of paragraph 10 was discussed on the basis of a variation of the hotel example included in section 7 above. Under the modified facts of the example, the handling of the keys, the cleaning and other aspects of the operation of the hotel would be subcontracted to a local independent enterprise but that enterprise would not conclude contracts on behalf of the hotel owner (the rooms would be rented through the internet). Members of the Group generally agreed that if the operation of a hotel was

entirely subcontracted, the owner of the hotel, who would obtain the profits, could still be viewed as having a permanent establishment.

9. Application of paragraph 3 to joint venture and partnership activities (paragraphs 10 and 19 of the Commentary)

Description of the issue

52. How does paragraph 3 apply when a construction site lasts for more than 12 months but no taxpayer is there for more than 12 months?

53. The following example, which was developed in the course of the preparation of the branch reports and general report for the IFA 2009 Congress, illustrates the issue:

Joint venture

ACO and BCO are two unrelated companies that are residents of State R. ACO is a construction company and BCO specializes in electronic, sound and light installations.

Both companies have decided to form a joint venture to build and subsequently sell a modern theatre in State S. ACO will be responsible for the construction of the building and BCO will install the furniture and equipment (including the sound, light and electronic equipment). The joint venture contract provides that each company will be solely responsible for its own costs and activities, that neither company will be an agent of the other, that the companies will not be partners in a partnership but that they will share equally the sale price of the theatre.

ACO employees are present in State S for 10 months to build the theatre in State S and BCO's employees subsequently spend 10 months to install the furniture and equipment.

Recommendation of the Working Group

54. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Add the following paragraphs 10.3 and 10.4 after the new paragraph 10.2 of the Commentary on Article 5 (the new paragraph 10.2 results from the recommendations in sections 7 and 8 above):

10.3 *It follows from the definition of “enterprise of a Contracting State” in Article 3 that this term, as used in Article 5, refers to any form of enterprise carried on by a resident of a Contracting State, whether this enterprise is legally set up as a company, partnership, sole proprietorship or other legal form. Different enterprises may collaborate on the same project and the question of whether their collaboration constitutes a separate enterprise (e.g. in the form of a partnership) is a question that depends on the facts and the domestic law of each State. Clearly, if two enterprises carried on by different persons decide to form a company in which these persons are shareholders, the company constitutes a legal person that will carry on what becomes a separate enterprise. It will often be the case, however, that different enterprises will simply agree to each carry on a separate part of the same project and that these enterprises will not jointly carry on business activities and share the profits thereof even though they may share the overall output from the project or the remuneration for the activities that will be carried on in the context of that project (e.g. what is considered to be a “joint venture” according to the law of some countries). In such a case, it would be difficult to consider that a separate enterprise has been set up.*

10.4 *In the case of an enterprise that takes the form of a fiscally transparent partnership,*

the enterprise is carried on by each partner and, as regards the partners' respective shares of the profits, is therefore an enterprise of each Contracting State of which a partner is a resident. If such a partnership has a permanent establishment in a Contracting State, each partner's share of the profits attributable to the permanent establishment will therefore constitute, for the purposes of Article 7, profits derived by an enterprise of the Contracting State of which that partner is a resident (see also paragraph 19.1 below).

Replace paragraph 19.1 of the Commentary on Article 5 by the following new paragraph 19.2 (the renumbering results from the recommendations in sections 8 and 11):

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

Background

55. The Group concluded that whilst members of a partnership would each have a permanent establishment if the partnership had one, the situation would be different in the case of a true joint venture that did not constitute a partnership. It also discussed the meaning of joint venture, which would depend on domestic law, and whether a joint venture could be considered to constitute a distinct enterprise.

56. The Group agreed that the distinction between a joint venture, an association and a partnership (especially in the case of a transparent partnership that would have legal personality) was an issue that essentially depended on facts and domestic law and that its report should include explanations to that effect. Looking at the particular facts of the example, it was concluded that because the companies were not liable for each other's activities, there were no co-ownership of assets or joint employment responsibilities and the companies did not share profits (although they each received a part of the overall sales price), the companies were not carrying on a joint business. Whether there was a permanent establishment, especially as regards to paragraph 3, should therefore be determined independently for each company.

57. The Group also discussed the statement, in existing paragraph 19.1, according to which the twelve-month test of Article 5(3) is applied at the level of the partnership. The question was asked how that principle would be applied in the case of a partnership that would have two partners resident of two different States, one of which would have a treaty providing that a construction site in a third State constitutes a permanent establishment whilst the other State would have a treaty with that third State that

would include a different time threshold according to which the construction site would not constitute a permanent establishment. The Group decided that this example and the conclusion that, in that case, the time threshold of each treaty would still be applied at the level of the partnership but only with respect to each partner's share of the profits covered by that treaty, should be included in paragraph 19.1.

10. Meaning of “place of management” (paragraph 12 of the Commentary)

Description of the issue

58. The question has been raised as to whether and in which circumstances a company that is a member of a corporate group may constitute a “place of management” of another company of the group so as to constitute a permanent establishment in accordance with the example in subparagraph 2 a) of Article 5.

59. This issue is illustrated by the following example, which was developed in the course of the preparation of the branch reports and general report for the IFA 2009 Congress:

Place of management

ACO, a company resident of State S, owns all the shares of BCO, a company resident of State R. Both companies are part of the ACO multinational group.

A part of the administrative functions of the multinational group have been centralised in the headquarters of ACO located in State S. The accounting, legal services, and most of the human resources functions of BCO are provided through ACO employees working at these headquarters.

The tax authorities of State S argue that since the headquarters of ACO constitute a place of management for BCO, BCO has a permanent establishment in State S under paragraph 5(1) and subparagraph 5(2)a).

Recommendation of the Working Group

60. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 12 of the Commentary on Article 5 by the following:

12. This paragraph contains a list, by no means exhaustive, of examples *of places of business*, each of which can be regarded, ~~*prima facie*~~, as constituting a permanent establishment ***under paragraph 1 provided that it meets the requirements of that paragraph***. As these examples are to be seen against the background ~~read in the context~~ of the general definition given in paragraph 1, ~~it is assumed that the Contracting States interpret~~ the terms listed, “a place of management”, “a branch”, “an office”, etc. ***must be interpreted*** in such a way that such places of business constitute permanent establishments only if they meet the requirements of paragraph 1.

61. As regards the above example, the Working Group concluded that the real issue underlying that example was the meaning of “at the disposal”, which was an issue that had already been discussed and that is directly addressed in paragraph 42 of the Commentary, which confirms that there would not be a permanent establishment in the example.

Background

62. The Group concluded that this issue raised two different questions. The first was the issue of the relationship between the list of examples in Article 5(2) and the definition in Article 5(1). The second one was the one raised by the above example.

63. As regards the first question, it was agreed that since some non-OECD countries have expressed the view that all examples listed in paragraph 2 were automatically permanent establishments, the relationship between paragraphs 1 and 2 could usefully be clarified even though paragraph 12 of the Commentary already indicated that the list of examples in paragraph 2 had to be interpreted in the light of paragraph 1.

64. As regards the second question, it was noted that paragraph 42 of the Commentary already dealt with the situation of one member of a corporate group providing management services to other members and that there was therefore no need to amend the Commentary with respect to the issue.

65. It was also agreed that no clarification was needed concerning the distinction between a “place of management” for the purposes of subparagraph 2 a) of Article 5 and the concept of “place of effective management” as the residence tie-breaker rule in paragraph 3 of Article 4: whilst an enterprise can have different places of management for the purposes of subparagraph 2 a) of Article 5, an entity such as a company can have only one place of effective management for the purposes of paragraph 3 of Article 4.

11. Additional work on a construction site (proposed new paragraph 19.1 of the Commentary)

Description of the issue

66. To what extent does additional work performed on a construction site count for the application of paragraph 3?

67. The following example, which was developed in the course of the preparation of the branch reports and general report for the IFA 2009 Congress, illustrates the issue:

Additional work on a construction site

CCO is a company resident in State R that carried on a technologically advanced construction project in State S for OILCO. The project lasted for 10 months and two weeks (assume 6 weeks less than the 12-month test in paragraph 3 of Article 5). The testing of the facilities took place over the following three weeks and the site was delivered to OILCO immediately after the testing was completed. Two employees of CCO remained on the site for one more week to train the employees of OILCO, for which OILCO did not make any additional payment. After three weeks of operation, a minor construction problem had to be fixed by employees of CCO; five employees of CCO returned to the site to make the reparation. The reparation work took two weeks; OILCO did not pay for that work as the initial construction work was guaranteed by CCO.

68. Whilst paragraph 19 of the Commentary on Article 5 indicates that a construction site continues to exist until work is completed or abandoned, the general report on the topic “Is there a Permanent Establishment?” that was prepared for the IFA 2009 Congress indicated that some tax administrations have been asked to clarify the practical application of that general guidance.

Recommendation of the Working Group

69. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 19 of the Commentary on Article 5 by the following (and renumber existing paragraph 19.1 as paragraph 19.2):

[19. See section 8 above]

19.1 In general, ~~if a site~~ continues to exist until the work is completed or permanently abandoned. ***The period during which the building or its facilities are being tested by the contractor or subcontractor should therefore generally be included in the period during which the construction site exists. In practice, the delivery of the building or facilities to the client will usually represent the end of the period of work, provided that the contractor and subcontractors no longer work on the site after its delivery.*** A site should not be regarded as ceasing to exist when work is temporarily discontinued. Seasonal or other temporary interruptions should be included in determining the life of a site. Seasonal interruptions include interruptions due to bad weather. Temporary interruption could be caused, for example, by shortage of material or labour difficulties. Thus, for example, if a contractor started work on a road on 1 May, stopped on 1 November because of bad weather conditions or a lack of materials but resumed work on 1 February the following year, completing the road on 1 June, his construction project should be regarded as a permanent establishment because thirteen months elapsed between the date he first commenced work (1 May) and the date he finally finished (1 June of the following year). ***Work that is undertaken on a site after the construction work has been completed pursuant to a guarantee that requires an enterprise to make repairs would normally not be included in the original construction period.***

Background

70. The Group supported the suggestion that some clarification should be added to the Commentary as to when work on a construction site should be considered to be completed for the purposes of computing the twelve-month period of paragraph 3. It was generally agreed that the period during which the facilities are tested would normally be included, that the hand-over of the building to the client would usually represent the end of that period, and that work undertaken subsequently pursuant to a guarantee would not be taken into account.

12. Must the activities referred to in paragraph 4 be of a preparatory or auxiliary nature? (paragraphs 21 and 23 of the Commentary)

Description of the issue

71. The question was raised as to whether the activities that are mentioned in subparagraphs *a)* to *d)* of paragraph 4 are automatic exceptions or whether these exceptions are conditional on the activities being of a preparatory or auxiliary nature.

72. This issue was discussed in section 4.A.d) of the 2004 report of the Business Profits TAG “Are The Current Treaty Rules For Taxing Business Profits Appropriate For E-Commerce?”:

The alternative option to subject the activities covered by the exception to the overall limitation that they be of a preparatory or auxiliary nature is based on the same rationale but is arguably better targeted as it implicitly restricts the exceptions to activities that contribute only marginally to the

profits of the enterprise. It could also be argued that this alternative option is fully in line with the purpose of paragraph 4, which is described as follows in paragraph 21 of the Commentary:

“The common feature of these activities is that they are, in general, preparatory or auxiliary activities” [...] “Thus the provisions of paragraph 4 are designed to prevent an enterprise of one State from being taxed in the other State, if it carries on in that other State, activities of a purely preparatory or auxiliary character.”

...The alternative option to make all the exceptions subject to the “preparatory or auxiliary” condition would reduce certainty by subjecting the existing exceptions that currently apply automatically and therefore provide a bright line test to a condition that is inherently more subjective. The change would therefore increase the potential for disputes between taxpayers and tax authorities. In light of paragraph 21 of the Commentary on Article 5, it could be argued, however, that there is already some uncertainty as to whether or not all the existing exceptions are implicitly subject to this condition.

73. The issue was also discussed by the Joint Working Group on Business Restructurings.

Recommendation of the Working Group

74. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 21 of the Commentary on Article 5 by the following:

21. This paragraph lists a number of business activities which are treated as exceptions to the general definition laid down in paragraph 1 and which are not permanent establishments, even if the activity is carried on through a fixed place of business. ***Where each of the activities listed in subparagraphs a) to d) is the only activity carried on at a fixed place of business, the place is deemed not to constitute a permanent establishment.*** The common feature of these activities is that they are, in general, preparatory or auxiliary activities. ***Since subparagraph e) deals with other unspecified activities, however, the requirement that the activity must have a preparatory or auxiliary character has been*** ~~This is~~ laid down explicitly in the case of the exception mentioned in ***that*** subparagraph ~~e)~~, which actually amounts to a general restriction of the scope of the definition contained in paragraph 1. Moreover subparagraph f) provides that combinations of activities mentioned in subparagraphs a) to e) in the same fixed place of business shall be deemed not to be a permanent establishment, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character. Thus the provisions of paragraph 4 are designed to prevent an enterprise of one State from being taxed in the other State, if it carries on in that other State, activities of a purely preparatory or auxiliary character.

Replace paragraph 23 of the Commentary on Article 5 by the following:

23. Subparagraph e) provides that a fixed place of business through which the enterprise exercises solely an activity which has for the enterprise a preparatory or auxiliary character, is deemed not to be a permanent establishment. The wording of this subparagraph makes it unnecessary to produce an exhaustive list of exceptions. Furthermore, this subparagraph provides a generalised exception to the general definition in paragraph 1 and, when read with that paragraph, provides a more selective test, by which to determine what constitutes a permanent establishment. To a considerable degree it limits that definition and excludes from its rather wide scope a number of forms of business organisations which, although they are carried on through a fixed place of business, ***and may well contribute to the productivity of the enterprise, involve activities which***

are so remote from the actual realisation of profits by the enterprise that they should not be treated as permanent establishments. ~~It is recognised that such a place of business may well contribute to the productivity of the enterprise, but the services it performs are so remote from the actual realisation of profits that it is difficult to allocate any profit to the fixed place of business in question.~~ Examples are fixed places of business solely for the purpose of advertising or for the supply of information or for scientific research or for the servicing of a patent or a know-how contract, if such activities have a preparatory or auxiliary character.

75. As explained below, however, the Working Group notes that whilst the last sentence of paragraph 23 is technically correct, it should not be misinterpreted as suggesting that research and development is, as a general rule, a preparatory or auxiliary activity.

Background

76. The Group agreed that the wording of subparagraphs *a)* to *d)* did not support the view that the application of these subparagraphs was subject to the additional condition that the relevant activity be of a preparatory or auxiliary character, which was a condition that was expressly included in subparagraphs *e)* and *f)*. It therefore agreed that the Commentary should be amended to clarify that subparagraphs *a)* to *d)* were not subject to the extra condition that the activities referred to therein be of a preparatory or auxiliary nature.

77. During its discussion of the issue, the Group also discussed the last sentence of paragraph 23 of the Commentary, which provides that “[e]xamples are fixed places of business solely for the purpose of advertising or for the supply of information or for scientific research or for the servicing of a patent or a know-how contract, if such activities have a preparatory or auxiliary character.” It was concluded that whilst the sentence was technically correct, it could be misinterpreted as suggesting that research and development was, as a general rule, a preparatory or auxiliary activity. After discussion, the Group decided that no changes should be made to the paragraph with respect to this issue but that the Group’s report should include that warning.

78. The Group agreed, however, to redraft the penultimate sentence of paragraph 23 in order to remove any suggestion that there could be a link between the attribution of profits and the existence of a permanent establishment.

13. Relationship between delivery and the sale of goods in subparagraph 4 *a)* (paragraphs 22 and 27.1 of the Commentary)

Description of the issue

79. Does the exception in subparagraph 4 *a)* apply to goods or merchandise to be sold from abroad?

80. This question was raised in the context of the work of the Joint Working Group on Business Restructurings, which noted that the exception of subparagraph 4 *a)* does not apply to the situation in which a fixed place of business maintained for the delivery of goods is also engaged in the sale of goods.

Recommendation of the Working Group

81. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 22 of the Commentary on Article 5 by the following [other changes to paragraph 22 resulting from the recommendations in sections 14 and 16 would also be made to the paragraph]:

22. Subparagraph *a)* relates only to the case in which an enterprise acquires the use of facilities for storing, displaying or delivering its own goods or merchandise. Subparagraph *b)* relates to the stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery. ***Subparagraphs a) and b) apply regardless of whether the storage or delivery takes place before or after a contract for the sale of the goods or merchandise has been concluded provided that the goods or merchandise belong to the enterprise whilst they are at the relevant location (e.g. the subparagraphs would remain applicable if contracts for the sale of some of the goods that are stored at a location have already been concluded but the property title to these goods only passes to the customer after their delivery)...*** [changes resulting from the recommendations in sections 14 and 16 will be inserted here; the rest of existing paragraph 22 is moved to new paragraph 22.1]

22.1 Subparagraph *c)* covers the case in which a stock of goods or merchandise belonging to one enterprise is processed by a second enterprise, on behalf of, or for the account of, the first-mentioned enterprise. The reference to the collection of information in subparagraph *d)* is intended to include the case of the newspaper bureau which has no purpose other than to act as one of many “tentacles” of the parent body; to exempt such a bureau is to do no more than to extend the concept of “mere purchase”.

Replace paragraph 27.1 of the Commentary on Article 5 by the following:

27.1 Subparagraph *f)* is of no importance in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs *a)* to *e)* provided that they are separated from each other locally and organisationally, as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists. Places of business are not “separated organisationally” where they each perform in a Contracting State complementary functions such as receiving and storing goods in one place, distributing those goods through another etc. An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity. ***The same approach applies where an enterprise that maintains in a Contracting State one or more fixed places of business within the meaning of subparagraphs a) to e) is also deemed, through the application of paragraph 5, to have a permanent establishment in the same State; in that case, if the activities that resulted in that deemed permanent establishment are not separated organisationally from these fixed places of business, it could not be argued that the enterprise is solely engaged in a preparatory or auxiliary activity at these places.***

Background

82. Based on the wording of subparagraphs 4 *a)* and *b)*, which refer to the use of facilities or maintenance of a stock of goods or merchandise “***solely***” for the purpose of storage, display or delivery, there was general agreement with a member’s conclusion that a place used for display or delivery that was also used for making sales would not be covered by these subparagraphs. The Group also agreed, however, that the wording of subparagraph 4 *a)* did not support the suggestion that the application of that subparagraph would depend on whether or not the goods or merchandise stored, displayed or delivered had already been sold and it was agreed that this should be clarified in the Commentary.

83. During the discussion, a member of the Group described a situation where an agent would sell goods stored by the foreign enterprise at a particular location so that the sale activities would constitute a permanent establishment under Article 5(5); in that case, he did not consider that the exception of subparagraph 4 *a*) should be applicable to the location where the goods were stored. It was agreed that paragraph 27.1 of the Commentary should be clarified to indicate that an agency permanent establishment resulting from Article 5(5) should be treated in the same way as a fixed place of business for the purposes of the application of the non-fragmentation approach described in that paragraph.

14. Does a development property constitute a PE? (paragraph 22 of the Commentary)

Description of the issue

84. The question has been asked whether, in a situation where a developer develops and sells immovable property, the property would constitute a permanent establishment notwithstanding the fact that the business of the developer is to sell that property.

Recommendation of the Working Group

85. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 22 of the Commentary on Article 5 by the following [other changes to paragraph 22 resulting from the recommendations in sections 13 and 16 would also be made to the paragraph]:

22. Subparagraph *a*) relates only to the case in which an enterprise acquires the use of facilities for storing, displaying or delivering its own goods or merchandise. Subparagraph *b*) relates to the stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery. *[the changes resulting from the recommendations in sections 13 and 16 will be inserted here]* ***In the context of these subparagraphs, the words “goods” and “merchandise” refer to tangible property that can be stored, displayed and delivered and would not cover, for example, immovable property and data (although the subparagraphs would cover tangible products that include data such as CDs and DVDs).*** *[the rest of paragraph 22 is moved to new paragraph 22.1 – see section 13]*

Background

86. One member of the Group described the situation of a non-resident developer who sells land situated in a country without having a sales office or other similar permanent establishment in that country and who argues that Article 7 prevents that country from taxing the profits from these sales (in that case the country would not tax these profits as capital gains). The Group concluded that the last part of paragraph 4 of the Commentary on Article 13⁷ already clarifies that the Convention allowed the country to tax these profits and that it was purely a question of domestic law how the country decided to tax them (*i.e.* as business profits or as capital gains).

7. “...Accordingly, no distinction between capital gains and commercial profits is made nor is it necessary to have special provisions as to whether the Article on capital gains or Article 7 on the taxation of business profits should apply. It is however left to the domestic law of the taxing State to decide whether a tax on capital gains or on ordinary income must be levied. The Convention does not prejudice this question.”

87. This led to the discussion of another example in which a non-resident developer would hold a stock of recently-built houses for sale without having another form of physical presence in the country. In that case, the issue would be whether it could be argued that the developer does not have a permanent establishment on the basis that the houses constitute “a stock of goods or merchandise” for the purposes of subparagraph 4 *b*).

88. It was concluded that whilst this would not affect the State of source’s right to tax the gains from the sales (since this right is granted by paragraph 1 of Article 13 regardless of whether or not there is PE), the issue could be relevant for the application of provisions such as paragraph 5 of Article 11. It was therefore agreed that the Commentary on subparagraphs *a*) and *b*) should clarify that these subparagraphs do not cover property such as real estate and data, although they would cover tangible products that included data, such as CDs and DVDs.

15. Do “goods or merchandise” cover digital products or data? (paragraph 22 of the Commentary)

Description of the issue

89. Does the reference to “goods or merchandise” in subparagraphs 4 *a*), *b*) and *c*) apply to digital products or, more generally, data?

90. This issue was discussed in the Business Profits TAG’s report “Are The Current Treaty Rules For Taxing Business Profits Appropriate For E-Commerce?” (section 4.A.d)):

For instance, it is not clear to what extent the reference to “goods or merchandise” in subparagraphs *a*), *b*) and *c*) can apply to digital products or, more generally, data. It is also not clear to what extent the words “storage” and “delivery” can apply to digital products downloaded from servers through computer networks ... Regardless of the views expressed on the option to eliminate these exceptions, the TAG agreed that it would be useful if these questions were dealt with in the Commentary in order to provide greater certainty to taxpayers and tax administrations as to the exact scope of the current exceptions included in paragraph 4.

Recommendation of the Working Group

91. The recommendation included in section 14 above addresses this issue.

Background

92. The Group concluded that since the storage of digital products would be done on servers, this issue appeared to have already been addressed through the explanations included in paragraphs 42.7 to 42.9 of the Commentary, which deal with the issue of whether activities carried on through servers are covered by the exceptions of Article 5(4). After the discussion of the issue in section 14 above, however, the Group concluded that the issue of the application of subparagraphs *a*), *b*) and *c*) to digital products and data could be easily addressed in combination with that other issue.

16. Carrying on various activities listed alternatively in subparagraphs 4 a) and b) (paragraph 22 of the Commentary)

Description of the issue

93. To what extent do the specific exceptions in subparagraphs 4 a) and b) apply if various activities listed alternatively in these subparagraphs are carried out at the same location and if these activities, taken together, go beyond the preparatory or auxiliary threshold so as to preclude the application of paragraph f)?

94. This issue was discussed in the Business Profits TAG's report "Are The Current Treaty Rules For Taxing Business Profits Appropriate For E-Commerce?" (section 4.A.e)):

The question was also discussed whether or not paragraph 4 would apply where various activities listed alternatively in subparagraph a) and b) are carried on at the same location and these activities go beyond the preparatory or auxiliary threshold so as to preclude the application of subparagraph f). Regardless of the views expressed on the option to eliminate these exceptions, the TAG agreed that it would be useful if these questions were dealt with in the Commentary in order to provide greater certainty to taxpayers and tax administrations as to the exact scope of the current exceptions included in paragraph 4.

95. The Joint Working Group on Business Restructurings raised one specific example of that issue when it discussed whether the exception of subparagraph a), which is applicable to "storage, display *or* delivery", would apply if two or all three of these activities were performed simultaneously at the same location.

Recommendation of the Working Group

96. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 22 of the Commentary on Article 5 by the following [other changes to paragraph 22 resulting from the recommendations in sections 13 and 14 would also be made to the paragraph]:

22. Subparagraph a) relates only to the case in which an enterprise acquires the use of facilities for storing, displaying or delivering its own goods or merchandise. Subparagraph b) relates to the stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery. *[the changes resulting from the recommendation in section 13 will be inserted here] These subparagraphs also cover situations where a facility is used, or a stock of goods or merchandise is maintained, for any combination of storage, display and delivery since facilities used for the delivery of goods will almost always be also used for the storage of these goods, at least for a short period. [the changes resulting from the recommendation in section 14 will be inserted here; the rest of existing paragraph 22 is moved to new paragraph 22.1 – see section 13]*

Background

97. The Group agreed that the issue, which relates to the fact that subparagraphs 4 a) and 4 b) refer alternatively to storage, display or delivery, was a relatively minor drafting issue; it concluded that the phrase "storage, display or delivery" in subparagraphs 4 a) and 4 b) should be interpreted as "storage, display and/or delivery" and that this should be made clear in the Commentary.

17. Negotiation of import contracts as an activity of a preparatory or auxiliary activity (paragraphs 24 and 25 of the Commentary)

Description of the issue

98. The question was asked whether the observation in paragraph 44 of the Commentary reflects a disagreement with the interpretation of the permanent establishment's definition included in the Commentary or with the views of other countries.

99. This observation by the Czech Republic and the Slovak Republic reads as follows:

44. The *Czech Republic* and the *Slovak Republic* would add to paragraph 25 their view that when an enterprise has established an office (such as a commercial representation office) in a country, and the employees working at that office are substantially involved in the negotiation of contracts for the import of products or services into that country, the office will in most cases not fall within paragraph 4 of Article 5. Substantial involvement in the negotiations exists when the essential parts of the contract — the type, quality, and amount of goods, for example, and the time and terms of delivery — are determined by the office. These activities form a separate and indispensable part of the business activities of the foreign enterprise, and are not simply activities of an auxiliary or preparatory character.

Recommendation of the Working Group

100. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 24 of the Commentary on Article 5 by the following:

24. It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity. Where, for example, the servicing of patents and know-how is the purpose of an enterprise, a fixed place of business of such enterprise exercising such an activity cannot get the benefits of subparagraph e). [the rest of paragraph 24 is moved to new paragraph 24.1]

24.1 A fixed place of business which has the function of managing an enterprise or even only a part of an enterprise or of a group of the concern cannot be regarded as doing a preparatory or auxiliary activity, for such a managerial activity exceeds this level. If enterprises with international ramifications establish a so-called "management office" in States in which they maintain subsidiaries, permanent establishments, agents or licensees, such office having supervisory and co-ordinating functions for all departments of the enterprise located within the region concerned, a permanent establishment will normally be deemed to exist, because the management office may be regarded as an office within the meaning of paragraph 2. Where a big international concern has delegated all management functions to its regional management offices so that the functions of the head office of the concern are restricted to general supervision (so-called polycentric enterprises), the regional management offices even have to be regarded as a "place of management" within the meaning of subparagraph a) of paragraph 2. The function of managing an enterprise, even if it only covers a certain area of the operations of the concern, constitutes an essential part of the business operations of the enterprise and therefore can in no

way be regarded as an activity which has a preparatory or auxiliary character within the meaning of subparagraph e) of paragraph 4.

24.2 Similarly, where an enterprise that sells goods worldwide establishes an office in one State, and the employees working at that office take an active part in the negotiation of important parts of contracts for the sale of goods to buyers in that State (e.g. by participating in decisions related to the type, quality or quantity of products covered by these contracts) even if they do not exercise an authority to conclude contracts in the name of their employer, such activities will usually constitute an essential part of the business operations of the enterprise and should not be regarded as having a preparatory or auxiliary character within the meaning of subparagraph e) of paragraph 4. If the conditions of paragraph 1 are met, such an office will therefore constitute a permanent establishment.

Delete the following paragraph 44 of the Commentary on Article 5:

~~44.—The Czech Republic and the Slovak Republic would add to paragraph 25 their view that when an enterprise has established an office (such as a commercial representation office) in a country, and the employees working at that office are substantially involved in the negotiation of contracts for the import of products or services into that country, the office will in most cases not fall within paragraph 4 of Article 5. Substantial involvement in the negotiations exists when the essential parts of the contract—the type, quality, and amount of goods, for example, and the time and terms of delivery—are determined by the office. These activities form a separate and indispensable part of the business activities of the foreign enterprise, and are not simply activities of an auxiliary or preparatory character.~~

Background

101. The Delegate for the Czech Republic indicated that the observation in paragraph 44 of the Commentary was an additional clarification rather than a disagreement with an interpretation included in the Commentary and that the reference to contracts “for the import of products or services” was merely illustrative. The situation that was envisaged in that observation was that of an office situated in a State that would be involved in the negotiation of important parts of contracts for the sale of goods to buyers in that State without exercising an authority to conclude contracts in the name of the enterprise. The Group agreed that a proposed clarification should be added to the Commentary to address the issue raised in that observation.

102. The Delegates for the Czech Republic and the Slovak Republic have both indicated that their country would delete its observation if the proposed change is included in the Commentary.

18. Fragmentation of activities (paragraphs 27.1 of the Commentary)

Description of the issue

103. Paragraph 27.1 of the Commentary on Article 5 reads as follows:

27.1 Subparagraph *f)* is of no importance in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs *a)* to *e)* provided that they are separated from each other locally and organisationally, as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists. Places of business are not “separated organisationally” where they each perform in a Contracting State complementary functions such as receiving and storing goods in one place, distributing those goods

through another etc. An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity.

104. In the context of the work on business restructurings, the question was asked whether and to what extent the language in paragraph 27.1 of the Commentary on Article 5 on the fragmentation of activities may be relevant in dealing with the situation in which a non-resident is doing through a converted (“stripped”) local enterprise what was previously done as a full-fledged operation.

Recommendation of the Working Group

105. The Working Group concluded that no changes should be made to the Commentary with respect to this issue because paragraph 27.1 of the Commentary deals with the combination of activities carried on by a single enterprise at different locations in a given State and is therefore not relevant in the situation where a foreign enterprise maintains places of business covered by the exceptions of Article 5(4) and a converted (“stripped”) local enterprise is also carrying on in that State activities that were previously carried on as a full-fledged operation. The Working Group also noted, however, that such situations could, depending on the circumstances, be addressed through the application of legislative or judicial anti-abuse rules (as was the case for the fragmentation of contracts referred to in paragraph 18 of the Commentary).

Background

106. The Group noted that paragraph 27.1 of the Commentary dealt with the fragmentation of an enterprise’s activities between different places of business of that same enterprise and was therefore not relevant in the situation where a foreign enterprise maintained places of business covered by the exceptions of Article 5(4) and a converted (“stripped”) local enterprise was also carrying on activities that were previously carried on as a full-fledged operation. It was also agreed, however, that whilst no changes should be made to the Commentary with respect to this issue, the report of the Working Group should recognise that such situations could, depending on the circumstances, be addressed through the application of legislative or judicial anti-abuse rules (as is the case for the fragmentation of contracts referred to in paragraph 18 of the Commentary). It was noted, however, that, in practice, a better approach will often be to examine whether the various local companies have received an arm’s length consideration for their activities.

19. Meaning of “to conclude contracts in the name of the enterprise” (paragraph 32.1 of the Commentary)

Description of the issue

107. Does the phrase “to conclude contracts in the name of the enterprise” only refer to cases where the principal is legally bound vis-à-vis the third party, under agency law, by reason of the contract concluded by the agent, or is it sufficient that the foreign principal is economically bound by the contracts concluded by the person acting for it in order for a permanent establishment to exist (provided the other conditions are met)?

108. This issue was discussed by the Joint Working Group on Business Restructurings and is illustrated by the following example, which was developed in the course of the preparation of the branch reports and general report for the IFA 2009 Congress:

Commissionnaire arrangements

PARENTCO, a company resident of State R, and SUBCO, a company resident of State S, are parts of the same multinational group.

Until 2008, SUBCO is the distributor in State S of the products of PARENTCO, which it buys from its parent and resells in State S. In 2008, the distributorship arrangement is replaced by a contract of *commissionnaire*. Under that contract, SUBCO will act as an agent of PARENTCO to sell in State S products owned by PARENTCO. As such, SUBCO will accept orders, submit quotes and documents in tender offers and conclude sales contracts for PARENTCO's products and will be authorized to engage in price negotiations and to grant discounts or terms of payment with current or new customers without specific prior approval by PARENTCO.

In jurisdictions where agency law recognizes indirect representation, the contract will provide that SUBCO is acting as a *commissionnaire*. In jurisdictions where this is not possible, each contract concluded by SUBCO with a customer will specifically provide that the contract is exclusively between the parties and does not bind any other party, including PARENTCO.

In a separate agreement, PARENTCO has agreed to fully reimburse SUBCO for any amount that it may be required to pay customers under its contractual liability. PARENTCO will also control the types of products that will be sold through SUBCO.

109. A related issue that was discussed by the Joint Working Group on Business Restructurings in relation to such arrangements was whether a dependent agent permanent establishment could be deemed to exist if it were established that the arrangements entered into in a particular case did not make commercial sense and were primarily structured in such a way as to avoid the creation of a permanent establishment.

Recommendation of the Working Group

110. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 32.1 of the Commentary on Article 5 by the following:

32.1 Also, the phrase “authority to conclude contracts in the name of the enterprise” does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise. ***For example, in some countries an enterprise would be bound, in certain cases, by a contract concluded with a third party by a person acting on behalf of the enterprise even if the person did not formally disclose that it was acting for the enterprise and the name of the enterprise was not referred to in the contract. [the rest of existing paragraph 32.1 is moved to new paragraph 32.2]***

32.2 Lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions.

Background

111. The Group had an extensive discussion of this issue based on recent court decisions on *commissionnaire* arrangements in France (*Zimmer Ltd.*) and Norway (*Dell DUF*).

112. A large part of the discussion focused on the meaning of the first sentence of paragraph 32.1 of the Commentary, the relevant part of which reads “paragraph [5] applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name

of the enterprise”. Whilst there was also a reference to the second part of paragraph 32.1,⁸ it was explained that this part of the paragraph did not deal with the issue of “in the name of” (*i.e.* whether or not the contract, once concluded, was binding on the foreign enterprise) but focussed instead on whether the activities of the agent were enough to consider that the agent had concluded the contract.

114. The Group agreed that whilst it was not possible to reach a common view on the situations dealt with in the court decisions, it would be helpful to add to paragraph 32.1 of the Commentary an example of a situation where a foreign principal would be bound by a contract even though the contract would not literally be concluded in his name.

113. The Group also examined comments received from BIAC on the phrase “concluding contracts in the name of”. It was explained that these comments referred to three particular situations: (1) “when a multinational group’s contracting policies require multiple personnel in an organization to approve contracts, not all of whom may be employees of the enterprise being bound”; (2) “when contracts are in a standard form for all customers (e.g., online contracts) so that no negotiation occurs when the contracts are formed”; (3) “when sales are governed by a framework contract applicable to all group companies and there follows specific purchase orders in which various personnel are able to conclude contracts for specific entities within the framework agreement”. It was suggested that in cases 2 and 3, as long as sales contracts were concluded in the name of a foreign enterprise, the extent to which the person concluding these contracts (*e.g.* by accepting an order) was using standard contracts or was constrained by a framework contract would not seem to matter. With reference to case 3, one delegate indicated that his administration had dealt with a similar situation and had concluded that the acceptance of the order was the conclusion of the contract. It was clarified that this was done when the final nature and quantity to be delivered under the framework agreement was determined under a specific purchase order. As regards case 1, it was suggested that Article 5(5) referred to the level of approval that was decisive for the contract to be legally concluded, subject to the comments in paragraphs 32.1 to 33.1 of the Commentary. The Group agreed that these three cases raised questions of facts and that the Commentary already provided enough guidance to deal with them.

20. Is paragraph 5 restricted to situations where sales are concluded? (paragraph 33 of the Commentary)

Description of the issue

114. One of the conditions for an agency permanent establishment to exist is that the agent must have an *authority to conclude contracts* in the name of the foreign enterprise. The question was raised whether this means that the possible application of paragraph 5 to business restructurings is restricted to situations in which a full-fledged distributor is converted into a *commissionnaire* or other sales agent (that has and habitually exercises an authority to conclude contracts). Where a local manufacturer is converted into a contract or toll manufacturer or where a full-fledged research operation is converted into contract research, the converted local entity will not, in general, have an authority to conclude contracts with third parties.

115. This issue was raised during the work of the Joint Working Group on Business Restructurings.

8. “Lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions”.

Recommendation of the Working Group

116. The Working Group recommends that the following changes be made to the Commentary on Article 5 in order to address this issue:

Replace paragraph 33 of the Commentary on Article 5 by the following (and renumber existing paragraph 33.1 as paragraph 33.2):

33. The authority to conclude contracts must cover contracts relating to operations which constitute the business proper of the enterprise. It would be irrelevant, for instance, if the person had authority to engage employees for the enterprise to assist that person's activity for the enterprise or if the person were authorised to conclude, in the name of the enterprise, similar contracts relating to internal operations only. ***The types of contracts referred to in paragraph 5 are not restricted, however, to contracts for the sale of goods: the paragraph would cover, for example, a situation where a person has and habitually exercises an authority to conclude leasing contracts or contracts for services. [the rest of paragraph 33 is moved to new paragraph 33.1]***

33.1 Moreover the authority has to be habitually exercised in the other State; whether or not this is the case should be determined on the basis of the commercial realities of the situation. A person who is authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority "in that State", even if the contract is signed by another person in the State in which the enterprise is situated or if the first person has not formally been given a power of representation. The mere fact, however, that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has exercised in that State an authority to conclude contracts in the name of the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise. Since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either.

Background

117. The Group agreed that whilst paragraph 5 required the conclusion of contracts in the name of the foreign enterprise and could therefore not apply in the case of a local entity that did not have an authority to conclude contracts with third parties, the word "contracts" did not refer exclusively to contracts for the sale of goods and would include, for example, leasing contracts. It was agreed that this should be clarified in the Commentary.

21. Does paragraph 6 apply only to agents who do not conclude contracts in the name of their principal?

Description of the issue

118. Does paragraph 6 only apply to agents who do not conclude contracts in the name of their principal?

119. The issue was discussed, but not addressed, during the work that led to the adoption of the report on Issues Arising under Article 5 (Permanent Establishment) of the Model Tax Convention, which was adopted by the OECD Committee on Fiscal Affairs on 7 November 2002.⁹

Recommendation of the Working Group

120. The Working Group noted that the term “general commission agent” used in the English version of paragraph 6 of Article 5 does not appear to correspond to the term *commissionnaire* used in the French version. It also noted that the Commentary seemed to include conflicting statements concerning the scope of paragraph 6. For these reasons, the Group concluded that this issue could not be addressed merely through changes to the Commentary.

22. Assumption of entrepreneurial risk as a factor indicating independence

Description of the issue

121. As indicated in paragraph 38 of the Commentary, an important criterion for determining whether an agent is of an independent status is whether the entrepreneurial risk is borne by the agent or by the enterprise on behalf of which the agent is acting.

122. In 2002, the Working Party considered the following proposal for clarifying the meaning of entrepreneurial risk for the purposes of paragraph 38:

38.7 As indicated in paragraph 38 above, another important criterion the assumption of entrepreneurial risk is a distinguishing feature of the independent agent. The character of the remuneration which an agent receives may provide a useful indication of whether (or to what extent) the agent bears the commercial risk of his activities. Factors suggesting that risk is not borne by the agent include contractual protection from losses or guaranteed remuneration. However the existence of a guaranteed stream of revenues will not be decisive where the agent is able to show that there remains a real possibility of loss as a consequence of risk borne by him in the conduct of the business. Where the overall scale of the agent’s business is substantial this may be suggestive of the strength of the agent’s position vis-à-vis his principals and hence his independence. And instances where an agent has demonstrated the strength of his position in reaching agreements with principals may provide firm evidence of independence.

123. As a result of comments from business representatives concerning that proposed paragraph, the Working Party concluded that whilst there was no doubt that bearing the entrepreneurial risk was an important criterion to identify an independent agent (as already stated in paragraph 38), the clarification proposed in paragraph 38.7 raised a number of questions that should be more fully examined, in particular in light of the OECD Transfer Pricing Guidelines. It was therefore decided not to include paragraph 38.7 in the 2002 update in order to be able to further examine its wording. It was also decided that the paragraph would be reviewed in the course of other work related to the concept of dependent agent with a view to its possible inclusion in a subsequent update.

Recommendation of the Working Group

124. The Working Group concluded that it was not necessary to attempt to clarify the concept of “entrepreneurial risk”, which was used in only one of many factors put forward in paragraphs 38 to 38.6 for determining whether or not a person was an agent of an independent status.

9. Reproduced at page R(19)-1 in volume II of the complete version of the Model Tax Convention.

23. Activities of fund managers

Description of the issue

125. Representatives of the European Venture Capital Association (EVCA) have put forward permanent establishment issues related to venture capital funds. These issues are described in the *Report of the Venture Capital Tax Expert Group on Removing Tax Obstacles to Cross-Border Venture Capital Investments* (VC Tax Expert Group), which was published on 30 April 2010.¹⁰

Recommendation of the Working Group

126. The Working Group concluded that the issues raised by EVCA, including the question of “independence”, were essentially dependent on facts and circumstances. Some of the conclusions reached on other issues might be relevant and the Group did not consider that more specific guidance could be provided to the venture capital industry. The Group also agreed, however, that the following analysis of the application of the concepts of “enterprise of a Contracting State” and “permanent establishment” in the case of a venture capital fund set up as a limited partnership could provide useful guidance:

The definition of “enterprise of a Contracting State” in Article 3(1) refers to “an enterprise carried on by a resident of a Contracting State”.

The term “enterprise” itself is not defined, even though subparagraph *d*) of Article 3(1) clarifies that “it applies to the carrying on of any business”. The first part of paragraph 4 of the Commentary on Article 3 reflects different views as to whether the term refers to the organisation that carries on a business activity or to the activity itself:

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.

This ambivalence between the view that an enterprise is a business organisation and the view that it is a business activity appears in different parts of the Convention. In the context of Article 5(1), which refers to “the business of an enterprise”, it seems difficult, however, to refer to an enterprise as an activity and the term therefore seems to correspond to a business organisation. On that basis, the term would cover any form of enterprise carried on by a resident of a Contracting State, whether this enterprise is legally set up as a company, partnership, sole proprietorship or other legal form.

In the particular case of an enterprise taking the form of a fiscally transparent partnership, that enterprise should be viewed as a distinct enterprise carried on by the partners who share the profits of that joint enterprise. Paragraph 19.1 of the Commentary on Article 5 confirms that position (see also the third example in paragraph 42.38); that paragraph deals with the situation of a transparent partnership and concludes that:

In the case of fiscally transparent partnerships, the twelve month test is applied at the level of the partnership as concerns its own activities. If the period of time spent on the site by the

10. See http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/initiatives_small_businesses/venture_capital/tax_obstacles_venture_capital_en.pdf.

partners and the employees of the partnership exceeds twelve month[s], the enterprise carried on by the partnership will therefore be considered to have a permanent establishment. Each partner will thus be considered to have a permanent establishment for purposes of the taxation of his share of the business profits derived by the partnership regardless of the time spent by himself on the site. *[the Working Group's recommendation in section 9 above would amend paragraph 19.1 without affecting this interpretation]*

Applying this analysis to a venture capital fund set up as a transparent limited liability partnership, one would therefore consider that the fund forms a distinct enterprise carried on jointly by the limited partners and the general partner, who all share in the profits of that joint separate enterprise (*i.e.* separate from the partners' respective enterprises). This enterprise being carried on by each partner, it constitutes an enterprise of each Contracting State of which a partner is a resident as regards the share of that particular partner.

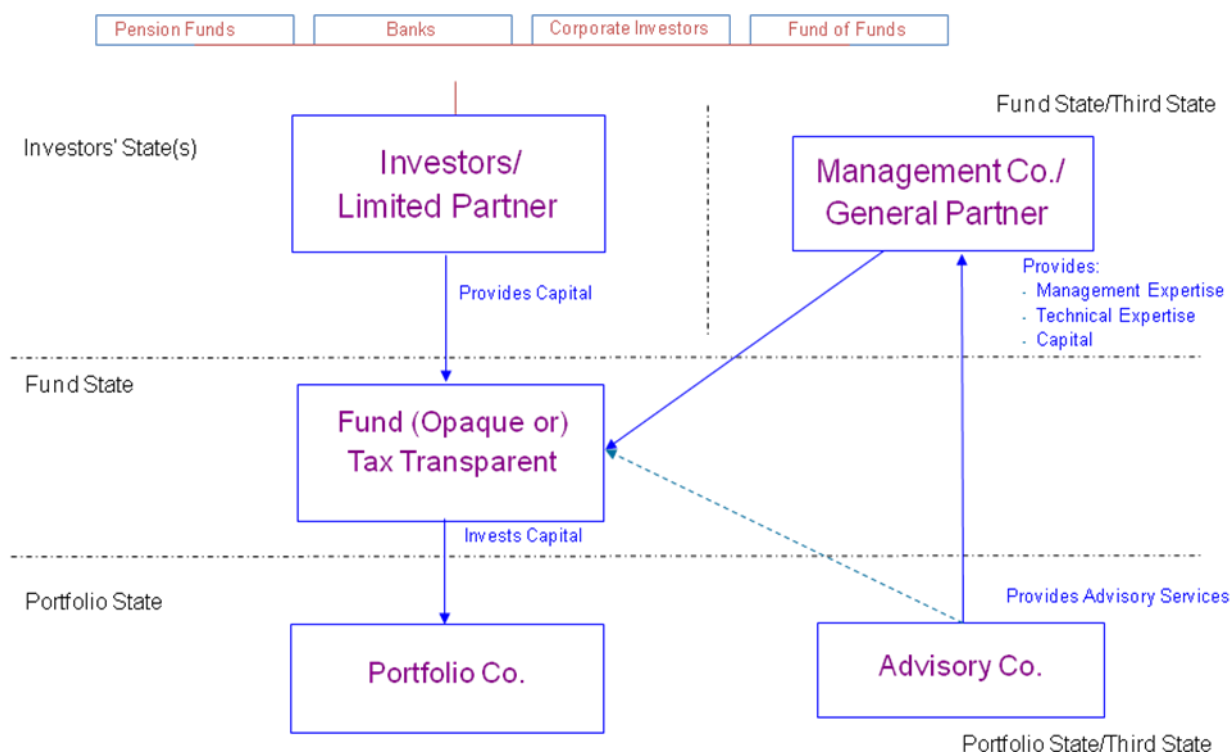
It follows from the above analysis that the reference, in Article 5(5), to a person acting on behalf of an enterprise and having the authority to conclude contracts in the name of that enterprise must therefore be applied with respect to the partnership, which is the relevant enterprise in whose name the fund's investment contracts could be concluded. If the conditions of paragraph 5 are met, it is that enterprise that will be considered to have a permanent establishment, and the result will be that an enterprise of each Contracting State in which a partner is a resident (in proportion to the share of the profits of that partner) will be considered to have a permanent establishment.

The analysis should be the same for the purposes of Article 5(6) and the independent status of a local fund manager should therefore be determined in relation to the limited partnership itself rather than by reference to each investor in that partnership.

Background

127. The Group discussed this issue on the basis a note presented on behalf of EVCA and the report mentioned above. It also took account of the conclusions reached on the application of paragraph 3 to joint venture and partnership activities (see section 9 above). It examined in detail the following example included in the report:¹¹

11. See page 10 of the Report.



128. The main issues raised by that example were

- whether the fund carried on a business;
- which enterprise’s business was carried on through the activities of the local advisory company;
- how did the transparent status of the fund affect the application of the concepts of “enterprise” and “permanent establishment”;
- whether the local advisory company or fund manager could claim to be an independent agent for the purposes of Article 5(6).

129. It was explained that an important practical issue was whether a local fund manager could be considered to be an independent agent in the event that it would be found to conclude contracts in the name of the enterprise. This, in turn, would depend on what was the “enterprise of a Contracting State” in the case of a fund.

130. Whilst it was suggested that the issue would not arise as long as the local fund manager would not exercise an authority to conclude contracts, it was noted that EVCA’s concern was that, in practice, it was difficult to ensure that the managers did not practically negotiate all the main elements of the contracts and that it seemed artificial and restrictive to limit the local expert’s activities to giving advice on the investments of the fund.

131. The Group discussed what clarification, if any, could be provided concerning this issue. It was concluded that it would be difficult to provide specific guidance as the situation was highly factual and was not restricted to venture capital funds. It was also concluded, however, that an analysis of the application of the concept of “enterprise” and “permanent establishment” in the case of a partnership could usefully be provided.

24. Clarification of paragraph 8 of the Commentary on Article 5

Description of the issue

132. Should paragraph 8 of the Commentary on Article 5, which deals with leasing activities, be clarified to provide that there will be a permanent establishment only if there is an office where leasing contracts are signed or rental equipment is stored?

133. When this issue was first discussed, the delegate who had raised it indicated that it related to the issue of whether a server farm that would lease server capacity would constitute a permanent establishment. It was concluded that this was somewhat different from the issue described above and that it seemed clear that a server farm through which an enterprise would lease server capacity to third parties would constitute a permanent establishment of the enterprise but not of the third parties (as indicated in paragraph 42.7 to 42.9 of the Commentary). It was noted, however that the issue would be different in the case of the maintenance of a server farm by an enterprise, such as a bank, which would store its own data on the servers; this led the Group to discuss the circumstances in which storing data on its own servers would constitute preparatory or auxiliary activities

Recommendation of the Working Group

134. The Working Group concluded that this issue was already dealt with in paragraphs 42.7 to 42.9 of the Commentary; since the question of whether activities carried on through a server are preparatory or auxiliary was essentially factual, it was agreed that no further clarification could be provided.

25. Activities of insurance agents

Description of the issue

135. To what extent do activities of local insurance agents who refer contracts for final approval by the foreign insurance company create a permanent establishment?

136. The issue is illustrated by the following example developed in the course of the preparation of the branch reports and general report on the topic “Is there a Permanent Establishment?” for the IFA 2009 Congress:

Insurance agents

ICO is a life insurance company resident in State R. It sells life insurance in State S through agents. All the agents work out of their private homes and thus do not need separate offices. Some minor paper work is done at home. None of the agents are employed by ICO but they work solely for ICO. The agents offer insurance policies on behalf of ICO, receive the applications from the clients and send them over to ICO in State R. The insurance policy is not in force until ICO has received and reviewed the medical information related to each client. In the meantime, a temporary life insurance policy is in force. This policy is automatically terminated when the draft policy is approved or rejected by ICO. Over time, ICO rejects some 10 per cent of the policies submitted by the agents.

Recommendation of the Working Group

137. The Working Group concluded that this issue was basically a policy question: whether the conclusion expressed in paragraph 39 of the Commentary that “it did not seem advisable to insert” a special provision for insurance agents was still shared by the member States. Since few countries included such a special provision in their treaties, it was agreed that no changes should be made to the Commentary with respect to this issue.

ANNEX

CONSOLIDATED VERSION OF PARAGRAPHS 1 TO 35 OF THE COMMENTARY ON ARTICLE 5 AS AMENDED BY THE PROPOSALS INCLUDED IN THIS NOTE

1. The main use of the concept of a permanent establishment is to determine the right of a Contracting State to tax the profits of an enterprise of the other Contracting State. Under Article 7 a Contracting State cannot tax the profits of an enterprise of the other Contracting State unless it carries on its business through a permanent establishment situated therein.

1.1 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.

Paragraph 1

2. Paragraph 1 gives a general definition of the term “permanent establishment” which brings out its essential characteristics of a permanent establishment in the sense of the Convention, *i.e.* a distinct “situs”, a “fixed place of business”. The paragraph defines the term “permanent establishment” as a fixed place of business, through which the business of an enterprise is wholly or partly carried on. This definition, therefore, contains the following conditions:

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

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

profits can properly be attributed for the purpose of tax in a particular territory (see Commentary on paragraph 4).

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

4. The term “place of business” covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is immaterial whether the premises, facilities or installations are owned or rented by or are otherwise at the disposal of the enterprise. A place of business may thus be constituted by a pitch in a market place, or by a certain permanently used area in a customs depot (e.g. for the storage of dutiable goods). Again the place of business may be situated in the business facilities of another enterprise. This may be the case for instance where the foreign enterprise has at its constant disposal certain premises or a part thereof owned by the other enterprise.

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

4.2 Whilst no formal legal right to use a particular place is required for that place to constitute a permanent establishment, the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise. ***Whether a location may be considered to be at the disposal of an enterprise in such a way that it may constitute a “place of business through which the business of [that] enterprise is wholly or partly carried on” will depend on the extent of the presence of an enterprise at that location and the activities that it performs there. Where an enterprise has an exclusive legal right to use a particular location which is used only for carrying on that enterprise’s own business activities, that location is clearly at the disposal of the enterprise. This will also be the case where an enterprise performs business activities on a continuous and regular basis during an extended period of time at a location that belongs to another enterprise or that is used by a number of enterprises. This will not be the case, however, where the enterprise’s presence at a location is so intermittent or incidental that the location cannot be considered a place of business of the enterprise. Where an enterprise does not have a right to be present at a location and does not, in fact, use that location itself, that location is clearly not at the disposal of the enterprise; thus, for instance, it cannot be considered that a plant that is owned and used exclusively by a supplier or contract-manufacturer is at the disposal of an enterprise that will receive the goods produced at that plant merely because all these goods will be used in the business of that enterprise (see also paragraph 42 below). It is also important to remember that even if a place is a place of business through which the activities of an enterprise are partly carried on, that place will be deemed not to be a permanent establishment if the only business activities carried on at that place are those listed in paragraph 4. [Rest of existing paragraph 4.2 becomes paragraphs 4.3 and 4.4]***

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

4.4 A first example is that of a salesman who regularly visits a major customer to take orders and meets the purchasing director in his office to do so. In that case, the customer's premises are not at the disposal of the enterprise for which the salesman is working and therefore do not constitute a ~~fixed~~ place of business through which the business of that enterprise is carried on (depending on the circumstances, however, paragraph 5 could apply to deem a permanent establishment to exist).

4.53 A second example is that of an employee of a company who, for a long period of time, is allowed to use an office in the headquarters of another company (e.g. a newly acquired subsidiary) in order to ensure that the latter company complies with its obligations under contracts concluded with the former company. In that case, the employee is carrying on activities related to the business of the former company and the office that is at his disposal at the headquarters of the other company will constitute a permanent establishment of his employer, provided that the office is at his disposal for a sufficiently long period of time so as to constitute a "fixed place of business" (see paragraphs 6 to 6.3) and that the activities that are performed there go beyond the activities referred to in paragraph 4 of the Article.

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

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

4.8 *Even though part of the business of an enterprise may be carried on at a location such as an individual's home office, that should not lead to the automatic conclusion that that location is at the disposal of that enterprise simply because that location is at the disposal of an individual (e.g. an employee) who works for the enterprise. Whether or not a home office constitutes a location at the disposal of the enterprise will depend on the facts and circumstances of each case. In many cases, the carrying on of business activities at the home of an individual (e.g. an employee) will be so intermittent or incidental that the home will not be considered to be a location at the disposal of the enterprise (see paragraph 4.2 above). Where, however, a home office is used on a regular and continuous basis for carrying on business activities for an enterprise and it is clear from the facts and circumstances that the enterprise has required the individual to work from home (e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office), the home office may be considered to be at the disposal of the enterprise.*

4.9 *A clear example is that of a non-resident consultant who is present for an extended period in a given State where she carries on most of the business activities of her own consulting enterprise from an office set up in her home in that State; in that case, that home office constitutes a location at the disposal of the enterprise. Where, however, a cross-frontier worker performs most of his work from his home situated in one State rather than from the office made available to him in the other State, one should not consider that the home is at the disposal of the enterprise. It should be noted, however, that since the vast majority of employees reside in a State where their employer has at its disposal one or more places of business to which these employees report, the question of whether or not a home office constitutes a location at the disposal of an enterprise will rarely be a practical issue. Also, the activities*

carried on at a home office will often be merely auxiliary and will therefore fall within the exception of subparagraph e) of paragraph 4.

4.106 The words “through which” must be given a wide meaning so as to apply to any situation where business activities are carried on at a particular location that is at the disposal of the enterprise for that purpose. Thus, for instance, an enterprise engaged in paving a road will be considered to be carrying on its business “through” the location where this activity takes place.

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

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

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

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

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

5.5 Similarly, a ship or boat that navigates within territorial waters or in inland waterways is not fixed and does not, therefore, constitute a fixed place of business (unless the operation of the ship or boat is restricted to a particular area that has commercial and geographic coherence). Business activities carried on aboard such a ship or boat, such as a shop or restaurant, must be treated the same way.

5.65 Clearly, a permanent establishment may only be considered to be situated in a Contracting State if the relevant place of business is situated in the territory of that State. The question of whether a satellite in geostationary orbit could constitute a permanent establishment for the satellite operator relates in part to how far the territory of a State extends into space. No member country would agree that the location of these satellites can be part of the territory of a Contracting State under the applicable rules of international law and could therefore be considered to be a permanent establishment situated therein. Also, the particular area over which a satellite's signals may be received (the satellite's "footprint") cannot be considered to be at the disposal of the operator of the satellite so as to make that area a place of business of the satellite's operator.

6. Since the place of business must be fixed, it also follows that a permanent establishment can be deemed to exist only if the place of business has a certain degree of permanency, i.e. if it is not of a purely temporary nature. A place of business may, however, constitute a permanent establishment even though it exists, in practice, only for a very short period of time because the nature of the business is such that it will only be carried on for that short period of time. It is sometimes difficult to determine whether this is the case. Whilst the practices followed by Member countries have not been consistent in so far as time requirements are concerned, experience has shown that permanent establishments normally have not been considered to exist in situations where a business had been carried on in a country through a place of business that was maintained for less than six months (conversely, practice shows that there were many cases where a permanent establishment has been considered to exist where the place of business was maintained for a period longer than six months). *[the rest of the paragraph is moved to new paragraphs 6.1 to 6.3]*

6.1 One exception to *this general practice* has been where the activities were of a recurrent nature; in such cases, each period of time during which the place is used needs to be considered in combination with the number of times during which that place is used (which may extend over a number of years). *That exception is illustrated by the following example. An individual resident of State R rents a stand at a commercial fair in State S for 15 consecutive years where he sells sculptures during a period of five weeks each year. In that case, it could be considered that the time requirement for a permanent establishment is met due to the recurring nature of the activity regardless of the fact that any consecutive presence lasts less than 6 months.*

6.2 Another exception to this *general* practice has been ~~made~~ where activities constituted a business that was carried on exclusively in that country; in this situation, the business may have short duration because of its nature but since it is wholly carried on in that country, its connection with that country is stronger. *That exception is illustrated by the following example. An individual resident of State R has learned that a television documentary will be shot in a remote village in State S where her parents still own a large house. Since the documentary will require the presence of a number of actors and technicians in that village during a period of four months, she decides to transform the house of her parents into a small restaurant which she will operate as sole proprietor during that period. These are the only business activities that she has carried on and she does not intend to carry on such activities in the future; the restaurant will therefore be the location where the business of that enterprise will be wholly carried on. In that case, it could be considered that the time requirement for a permanent establishment is met since the restaurant is operated during the whole existence of that particular business. This would not be the situation, however, where a company resident of State R which operates various catering facilities in State R would operate a cafeteria in State S during a four week international sports event. In that case, the company's business, which is permanently carried on in*

State R, is only temporarily carried on in State S.

6.3 For ease of administration, countries may want to consider these practices *reflected in paragraphs 6 to 6.2* when they address disagreements as to whether a particular place of business that exists only for a short period of time constitutes a permanent establishment.

6.41 As mentioned in paragraphs 11 and 19, temporary interruptions of activities do not cause a permanent establishment to cease to exist. Similarly, as discussed in paragraph 6, where a particular place of business is used for only very short periods of time but such usage takes place regularly over long periods of time, the place of business should not be considered to be of a purely temporary nature.

6.52 Also, there may be cases where a particular place of business would be used for very short periods of time by a number of similar businesses carried on by the same or related persons in an attempt to avoid that the place be considered to have been used for more than purely temporary purposes by each particular business. The remarks of paragraph 18 on arrangements intended to abuse the 12 month period provided for in paragraph 3 would equally apply to such cases.

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

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

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

9. The leasing of containers is one particular case of the leasing of industrial or commercial equipment which does, however, have specific features. The question of determining the circumstances in which an

enterprise involved in the leasing of containers should be considered as having a permanent establishment in another State is more fully discussed in a report entitled “The Taxation of Income Derived from the Leasing of Containers”.¹²

9.1 Another example where an enterprise cannot be considered to carry on its business wholly or partly through a place of business is that of a telecommunications operator of a Contracting State who enters into a “roaming” agreement with a foreign operator in order to allow its users to connect to the foreign operator’s telecommunications network. Under such an agreement, a user who is outside the geographical coverage of that user’s home network can automatically make and receive voice calls, send and receive data or access other services through the use of the foreign network. The foreign network operator then bills the operator of that user’s home network for that use. Under a typical roaming agreement, the home network operator merely transfers calls to the foreign operator’s network and does not operate or have physical access to that network. For these reasons, any place where the foreign network is located cannot be considered to be at the disposal of the home network operator and cannot, therefore, constitute a permanent establishment of that operator.

10. ***There are different ways in which an enterprise may carry on its business. In most cases, the business of an enterprise is carried on ~~mainly~~ by the entrepreneur or persons who are in a paid-employment relationship with the enterprise (personnel). This personnel includes employees and other persons receiving instructions from the enterprise (e.g. dependent agents). The powers of such personnel in its relationship with third parties are irrelevant. It makes no difference whether or not the dependent agent is authorised to conclude contracts if he works at the fixed place of business of the enterprise (see paragraph 35 below). [rest of the existing paragraph becomes new paragraph 10.2] As explained in paragraph 8.11 of the Commentary on Article 15, however, there may be cases where individuals who are formally employed by an enterprise will actually be carrying on the business of another enterprise and where, therefore, the first enterprise should not be considered to be carrying on its own business at the location where these individuals will perform that work. Within a multinational group, it is relatively frequent for employees of one company to be temporarily seconded to another company of the group and to perform business activities that clearly belong to the business of that other company. In such cases, administrative reasons (e.g. the need to preserve seniority or pension rights) often prevent a change in the employment contract. The analysis described in paragraph 8.13 to 8.15 of the Commentary on Article 15 will be relevant for the purposes of distinguishing these cases from other cases where employees of a foreign enterprise perform that enterprise’s own business activities.***

10.1 ***An enterprise may also carry on its business through subcontractors, acting alone or together with employees of the enterprise. In that case, a permanent establishment will only exist for the enterprise if the other conditions of Article 5 are met. In the context of paragraph 1, that will require that these subcontractors perform the work of the enterprise at a fixed place of business that is at the disposal of the enterprise for reasons other than the mere fact that these subcontractors perform such work at that location (see paragraph 4.2 above). An example would be where an enterprise that owns a small hotel and rents out the hotel’s rooms through the internet has subcontracted the on-site operation of the hotel to a company that is remunerated on a cost-plus basis.***

10.2 ***But ~~also~~, a permanent establishment may ~~nevertheless~~ exist if the business of the enterprise is carried on mainly through automatic equipment, the activities of the personnel being restricted to setting up, operating, controlling and maintaining such equipment. Whether or not gaming and vending machines and the like set up by an enterprise of a State in the other State constitute a permanent establishment thus depends on whether or not the enterprise carries on a business activity besides the initial setting up of the machines. A permanent establishment does not exist if the enterprise merely sets up the machines and then leases the machines to other enterprises. A permanent establishment may exist, however, if the enterprise which sets up***

12. Reproduced in Volume II of the loose-leaf version of the OECD Model Tax Convention, at page R(3)-1.

the machines also operates and maintains them for its own account. This also applies if the machines are operated and maintained by an agent dependent on the enterprise.

10.3 *It follows from the definition of “enterprise of a Contracting State” in Article 3 that this term, as used in Article 5, refers to any form of enterprise carried on by a resident of a Contracting State, whether this enterprise is legally set up as a company, partnership, sole proprietorship or other legal form. Different enterprises may collaborate on the same project and the question of whether their collaboration constitutes a separate enterprise (e.g. in the form of a partnership) is a question that depends on the facts and the domestic law of each State. Clearly, if two enterprises carried on by different persons decide to form a company in which these persons are shareholders, the company constitutes a legal person that will carry on what becomes a separate enterprise. It will often be the case, however, that different enterprises will simply agree each carry on a separate part of the same project and that these enterprises will not jointly carry on business activities and share the profits thereof even though they may share the overall output from the project or the remuneration for the activities that will be carried on in the context of that project (e.g. what is considered to be a “joint venture” according to the law of some countries). In such a case, it would be difficult to consider that a separate enterprise has been set up.*

10.4 *In the case of an enterprise that takes the form of a fiscally transparent partnership, the enterprise is carried on by each partner and, as regards the partners’ respective shares of the profits, is therefore an enterprise of each Contracting State of which a partner is a resident. If such a partnership has a permanent establishment in a Contracting State, each partner’s share of the profits attributable to the permanent establishment will therefore constitute, for the purposes of Article 7, profits derived by an enterprise of the Contracting State of which that partner is a resident (see also paragraph 19.1 below).*

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

Paragraph 2

12. This paragraph contains a list, by no means exhaustive, of examples *of places of business*, each of which can be regarded, *prima facie*, as constituting a permanent establishment **under paragraph 1 provided that it meets the requirements of that paragraph**. As these examples are to be seen against the background **read in the context** of the general definition—given in paragraph 1, it is assumed that the Contracting States interpret the terms listed, “a place of management”, “a branch”, “an office”, etc. **must be interpreted** in such a way that such places of business constitute permanent establishments only if they meet the requirements of paragraph 1.

13. The term “place of management” has been mentioned separately because it is not necessarily an “office”. However, where the laws of the two Contracting States do not contain the concept of “a place of

management” as distinct from an “office”, there will be no need to refer to the former term in their bilateral convention.

14. Subparagraph *f*) provides that mines, oil or gas wells, quarries or any other place of extraction of natural resources are permanent establishments. The term “any other place of extraction of natural resources” should be interpreted broadly. It includes, for example, all places of extraction of hydrocarbons whether on or off shore.

15. Subparagraph *f*) refers to the extraction of natural resources, but does not mention the exploration of such resources, whether on or off shore. Therefore, whenever income from such activities is considered to be business profits, the question whether these activities are carried on through a permanent establishment is governed by paragraph 1. Since, however, it has not been possible to arrive at a common view on the basic questions of the attribution of taxation rights and of the qualification of the income from exploration activities, the Contracting States may agree upon the insertion of specific provisions. They may agree, for instance, that an enterprise of a Contracting State, as regards its activities of exploration of natural resources in a place or area in the other Contracting State:

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

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

Paragraph 3

16. The paragraph provides expressly that a building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months. Any of those items which does not meet this condition does not of itself constitute a permanent establishment, even if there is within it an installation, for instance an office or a workshop within the meaning of paragraph 2, associated with the construction activity. Where, however, such an office or workshop is used for a number of construction projects and the activities performed therein go beyond those mentioned in paragraph 4, it will be considered a permanent establishment if the conditions of the Article are otherwise met even if none of the projects involve a building site or construction or installation project that lasts more than 12 months. In that case, the situation of the workshop or office will therefore be different from that of these sites or projects, none of which will constitute a permanent establishment, and it will be important to ensure that only the profits properly attributable to the functions performed through that office or workshop, taking into account the assets used and the risks assumed through that office or workshop, are attributed to the permanent establishment. This could include profits attributable to functions performed in relation to the various construction sites but only to the extent that these functions are properly attributable to the office.

17. The term “building site or construction or installation project” includes not only the construction of buildings but also the construction of roads, bridges or canals, the renovation (involving more than mere maintenance or redecoration) of buildings, roads, bridges or canals, the laying of pipe-lines and excavating and dredging. Additionally, the term “installation project” is not restricted to an installation related to a construction project; it also includes the installation of new equipment, such as a complex machine, in an existing building or outdoors. On-site planning and supervision of the erection of a building are covered by paragraph 3. States wishing to modify the text of the paragraph to provide expressly for that result are free to do so in their bilateral conventions.

18. The twelve month test applies to each individual site or project. In determining how long the site or project has existed, no account should be taken of the time previously spent by the contractor concerned on

other sites or projects which are totally unconnected with it. A building site should be regarded as a single unit, even if it is based on several contracts, provided that it forms a coherent whole commercially and geographically. Subject to this proviso, a building site forms a single unit even if the orders have been placed by several persons (*e.g.* for a row of houses). The twelve month threshold has given rise to abuses; it has sometimes been found that enterprises (mainly contractors or subcontractors working on the continental shelf or engaged in activities connected with the exploration and exploitation of the continental shelf) divided their contracts up into several parts, each covering a period less than twelve months and attributed to a different company which was, however, owned by the same group. Apart from the fact that such abuses may, depending on the circumstances, fall under the application of legislative or judicial anti-avoidance rules, countries concerned with this issue can adopt solutions in the framework of bilateral negotiations.

19. A site exists from the date on which the contractor begins his work, including any preparatory work, in the country where the construction is to be established, *e.g.* if he installs a planning office for the construction. *[the six subsequent sentences have been moved to new paragraph 19.1]* If an enterprise (general contractor) which has undertaken the performance of a comprehensive project subcontracts **all** or parts of such a project to other enterprises (subcontractors), the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor on the building project. ***In that case, the site should be considered to be at the disposal of the general contractor during the time spent on that site by any subcontractor where the general contractor has overall responsibility for the site and the site is made available to that general contractor for the purposes of carrying on its construction business.*** The subcontractor himself has a permanent establishment at the site if his activities there last more than twelve months.

19.1 In general, ~~it~~ **a site** continues to exist until the work is completed or permanently abandoned. ***The period during which the building or its facilities are being tested by the contractor or subcontractor should therefore generally be included in the period during which the construction site exists. In practice, the delivery of the building or facilities to the client will usually represent the end of the period of work, provided that the contractor and subcontractors no longer work on the site after its delivery.*** A site should not be regarded as ceasing to exist when work is temporarily discontinued. Seasonal or other temporary interruptions should be included in determining the life of a site. Seasonal interruptions include interruptions due to bad weather. Temporary interruption could be caused, for example, by shortage of material or labour difficulties. Thus, for example, if a contractor started work on a road on 1 May, stopped on 1 November because of bad weather conditions or a lack of materials but resumed work on 1 February the following year, completing the road on 1 June, his construction project should be regarded as a permanent establishment because thirteen months elapsed between the date he first commenced work (1 May) and the date he finally finished (1 June of the following year). ***Work that is undertaken on a site after the construction work has been completed pursuant to a guarantee that requires an enterprise to make repairs would normally not be included in the original construction period.***

19.24 In the case of fiscally transparent partnerships, the twelve month test is applied at the level of the partnership as concerns its own activities. If the period of time spent on the site by the partners and the employees of the partnership exceeds twelve months, the enterprise carried on ~~by~~ **through** the partnership will therefore be considered to have a permanent establishment. Each partner will thus be considered to have a permanent establishment for purposes of the taxation of his share of the business profits derived by the partnership regardless of the time spent by himself on the site. ***Assume for instance that a resident of State A and a resident of State B are partners in a partnership established in State B which carries on its construction activities on a construction site situated in State C that lasts 10 months. Whilst the tax treaty between States A and C is identical to the OECD Model, paragraph 3 of Article 5 of the treaty between State B and State C provides that a construction site constitutes a permanent establishment only if it lasts more than 8 months. Since the treaties provide for different time-thresholds, State C will have the right to tax the share of the profits of the partnership attributable to the partner who is a resident of***

State B but will not have the right to tax the share attributable to the partner who is a resident of State A. This results from the fact that whilst the provisions of paragraph 3 of each treaty are applied at the level of the same enterprise (i.e. the partnership), the outcome differs with respect to the different shares of the profits of the partnership depending on the time-threshold of the treaty that applies to each share.

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

Paragraph 4

21. This paragraph lists a number of business activities which are treated as exceptions to the general definition laid down in paragraph 1 and which are not permanent establishments, even if the activity is carried on through a fixed place of business. *Where each of the activities listed in subparagraphs a) to d) is the only activity carried on at a fixed place of business, the place is deemed not to constitute a permanent establishment.* The common feature of these activities is that they are, in general, preparatory or auxiliary activities. *Since subparagraph e) deals with other unspecified activities, however, the requirement that the activity must have a preparatory or auxiliary character has been*~~This is~~ laid down explicitly in the case of the exception mentioned in *that* ~~subparagraph e)~~, which actually amounts to a general restriction of the scope of the definition contained in paragraph 1. Moreover subparagraph f) provides that combinations of activities mentioned in subparagraphs a) to e) in the same fixed place of business shall be deemed not to be a permanent establishment, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character. Thus the provisions of paragraph 4 are designed to prevent an enterprise of one State from being taxed in the other State, if it carries on in that other State, activities of a purely preparatory or auxiliary character.

22. Subparagraph a) relates only to the case in which an enterprise acquires the use of facilities for storing, displaying or delivering its own goods or merchandise. Subparagraph b) relates to the stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery. *Subparagraphs a) and b) apply regardless of whether the storage or delivery takes place before or after the goods or merchandise have been sold provided that the goods or merchandise belong to the enterprise whilst they are at the relevant location (e.g. the subparagraphs would remain applicable if some of the goods that are stored at a location have already been sold but the property title to these goods will only pass to the customer after their delivery). These subparagraphs also cover situations where a facility is used, or a stock of goods or merchandise is maintained, for any combination of storage, display and delivery since facilities used for the delivery of goods will almost always be also used for the storage of these goods, at least for a short period. In the context of these subparagraphs, the words "goods" and "merchandise" refer to tangible property that can be stored, displayed and delivered and would not cover, for example, immovable property and data (although the subparagraphs would cover tangible products that include data such as CDs and DVDs).*

22.1 Subparagraph c) covers the case in which a stock of goods or merchandise belonging to one enterprise is processed by a second enterprise, on behalf of, or for the account of, the first-mentioned enterprise. The reference to the collection of information in subparagraph d) is intended to include the case of the newspaper bureau which has no purpose other than to act as one of many "tentacles" of the parent body; to exempt such a bureau is to do no more than to extend the concept of "mere purchase".

23. Subparagraph e) provides that a fixed place of business through which the enterprise exercises solely an activity which has for the enterprise a preparatory or auxiliary character, is deemed not to be a permanent establishment. The wording of this subparagraph makes it unnecessary to produce an exhaustive list of exceptions. Furthermore, this subparagraph provides a generalised exception to the general definition in paragraph 1 and, when read with that paragraph, provides a more selective test, by which to determine what constitutes a permanent establishment. To a considerable degree it limits that definition and excludes from its rather wide scope a number of forms of business organisations which, although they are carried on through a fixed place of business, **and may well contribute to the productivity of the enterprise, involve activities which are so remote from the actual realisation of profits by the enterprise that they** should not be treated as permanent establishments. ~~It is recognised that such a place of business may well contribute to the productivity of the enterprise, but the services it performs are so remote from the actual realisation of profits that it is difficult to allocate any profit to the fixed place of business in question.~~ Examples are fixed places of business solely for the purpose of advertising or for the supply of information or for scientific research or for the servicing of a patent or a know-how contract, if such activities have a preparatory or auxiliary character.

24. It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity. Where, for example, the servicing of patents and know-how is the purpose of an enterprise, a fixed place of business of such enterprise exercising such an activity cannot get the benefits of subparagraph e). *[the rest of paragraph 24 is moved to new paragraph 24.1]*

24.1 A fixed place of business which has the function of managing an enterprise or even only a part of an enterprise or of a group of the concern cannot be regarded as doing a preparatory or auxiliary activity, for such a managerial activity exceeds this level. If enterprises with international ramifications establish a so-called “management office” in States in which they maintain subsidiaries, permanent establishments, agents or licensees, such office having supervisory and co-ordinating functions for all departments of the enterprise located within the region concerned, a permanent establishment will normally be deemed to exist, because the management office may be regarded as an office within the meaning of paragraph 2. Where a big international concern has delegated all management functions to its regional management offices so that the functions of the head office of the concern are restricted to general supervision (so-called polycentric enterprises), the regional management offices even have to be regarded as a “place of management” within the meaning of subparagraph a) of paragraph 2. The function of managing an enterprise, even if it only covers a certain area of the operations of the concern, constitutes an essential part of the business operations of the enterprise and therefore can in no way be regarded as an activity which has a preparatory or auxiliary character within the meaning of subparagraph e) of paragraph 4.

24.2 *Similarly, where an enterprise that sells goods worldwide establishes an office in one State, and the employees working at that office take an active part in the negotiation of important parts of contracts for the sale of goods to buyers in that State (e.g. by participating in decisions related to the type, quality or quantity of products covered by these contracts) even if they do not exercise an authority to conclude contracts in the name of their employer, such activities will usually constitute an essential part of the business operations of the enterprise and should not be regarded as having a preparatory or auxiliary character within the meaning of subparagraph e) of paragraph 4. If the conditions of paragraph 1 are met, such an office will therefore constitute a permanent establishment.*

25. A permanent establishment could also be constituted if an enterprise maintains a fixed place of business for the delivery of spare parts to customers for machinery supplied to those customers where, in addition, it maintains or repairs such machinery, as this goes beyond the pure delivery mentioned in

subparagraph *a*) of paragraph 4. Since these after-sale organisations perform an essential and significant part of the services of an enterprise vis-à-vis its customers, their activities are not merely auxiliary ones. Subparagraph *e*) applies only if the activity of the fixed place of business is limited to a preparatory or auxiliary one. This would not be the case where, for example, the fixed place of business does not only give information but also furnishes plans etc. specially developed for the purposes of the individual customer. Nor would it be the case if a research establishment were to concern itself with manufacture.

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

26.1 Another example is that of facilities such as cables or pipelines that cross the territory of a country. Apart from the fact that income derived by the owner or operator of such facilities from their use by other enterprises is covered by Article 6 where they constitute immovable property under paragraph 2 of Article 6, the question may arise as to whether paragraph 4 applies to them. Where these facilities are used to transport property belonging to other enterprises, subparagraph *a*), which is restricted to delivery of goods or merchandise belonging to the enterprise that uses the facility, will not be applicable as concerns the owner or operator of these facilities. Subparagraph *e*) also will not be applicable as concerns that enterprise since the cable or pipeline is not used solely for the enterprise and its use is not of preparatory or auxiliary character given the nature of the business of that enterprise. The situation is different, however, where an enterprise owns and operates a cable or pipeline that crosses the territory of a country solely for purposes of transporting its own property and such transport is merely incidental to the business of that enterprise, as in the case of an enterprise that is in the business of refining oil and that owns and operates a pipeline that crosses the territory of a country solely to transport its own oil to its refinery located in another country. In such case, subparagraph *a*) would be applicable. An additional question is whether the cable or pipeline could also constitute a permanent establishment for the customer of the operator of the cable or pipeline, *i.e.* the enterprise whose data, power or property is transmitted or transported from one place to another. In such a case, the enterprise is merely obtaining transmission or transportation services provided by the operator of the cable or pipeline and does not have the cable or pipeline at its disposal. As a consequence, the cable or pipeline cannot be considered to be a permanent establishment of that enterprise.

27. As already mentioned in paragraph 21 above, paragraph 4 is designed to provide for exceptions to the general definition of paragraph 1 in respect of fixed places of business which are engaged in activities having a preparatory or auxiliary character. Therefore, according to subparagraph *f*) of paragraph 4, the fact that one fixed place of business combines any of the activities mentioned in the subparagraphs *a*) to *e*) of paragraph 4 does not mean of itself that a permanent establishment exists. As long as the combined activity of such a fixed place of business is merely preparatory or auxiliary a permanent establishment should be deemed not to exist. Such combinations should not be viewed on rigid lines, but should be considered in the light of the particular circumstances. The criterion “preparatory or auxiliary character” is to be interpreted in the same way as is set out for the same criterion of subparagraph *e*) (see paragraphs 24 and 25 above). States which want to allow any combination of the items mentioned in subparagraphs *a*) to *e*), disregarding whether or not the criterion of the preparatory or auxiliary character of such a combination is met, are free to do so by deleting the words “provided” to “character” in subparagraph *f*).

27.1 Subparagraph *f*) is of no importance in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs *a*) to *e*) provided that they are separated from each other locally and organisationally, as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists. Places of business are not “separated organisationally” where they each perform in a Contracting State complementary functions such as receiving and storing goods in one place, distributing those goods through another etc. An enterprise

cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity. *The same approach applies where an enterprise that maintains in a Contracting State one or more fixed places of business within the meaning of subparagraphs a) to e) is also deemed, through the application of paragraph 5, to have a permanent establishment in the same State; in that case, if the activities that resulted in that deemed permanent establishment are not separated organisationally from these fixed places of business, it could not be argued that the enterprise is solely engaged in a preparatory or auxiliary activity at these places.*

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

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

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

Paragraph 5

31. It is a generally accepted principle that an enterprise should be treated as having a permanent establishment in a State if there is under certain conditions a person acting for it, even though the enterprise may not have a fixed place of business in that State within the meaning of paragraphs 1 and 2. This provision intends to give that State the right to tax in such cases. Thus paragraph 5 stipulates the conditions under which an enterprise is deemed to have a permanent establishment in respect of any activity of a person acting for it. The paragraph was redrafted in the 1977 Model Convention to clarify the intention of the corresponding provision of the 1963 Draft Convention without altering its substance apart from an extension of the excepted activities of the person.

32. Persons whose activities may create a permanent establishment for the enterprise are so-called dependent agents *i.e.* persons, whether or not employees of the enterprise, who are not independent agents falling under paragraph 6. Such persons may be either individuals or companies and need not be residents of, nor have a place of business in, the State in which they act for the enterprise. It would not have been in the interest of international economic relations to provide that the maintenance of any dependent person would

lead to a permanent establishment for the enterprise. Such treatment is to be limited to persons who in view of the scope of their authority or the nature of their activity involve the enterprise to a particular extent in business activities in the State concerned. Therefore, paragraph 5 proceeds on the basis that only persons having the authority to conclude contracts can lead to a permanent establishment for the enterprise maintaining them. In such a case the person has sufficient authority to bind the enterprise's participation in the business activity in the State concerned. The use of the term "permanent establishment" in this context presupposes, of course, that that person makes use of this authority repeatedly and not merely in isolated cases.

32.1 Also, the phrase "authority to conclude contracts in the name of the enterprise" does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise. ***For example, in some countries an enterprise would be bound, in certain cases, by a contract concluded with a third party by a person acting on behalf of the enterprise even if the person did not formally disclose that it was acting for the enterprise and the name of the enterprise was not referred to in the contract. [the rest of existing paragraph 32.1 becomes paragraph 32.2]***

32.2 Lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions.

33. The authority to conclude contracts must cover contracts relating to operations which constitute the business proper of the enterprise. It would be irrelevant, for instance, if the person had authority to engage employees for the enterprise to assist that person's activity for the enterprise or if the person were authorised to conclude, in the name of the enterprise, similar contracts relating to internal operations only. ***The types of contracts referred to in paragraph 5 are not restricted, however, to contracts for the sale of goods: the paragraph would cover, for example, a situation where a person has and habitually exercises an authority to conclude leasing contracts or contracts for services. [the rest of paragraph 33 is moved to new paragraph 33.1]***

33.1 Moreover the authority has to be habitually exercised in the other State; whether or not this is the case should be determined on the basis of the commercial realities of the situation. A person who is authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority "in that State", even if the contract is signed by another person in the State in which the enterprise is situated or if the first person has not formally been given a power of representation. The mere fact, however, that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has exercised in that State an authority to conclude contracts in the name of the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise. Since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either.

33.24 The requirement that an agent must "habitually" exercise an authority to conclude contracts reflects the underlying principle in Article 5 that the presence which an enterprise maintains in a Contracting State should be more than merely transitory if the enterprise is to be regarded as maintaining a permanent establishment, and thus a taxable presence, in that State. The extent and frequency of activity necessary to conclude that the agent is "habitually exercising" contracting authority will depend on the nature of the

contracts and the business of the principal. It is not possible to lay down a precise frequency test. Nonetheless, the same sorts of factors considered in paragraph 6 would be relevant in making that determination.

34. Where the requirements set out in paragraph 5 are met, a permanent establishment of the enterprise exists to the extent that the person acts for the latter, *i.e.* not only to the extent that such a person exercises the authority to conclude contracts in the name of the enterprise.

35. Under paragraph 5, only those persons who meet the specific conditions may create a permanent establishment; all other persons are excluded. It should be borne in mind, however, that paragraph 5 simply provides an alternative test of whether an enterprise has a permanent establishment in a State. If it can be shown that the enterprise has a permanent establishment within the meaning of paragraphs 1 and 2 (subject to the provisions of paragraph 4), it is not necessary to show that the person in charge is one who would fall under paragraph 5.

[the rest of the Commentary on Article 5 is unchanged]