IFA (Canadian Branch) 2010 Travelling Lectureship Program

THE DEFINITION OF PERMANENT ESTABLISHMENT: ERODING OR EVOLVING?

Brian J. Arnold
Jacques Sasseville

MATERIALS FOR PARTICIPANTS

IFA (Canadian Branch) 2010 Travelling Lectureship Program

THE DEFINITION OF PERMANENT ESTABLISHMENT: ERODING OR EVOLVING?

Brian J. Arnold and Jacques Sasseville

MATERIALS FOR PARTICIPANTS

Table of Contents

NOTE TO THE PARTICIPANTS IN THE 2010 IFA TRAVELLING LECTURESHIP

The focus of the 2010 IFA Travelling Lectureship is the definition of a permanent establishment for purposes of the OECD Model Convention and Canadian tax treaties. We will concentrate our discussions on the most important and controversial aspects of the definition, such as the question of whether a fixed place of business is "at the disposal" of an enterprise and the new services PE rule in Article V(9) of the Canada-United States treaty. Not surprisingly, the Commentary on Article 5 of the OECD Model Convention will receive a great deal of scrutiny. Some time will be devoted to a discussion of possible improvements to the wording of Article 5 and the Commentary.

You are invited to review the following material as background to the seminar. In addition to the General Report and the Canada Branch Report from the 2009 IFA Cahiers, volume 1, the material contains Article 5 of the OECD Model and Commentary, which we would suggest that you bring with you to the seminar, other selected permanent establishment provisions, and a list of the major cases that will be discussed. For a recent discussion of several of the issues to be discussed, see Joel Nitikman, "The Painter and the PE," (2009) Vol. 57, No. 2 *Canadian Tax Journal* 213-58.

A hard copy of the PowerPoint slides and selected permanent establishment provisions will be distributed at the seminar. We look forward to seeing you there.

Brian J. Arnold
Jacques Sasseville

General Report

Jacques Sasseville*
(OECD)
Arvid A. Skaar**
(Norway)

Table of contents

* Head, Tax Treaty Unit, OECD
The views expressed in this report represent the personal views of the reporters and should not be considered in any way to be the views of the OECD or of any of its member countries.
** Dr juris; partner in the law firm Wiersholm, Oslo, and adjunct professor at the Norwegian School of Management, Oslo

Section 1 of this report has been prepared by both reporters; section 2 is by Arvid Skaar, and sections 3–7 by Jacques Sasseville.

This is a shortened version of sections 3–7 of the general report. A full version is available on the secured part of the IFA website (see website IFA.nl).

1. Introduction

The question "Is there a permanent establishment?" is probably the most frequent tax treaty issue that advisers, government officials and courts have to deal with. It is also a question that has a large number of ramifications and on which much has already been written.

Given the breadth of the issue and in order to maximize the usefulness of branch reports, the general reporters have decided to focus on the judicial and administrative guidance that is available, in the jurisdictions covered by the branch reports, to interpret the tax treaty definition of permanent establishment (PE). The reports included in this book therefore seek to present a global picture of how the short treaty definition of PE, and the most common extensions and exceptions to this definition, have been interpreted by courts and tax administrations.

As a general rule, therefore, this general report and the branch reports included in this book do not present the views of their authors as to how the PE concept *should* be interpreted but, rather, describe how it has *in fact* been interpreted by courts and tax administrations in various jurisdictions. We hope that this collective work will eventually contribute to a more uniform interpretation of the PE definition through the identification of those aspects where there are substantial differences between jurisdictions and where further guidance might be needed at the international level.

The approach that we adopted to address the issue meant that in some jurisdictions there was an abundance of material to write about, while in others there was little or no judicial and administrative guidance to report on. Also, some countries[1] reported that although comprehensive guidance existed, it was primarily or exclusively administrative in nature. This is useful information in itself as one would expect a reader who is looking for guidance on the meaning of the treaty concept of PE to want to focus his/her attention primarily on the jurisdictions that have substantial practical experience in interpreting that concept. At the risk of oversimplification and based on a purely subjective classification, we have included the branch reports in the three broad categories shown in Table 1.

All branch reports except those from Estonia and Sri Lanka indicated that the commentary on the OECD model tax convention[2] would probably play a significant role in interpreting the PE treaty definition. The importance of that role, however, varies considerably between jurisdictions. While some reports state expressly that the OECD commentary would not be binding for the courts, that is probably implicit for all countries (except where the OECD model has specifically been referred to in the treaty or domestic legislation). Some reports similarly suggest that the commentary of the UN model would play a role in the interpretation of the PE treaty concept in these countries.[3]

The main aspects of the PE definition being identical in the vast majority of tax treaties, one would expect that court decisions in other countries would also

1 In particular Ireland, the UK and the USA.

2 Unless indicated otherwise, all references in this report to the OECD commentary are references to the commentary on art. 5.

3 Argentina, Canada, Chinese Taipei, Chile, Peru, South Africa, Uruguay and Venezuela.

Table 1

Reports from jurisdictions that appear to have abundant judicial and administrative guidance on the interpretation of the treaty PE concept	Reports from jurisdictions that seem to have some important judicial or administrative guidance on the interpretation of the treaty PE concept	Reports from jurisdictions that seem to have little or no judicial or administrative guidance on the interpretation of the treaty PE concept
Australia	Argentina	Brazil
Austria	Chile	Estonia
Belgium	Chinese Taipei	Hungary
Canada	Czech Republic	Japan
Denmark	Finland	Peru
France	Ireland	Portugal
Germany	Israel	Romania
India	Italy	Serbia
Netherlands	Korea	Sri Lanka
Norway	Luxembourg	Uruguay
United States	Mexico	Venezuela
	Poland	
	Russia	
	South Africa	
	Spain	
	Sweden	
	Switzerland	
	United Kingdom	

be a main source of guidance. This was expressly noted in the branch reports from Sri Lanka and Sweden.[4] Ireland's branch report similarly indicated that since Ireland is a common law country, recourse to English case law might be possible.[5] A similar conclusion was expressed in Australia's branch report on the basis of the decision of the Full Federal Court[6] which has expressly approved the use of foreign court decisions for the interpretation of treaty provisions. Canada's branch report goes one step further and actually gives examples where the Canadian courts have referred to foreign case law when interpreting the PE definition.[7] As noted in a few reports, however, one needs to take account of the fact that the judicial system of some countries does not recognize judicial precedents, even though judges are likely to use previous decisions as guidance.

Also, since the domestic laws of many countries use the concept of PE for various tax purposes, further guidance may be derived from the interpretation of the domestic PE, or PE-equivalent, concepts. As explained in section 7, however, the effect is reciprocal and in many cases it is the interpretation of the

4 Sri Lanka and Sweden.
5 Ireland.
6 Australia in *FC of T* v. *Lamesa Holdings BV* in 97 ATC 4752.
7 Canada in *Fiebert* v. *MNR*, 86 DTC 1017; *American Income Life Company* v. *The Queen*, 2008 TCC 306, 1.

domestic law provisions that has benefited from the guidance available on the treaty PE concept.

Finally, a point made in Finland's branch report is probably relevant for many jurisdictions: many administrative rulings and court decisions have based their conclusions on the PE definition as a whole rather than on a detailed interpretation of each paragraph and the guidance that can be derived from these rulings and decisions may therefore be limited.

2. The basic definition of a PE (the basic rule) paragraph 1 of article 5

[Section 2 is by Arvid A. Skaar]

2.1. Introduction

The provisions of the "basic rule" in the OECD model convention define the term PE as a fixed place of business through which the business of an enterprise is wholly or partly carried on. The OECD commentary explains in more detail how the OECD member countries have thought that this term should be interpreted.

Practice in some countries has had a significant influence upon the PE definition in the OECD commentary.[8] On the other hand, practice in countries with little experience in this field is greatly influenced by the OECD commentary.[9] The reports also show that some countries have very little experience with the notion of PE in itself.[10]

2.2. The "place of business" test

2.2.1. The physical presence of the non-resident

The commonly accepted understanding of the "place of business" is that it is the physical presence of the non-resident taxpayer in the source state.[11] The place of business is a tangible asset of a substantial nature.[12] Securities and bank accounts do not meet the place of business test.[13]

Thus, a website cannot in itself be a "place of business".[14] Furthermore, neither a letter-box, a mailing address,[15] an address used for transmitting mail to the recipient, nor a registration may constitute a place of business.[16]

8 Germany.
9 E.g. Peru, Serbia, Mexico, Uruguay.
10 E.g. Brazil.
11 E.g. Belgium, Canada, Chile, Estonia, Hungary, Japan, Korea, the Netherlands, Poland, Portugal and Sweden.
12 Ireland, Finland; *con* India.
13 Russia.
14 Australia, Canada, Estonia, Finland, Israel, Poland, Sweden; possibly *con* India and Taiwan.
15 USA, Denmark and Hungary.
16 Austria, Russia and Switzerland (addendum).

The wording used in the different languages may not always translate "place of business" well,[17] but these differences do not have much significance for the interpretation of the treaty. The local wording is interpreted in the light of the OECD model convention's term "place of business" and the commentary.

2.2.2. A wide meaning of "place"

A "place" which qualifies for a "place of business" has been interpreted broadly.[18] Any open-air place, e.g. in a forest where logging equipment is demonstrated, may be such a "place".[19] Similarly, the wharf of a shipping enterprise[20] and the place where a drilling ship or a rig is located may also be a "place of business".[21] In addition, the vessel itself is also a "place".[22]

Also a home office may qualify as a place of business,[23] including a desk and a filing cabinet in a corner of a private residence.[24] Generally speaking, any "place" in the ordinary sense of the word may be a "place of business",[25] e.g. also a bookmaker's patch at a racecourse.[26]

Substantial machinery and equipment, such as computer hardware, is accepted as a "place of business", and may qualify for a PE if other conditions for a PE are met.[27]

A place of business may be situated underground, such as mines, quarries and underground pipelines.[28] These objects are clearly situated "in" a country.

2.2.3. Places without staff or any other personnel

The term "place of business" does not require any presence of human beings. Vending machines, gaming machines, antennas and satellite receivers, water pipelines, electrical cables, transformer stations and pumping stations and underground cables for telecommunication purposes should be considered places of business regardless of whether the facility is staffed.[29] Based on analogy it is also concluded that a server may be a "place of business".[30]

17 E.g. Germany and Austria, *Geschäftseinrichtung*; Norway, *forretningsinnretning*.
18 Czech Republic.
19 USA, Norway, France and Germany.
20 Luxembourg.
21 Japan and Norway.
22 France, Norway, Denmark, Ireland, Japan, the Netherlands and USA; cf. Venezuela.
23 Italy and Russia.
24 Germany and Finland.
25 Chile, Romania, Portugal and South Africa.
26 Ireland.
27 Austria, Australia, Canada, Estonia, Finland, Germany, India, Israel, Italy and Uruguay; *con* UK.
28 Germany and Italy.
29 Austria, Chile and Finland; *con* France.
30 E.g. USA and Italy.

2.2.4. The "object" of the business

In some countries it is controversial whether the place where the activity is conducted can be a place of business if it is also the object of the business activity of the taxpayer.[31]

Conceptually speaking, these countries distinguish between the object of the business and the "place of business". Real estate can be a place of business, but in addition the building is also an asset which is the object of the taxpayer's business activities. Similarly, stocks of goods are tangible assets, but are also the object of the business activities[32] (the place where the stocks are located is in any case a place of business).

It is not sufficient for these countries that the enterprise has the objective of business activities. The taxpayer must in addition have something else, another "place", which is at the taxpayer's disposal in a certain qualified way. The Swedish case where participation in real estate business was considered to be a sale of a PE, because the real estate was held to be a fixed place of business, is an example of an "object" of the business that was considered to be a "place of business".[33]

In the OECD commentary's painter example (second alternative) the building is not only the "object" of the business activity of the painter, but also the "place" where the painter is contractually obliged to perform his business. Most of the reports do not seem to make this distinction, and seem to accept that the building is the "place" where the taxpayer has a contractual right to conduct the business and is therefore both a place of business and the object of the business.

2.2.5. Animals as a "place of business"

From a conceptual point of view, it may be questioned whether animals can be a "place of business".[34] The issue is not practical for livestock, because those animals are normally covered by article 6 of the OECD model convention. When entering a horse or a dog in races, the animal itself is a "place of business", as well as the track and the stable or other facilities used during the stay. However, even if the answer is confirmative, other conditions for a PE are normally not met in these cases.

2.3. The location test ("fixed")

2.3.1. Geographical nexus to the source state

The place of business needs to be located at a specific geographical nexus to constitute a "fixed place of business" for PE purposes. However, the nexus to the earth does not have to be visible from the surface of the earth. Underground

31 Austria and Germany; cf. Italy.
32 Cf. Mexico.
33 Sweden.
34 USA.

pipelines, railroads, mines, etc., meet the requirements under the location test for a PE. Given that the place of business does not have to be a construction of any kind, no requirement of a mechanical connection to the earth can be established; a tent or a shanty is sufficiently connected for location test purposes.[35]

2.3.2. Movable places of business

The 1955 Dutch rejection of a PE under the location test, when the locations were changed all the time, is still a correct analysis (no geographical coherence seems to have existed in that matter).[36] It is not required that equipment or devices are "fixed" to the soil.[37] A transportable newsstand, a tent or a van equipped for selling products may constitute a "fixed" place of business.[38] However, if those devices are regularly moved to different places, those different places cannot as a starting point be considered to be one place.[39]

Even if a motor caravan,[40] a taxi,[41] a truck, an aircraft or a vessel obviously are places of business, they will not meet the location test as long as they are used for their normal purposes.[42] This is because they change position repeatedly. Although old exceptions (not based on the OECD model convention) can be found,[43] the same applies to travelling circuses, funfairs, etc.[44] This conclusion will naturally apply also to business activities undertaken on board ships and aircraft, typically restaurants, shops, etc., as long as the ship, etc., is in normal operation.[45] Hence, sales agents who are engaged at different fairs, shows, music bands and other enterprises that carry on business by travelling do not constitute a basic rule PE, because the location test is not met.

A ship, a train or a truck does not normally constitute a basic rule PE because the place of business does not remain at a particular location during its normal use; the movement from one location to another will disqualify under the location test. Hence, the point is not the fact that these places of business have no nexus to the ground itself because they are floating or flying.[46] A ship that is docked will for example meet the location test; the same will apply to a vessel that remains in one particular place under the control of engines directed by computers.

One country reports that the registration of ships in inland waterways in the ships registry of a country in which the shipping activity is actually carried on justifies the assumption that the location test is met, unless it is proven that the shipping is performed from another location.[47] However, the registration in the

35 E.g. Germany.
36 The Netherlands; *con* Czech Republic.
37 E.g. Estonia.
38 Austria.
39 Switzerland.
40 Portugal.
41 Germany.
42 Canada and Germany.
43 The Netherlands.
44 USA, Norway and Sweden; *con* India and Estonia.
45 Denmark.
46 Japan.
47 Germany.

registry has in itself little relevance for the question of whether the location test for a PE is met.[48]

The operation of barges for excursions has been considered sufficient for the location test.[49] However, it is questionable whether there is a general consensus that the location test is met in the case of a ship cruising exclusively in inland waterways of a country,[50] for example along a river or the coastline of a country, even if it calls at the same ports on each trip. A fishing vessel will not meet the location test under its normal operation.[51]

2.3.3. Business activities that constitute a geographical and commercial coherent whole

Sources from many countries show that if the taxpayer is moving around within a geographically coherent area, performing a commercially coherent business activity for clients, that area may constitute one "place" under the location test.[52] However, often the emphasis is on commercial coherence,[53] and a PE is constituted even if the geographical coherence may be questioned,[54] while others adhere to the OECD view.[55] Practice starting in the 1980s relating to offshore business activities such as drilling for natural resources laid the ground for these conclusions.[56]

An onshore example of geographical and commercial coherence is a marketplace within which the sales stand is placed at different locations.[57] Even if the sales stand is located at different positions, the place of business is considered to be "fixed", because the marketplace as distinguished from the actual location of the stand is considered to be one place.[58]

The typical OECD example mentioned in several reports is that the different places are "isolated islands", and the taxpayer does not have any right of use to the area between the "islands"; thus a PE cannot be constituted.[59] The conclusion of the OECD commentary is that the location test is not met in such a case, and this conclusion seems to be supported in most of the reports that address the issue. However, if the taxpayer works in different rooms within one office building belonging to the client, geographical coherence exists, and the location test for a PE is met.

According to the OECD commentary, places that are only connected commercially, but not connected geographically, do not constitute one "place".[60] Accordingly, activities that are carried on as part of a single project constituting a coherent commercial whole may lack the necessary geographical coherence to be considered as one single place (of business).

48 E.g. Estonia.
49 France.
50 The Netherlands.
51 Norway; cf. Argentina.
52 Chile, Denmark and Estonia; cf. Czech Republic.
53 Czech Republic.
54 Australia, Ireland, Japan, Russia and Sri Lanka.
55 E.g. Belgium, Korea, Romania and Serbia.
56 France, USA, Norway, Australia, Denmark and Japan.
57 Australia, Germany and Austria.
58 Cf. Czech Republic.
59 *Con* Taiwan.
60 *Con* UK and India.

Thus, a forest may be considered "one place", and the location test may be considered met, if the business activities constitute a coherent whole. This has been the practice in some countries,[61] while other countries require loggers to have a "base", e.g. a container at one particular place within the forest, in order to meet the location test.[62] In a US logging equipment case[63] from the 1960s, commercial coherence within a forest was probably sufficient for a PE.

2.4. The duration test ("fixed")

2.4.1. The relation between the duration test and the right of use test

Is a PE constituted when the business activity lasts for eight months, while the taxpayer has a place of business at its disposal only for one month? In other words, should the duration test be related to the place of business, to the business activity or to anything else?

In Germany, for example, the duration test is linked to the right of use test: for the place of business to be considered as a place through which the business of an enterprise is wholly or partly carried on (i.e. a PE), the enterprise must have a right to use a particular place not only temporarily.[64] If a legal right of use to the place of business is required for a PE to be constituted, it is conceptually logical to relate it to the duration test. The place of business itself, e.g. an office, normally lasts for a long period of time, and a business activity is not a PE unless it is performed through a place of business. It is therefore logical to link the required duration to the period of time the place of business is at the taxpayer's disposal.

2.4.2. Indefinite vs factual duration

The branch reports do not focus much on the significance of the term "permanent" in the interpretation of the duration test. Historically, no PE could be constituted if the right of use of the place of business according to the nature of the business only lasted for a definite period of time, as is the case with construction projects. In Europe, the 12-month test of the construction clause in the bilateral treaties was included in the 1930s in order to make it clear that a certain period of time was sufficient for a PE under the construction clause.

Although it is difficult to pinpoint exactly when, the requirement of an indefinite period of time in the basic rule was probably abandoned by all countries several decades ago. None of the branch reports reflect the view that "permanent" requires perpetuity, and this view has been explicitly rejected in the USA.[65] Thus, US practice shows an example from the 1960s that a certain period of time is considered sufficient. The Italian reporter has observed this change in Italy's practice.[66]

61 Germany and Norway.
62 Austria.
63 USA.
64 Germany.
65 USA.
66 Italy.

2.4.3. Intentions vs factual duration

The branch reports are based on the view that a right of use for an indefinite period of time is sufficient to meet the duration test, but that it is not necessary.

The duration test is applied retrospectively, i.e. a business which is intended to last for a short period of time, but lasts in practice for a longer period, may be considered to meet the duration test.[67] Thus, in this respect, the intentions of the taxpayer are less important than the factual duration of the right of use.

However, if the intention of the taxpayer was that the right of use to the place of business should last for a long or an indefinite period of time, but was in fact terminated after a short period of time, a PE is nevertheless constituted.[68] Thus, in these situations the intentions of the taxpayer are more important than the factual duration of the right of use.

2.4.4. Temporary suspensions

It is generally accepted that temporary suspensions of business activity in a country are not considered to be a cessation of the PE.[69] Thus, rejection of a PE with reference to the duration test in a case where the business activity was split into 50 visits of altogether 600 days over several years[70] is difficult to accept, because the taxpayer's right of use to the place of business was not suspended even though he left the country for periods of time.[71] However, there is a fine line between this example and occasional visiting in a country using a client's premises which does not trigger the duration test at all (because the right of use test is not met).[72]

In some cases, however, the business activity has ceased in such a way that it may be concluded that the taxpayer's right of use to the place of business has also ceased, and thus the absence is not temporary.[73] A suspension of 14 months has been considered "temporary" under the circumstances.[74] In cases where the activity has ceased in such a way that it cannot be considered temporary (the intention of the taxpayer is not to come back), the lapse of the duration test is terminated. If the business activity nevertheless is continued in the future, a new duration test is triggered.

2.4.5. Minimum duration – six months?

Many of the branch reports point to a six-month minimum duration found in practice and reported in the OECD commentary. Subject to the circumstances in each case, practice has shown that the duration test is met where the right of use to the place of business was maintained for a period of at least six

67 Chile, Estonia, Portugal, Romania and UK.
68 Chile, UK, Ireland and Poland.
69 France, Poland and South Africa.
70 Norway.
71 Cf. Luxembourg.
72 E.g. France, Canada, Israel and Uruguay; *con* Russia.
73 South Africa.
74 South Africa.

months,[75] whereas the duration test has often been denied for shorter periods.[76] The official policy of some countries is that the duration test under the basic rule is complied with when the right of use is maintained for at least six months.[77]

Some countries specifically adhere to a minimum requirement of six months, while others report that the duration test should not be considered an exact quantitative test in the sense that one day less than six months will necessarily always disqualify a PE. However, case law shows a number of cases where a PE has been denied on the grounds that the duration test is not met, e.g. a three-month lease period in temporary facilities due to a fire has not been considered sufficient.[78]

In general, there is little if any guidance to be found in the 12-month duration test for a PE under the construction clause to establish the duration test of the basic rule, with the possible exception that the relevant duration is not (exactly) 12 months unless the treaty or a mutual agreement states otherwise. However, some countries have concluded agreements to this effect.[79] A 12-month time requirement has been used in some countries with respect to drilling activities offshore,[80] but this may be because drilling for natural resources has been considered a construction activity.

2.4.6. Recurrent activities

International practice shows examples of business activities of a recurrent nature that comply with the duration test in aggregate, even though each "season" does not last long enough to constitute a PE. Many reports state that in such cases each "season" should be considered in combination with the number of times during which that place of business is used (which may extend over a number of years).[81]

This applies first of all to the situation where the non-resident taxpayer concludes a contract which requires the taxpayer to come back for several years, e.g. drilling for oil in northern seas under a contract with an oil company for several summers. In this case, the duration test is met on the basis of the contract and the business conducted during the first season. However, the duration test may be complied with also in a situation where a non-resident taxpayer does not have a contract with a client, but chooses to come back each year.[82] Thus, a non-resident travel agency which rents every year rooms in a hotel for a period of three months in order to take care of its customers (tourists) meets the duration test when the total amount of time exceeds the general duration required under the basic rule (retrospectively).[83]

75 E.g. Belgium, Chile, Czech Republic, Estonia, Mexico, Spain and Sweden.
76 Australia and Norway.
77 E.g. Korea.
78 Germany.
79 Austria.
80 Denmark and USA.
81 Canada, Ireland, Korea and Sweden; cf. Sri Lanka and Switzerland (addendum).
82 Chile and Korea.
83 Austria.

In the case of recurrent activities, the same time requirement, i.e. approximately six months, should apply.

Other examples mentioned in the reports are a non-resident enterprise that is selling goods from a movable stand in a street once a week may comply with the duration test when the aggregate time exceeds the threshold. Thus, a non-resident engineer who is working for less than six months per year in a country may constitute a PE if he or she is working for the same client in the same premises for several years, and a nurse may (retrospectively) constitute a PE if he or she is working in the home of the same patient regularly, e.g. once a week.[84]

2.4.7. "One-off projects"

It follows from the reports that some countries support the view that a short time limit is sufficient for activities of a special nature,[85] while others reject this view.[86] A sporting event of one week is clearly not sufficient,[87] and cannot be considered a "one-off project". The same applies to teaching classes for a few days,[88] as well as a trade fair of a week.[89] Moreover, there is no reason to consider theatrical shows as a "one-off project", and the duration test is not met unless the shows are of a recurrent nature.[90] Similarly, in the Israeli Supreme Court's *Cliff Richard* decision the duration of a few days was not accepted, although a rock star's concerts are necessarily of a short duration.[91] Moreover, seismic surveying, which is normally performed at a specific location only once, because of the nature of the business, has been considered not to be a "one-off project" in this respect.[92]

2.5. Listed examples (the positive list) of fixed places of business

2.5.1. A "deeming provision"?

The initial question to be decided is whether the positive list is a list of examples of different places of business, which may or may not meet the other conditions for a PE, e.g. the duration test, or whether the positive list is a deeming provision, i.e. a list of examples that constitute a PE regardless of whether the conditions in the basic rule are met.

The wording of the OECD model convention is not helpful in this respect. The positive list in article 5(2) starts with the words "[t]he term '*permanent establishment*' includes especially (emphasis added)". This wording alone indicates that the following list is a list of PEs notwithstanding article 5(1). The appropri-

84 Austria.
85 Chile, France, Ireland and Sweden.
86 Denmark.
87 India.
88 Belgium, inconsistent.
89 Sri Lanka.
90 USA.
91 Israel.
92 Norway.

ate wording should have been "[t]he term '*place of business*' includes especially (emphasis added)".

Many reports consider this issue of whether the positive list is a deeming provision solved by the OECD commentary, and the general consensus is that the examples in the positive list require the basic rule conditions to be met.[93] Thus, a branch for example is not a PE unless the taxpayer has a right of use to a fixed place of business through which a business activity is conducted. Furthermore, treaties based on the OECD model convention should be interpreted so that the positive list requires the basic rule conditions to be met,[94] unless a state has made an observation to the commentary in this respect.

Consistent with this view, the mere registration of a branch, which is required in some countries, is not sufficient for the constitution of a basic rule PE,[95] but it may serve as external evidence that some sort of establishment exists, together with a business address, etc.[96]

Non-members of the OECD may have a different position,[97] which is easy to understand in the light of the confusing wording of the OECD model convention as mentioned above.

If the positive list were a deeming provision, it would leave the basic rule relatively speaking worthless, because most practical examples of PEs are covered by the positive list. Moreover, it is difficult to explain why the treaty negotiators should want an enterprise that is using an office to have a PE from the first day, regardless of the duration and other conditions for a PE, while another enterprise which does not need an office, but uses other facilities not mentioned in the positive list, may escape taxation as a PE because the duration of the taxpayer's right of use to the place of business is too short.

2.5.2. The positive list is not exhaustive

It does not seem that the reports require that a place of business under article 5(1) is similar to any of the examples in the positive list (*ejusdem generis*).[98] Hence, the positive list may be seen as an illustration of what may constitute a PE if the other conditions in the basic rule are met,[99] but any other facility that meets the general definition in the basic rule may also constitute a PE.

2.5.3. The "place of management"

The positive list alternative "place of management" directly points to the activity performed through the place, i.e. "management" which is a place where *de facto* controlling and directive power is exercised.[100]

93 E.g. Korea and South Africa; different Switzerland.
94 France, the Netherlands, Norway, Russia, Uruguay and USA; different Switzerland.
95 *Con* Switzerland.
96 Argentina.
97 E.g. Serbia.
98 Possibly different Taiwan.
99 The Netherlands and USA.
100 India.

It is a general view in the reports that a place of management in terms of the positive list is different from the term "place of effective management" which is used by the OECD model convention to decide the residence of a company. Hence, a place of management does not have to be the centre of the management of the enterprise. It may refer to parts of the management of the enterprise, and an enterprise may therefore have more than one place of management. An enterprise can only have one place of effective management, but it may have several places of management.[101]

In order to find out whether a place of management exists, it is necessary to establish that a part of the management of the taxpayer is indeed conducted through the place of business.[102] Hence, if it is clear that a place of management exists, it can be assumed *a priori* that some conditions for a PE are met, i.e. the place of business test, the location test, the business activity test, and the business connection test. Thus, the remaining basic rule tests to be considered as far as the place of management is concerned are the duration test and the right of use test.

The place of management will normally be an office where business decisions on some level are made.[103] However, decisions of a solely technical or scientific nature will not qualify for this purpose.[104] The main effect of listing the place of management in the positive list is to establish that certain management activities different from those covered by the term "place of effective management" in article 4(3) of the OECD model convention may constitute a PE.[105]

Hence, a "place of management" in terms of the positive list is constituted if a part of the management of an enterprise, e.g. through a regional or local headquarters, is conducted through an office.[106] The normal activities of headquarters may be considered an auxiliary business activity.[107] The surprising decision by the Swedish Court of Appeals,[108] where strategic decisions regarding funding, sale, purchasing and leasing were not considered to constitute a place of management because no binding agreements in this respect were concluded, may be an example of the often seen confusion between an enterprise's place of management and the enterprise's place of effective management.

A case at the other end of the scale dealt with a company resident in Cyprus, with no employees of its own, which purchased management services from a company in Sweden, and was considered to have a PE in Sweden where the services were provided. This case seems to be inconsistent with other Swedish cases reported.[109]

2.5.4. The "branch"

The alternative "branch" does not give any information as to what kind of place of business, or location of that place, is required. This alternative also leaves open

101 France.
102 Cf. Russia.
103 Belgium, France, Taiwan and USA.
104 USA.
105 The Netherlands; cf. Czech Republic, South Africa and Venezuela.
106 Different France.
107 Belgium and France.
108 Sweden.
109 Sweden.

the issue of activities. This alternative in the positive list does not point to the nature of the activity at all. The activity may be a core business activity, or it may be an auxiliary or preparatory activity.[110] In fact, there may not be an activity at all, because the enterprise has chosen to register a branch either as a consequence of a statutory obligation or for other reasons, which may require a burden of proof if no activities are conducted there at all,[111] and may be taxed even if the conditions of the basic rule are not met.[112] However, as pointed out in some reports, the mere registration of a branch is not sufficient to meet the place of business or location test.

Under this alternative, all the basic rule conditions need to be considered in order to establish a PE. Hence, it is not very helpful to list a branch as a "PE", as it is neither *a priori* a "place of business" nor a business activity.

2.5.5. The "office"

The alternative "office" in the positive list points to the "place of business test". Normally, an office does not exist unless it is located in a building. Thus, it can be assumed that this positive list alternative *a priori* also meets the location test. However, all the other basic rule conditions have to be considered in relation to this alternative, in particular the business activity test and the business connection test.

2.5.6. Mines, oil or gas wells

With respect to places for extraction of natural resources, such as the positive list alternatives mine, oil or gas well, quarry or other places of extraction of natural resources it is clear that the examples are pointing to a core business activity (extraction), and if extraction activities are indeed conducted through these places a PE is constituted. If resources are found and the extraction (production) is commencing, this positive list alternative may constitute a PE.

2.5.7. Overlapping

Clearly, since the positive list alternatives omit different PE conditions, some of them may overlap. For example, in the alternative "place of management" it is required that the location test is met, while the office alternative requires the business activity test to be considered. If for example the activity performed through the office is a management activity, a place of management exists. An example mentioned in a report[113] is an office that controls and coordinates the accounting and reporting of subsidiaries or PEs, consolidates their annual financial statements, programmes, purchasing, production plans and performs other administrative related services. Such an office would be a place of management. Furthermore, it should also be considered a "branch".

[110] Venezuela.
[111] France.
[112] Romania.
[113] Germany.

2.6. The "right of use" test – is the place of business "at the disposal of"?

2.6.1. The issue

The question in this subsection deals with the issue of whether there is a requirement that the enterprise has some kind of legal right to use a particular place in order for that place to be considered as a place "through which the business of an enterprise is wholly or partly carried on".

Specifically, is it a fundamental requirement under the right of use test that the taxpayer's use of the facilities cannot be denied, withdrawn or removed without the consent of the taxpayer?

2.6.2. Is a legal right required?

In the view of some countries, the taxpayer needs to have some sort of legal right to dispose of the place of business.[114] However, there is a general consensus that no formal legal right to use the place is required.[115] On the other hand, the non-resident enterprise may under statutory requirements have to prove that it has a place of business at its disposal, in order to get a branch registered.[116]

The view of some countries is that factual use is enough,[117] but one report states explicitly that by factual use it means use that cannot be altered unilaterally by a third party.[118] Use of public areas without a proper permit is in some reports considered to comply with the right of use test.[119]

One country reports that the factual use of the place of business should be considered an additional condition for a PE, because if factual use is enough, the right of use test is superfluous,[120] which is logical. The extreme position that the right of use test is met when the six-month duration test is complied with is also reported.[121] Under any circumstances, it is recognized that the taxpayer's "control" (factually or legally) over the place of business is a factor when determining whether a PE exists.[122]

The mere use of public facilities in e.g. a hotel is reported not sufficient to meet the right of use test.[123]

The OECD commentary's reference to illegal use of the place of business causes confusion from a conceptual point of view.[124] Clearly, the "mere presence" at a place of business cannot constitute a PE, because there is a requirement that

114 Germany; cf. Austria.
115 Austria, Belgium, Canada, Czech Republic, Estonia, Germany, Ireland, Italy, Russia, Portugal, Poland, Spain, Sweden, Switzerland, Taiwan and Venezuela.
116 Romania.
117 Czech Republic, Portugal, Poland, South Africa and Sweden.
118 Belgium.
119 E.g. Estonia.
120 Estonia.
121 Czech Republic.
122 Estonia, South Africa and Spain.
123 UK and Canada.
124 E.g. India.

a business activity is performed,[125] e.g. the salesman who is taking orders and meeting with the purchasing director of the customer is doing business, and is not "merely" present in the facilities of the customer.

2.6.3. The "implied" legal right of use

The famous German *Hotel Manager* case from 1993[126] has been confirmed in more recent German cases, and is based on previous German case law. A UK management company took over the administration of a German hotel, which was operated by a German limited partnership. Pursuant to the contract between the management company and the limited partnership, which was concluded for a period of over 20 years, the general manager had the exclusive right to use the hotel, even though no specific room was available for the management activity. The German Supreme Court for tax cases held that a formal right to use a place of business is not required if the foreign entrepreneur is locally connected (*verwurzelt*) with the place where his business activity is carried out. Clearly, if the German limited partnership wanted to remove the UK manager from the facilities it used to manage the hotel, this removal would require consent by the manager.

Generally, any service provider must be considered to have a legally based access to the client's facilities if the service contract presupposes that he or she is going to render his or her services.[127]

The implied right of use test has been understood as a reduction of the requirements for a right of use to the place of business.[128] However, it may simply be a refinement of the right of use test. The German Supreme Court required for decades prior to the *Hotel Manager* case that the taxpayer's right of use could not be taken from the taxpayer (or amended) without the taxpayer's consent. The same rationale can be crystallized from the German *Service Provider* case in 2004.

Based on these principles, it should be concluded that the receipt of a service from a service provider that is using electronic equipment such as a server located in a particular country does not, unlike the view of some reporters, raise any questions under the right of use test. The non-resident is not using the server, but the service provider is. However, a question arises under the business activity test because the enterprise is doing business in the other country; the argument could be that it is simply purchasing a service from somebody in that country. Thus, the example from one report of a non-resident enterprise selling data stored at an addressable location on a server provided by a local telecommunication enterprise does not constitute a PE.

An example of the implied legal right of use is reported when a consulting firm provides services to a non-resident client and the employees of the client get to use office facilities in an open-plan office on a continuing long-term basis in

[125] Cf. Romania.
[126] Germany.
[127] Ireland and Romania.
[128] Germany.

order to receive the services from the consulting firm. Such a work station may constitute a PE of the client.[129]

2.6.4. The right of use test and home offices

A home office of a resident employee of a non-resident enterprise may qualify as a fixed place of business.[130]

The question will be, however, whether or not the resident employee's home office is at the employer's disposal.[131] Without any evidence to the contrary, the starting point must be that the private home of an employee is not at the disposal of the employer, even if the employee is doing some work at home.[132] This applies even more so if the residence is used only occasionally.[133] An employee's work at home does not meet the right of use test for the employer and does not therefore create a PE, unless specific requirements are met.

In the Canadian insurance cases,[134] the court considered a number of issues such as (a) what kind of activities the agents conducted at home, (b) the products kept at home, (c) visible signs, (d) the taxpayer's control over the agent, (e) expenses covered by the taxpayer and (f) the taxpayer's control over the premises, and concluded that the right of use test was not met. However, only (c) to (f) are particularly relevant with regard to the right of use, while (a) and (b) raise the issue of whether the business activity test is met.

Evidence that the employer has a right of use to the home office could be that the employer reimburses the employee's expenses for (a part of) the home,[135] or even more so has a key to the house or at least an agreement to have access to the residence of the employee.

2.6.5. The right of use test and tax transparent entities

Is a non-resident partner's share of income in a tax-transparent partnership subject to PE taxation?

In the case of a regular partnership, the common view is that the partnership's premises are at the disposal of the other partners, regardless of whether the non-resident partner is *de facto* using the premises, provided he or she earns a share of the partnership's profits.[136]

The same does not apply to a special purpose joint venture or a consortium (a "pool") formed by resident and non-resident enterprises. The legal right of use of one partner in an *ad hoc* joint venture does not necessarily affect the other partner, unless that partner also *de facto* uses the place.[137] Thus, it may be clear

129 Austria.
130 Australia, Denmark and Canada.
131 Luxembourg, Russia and Sweden.
132 Canada.
133 Denmark.
134 Canada.
135 Norway and Canada.
136 Canada, Japan, Luxembourg and Venezuela; cf. Korea.
137 The Netherlands.

that the premises of one member of the joint venture or pool arrangement are not at the disposal of the other members.[138] In such a case the conclusion should be that the right of use test is not met.

2.6.6. Other aspects of the right of use

It cannot be required that the enterprise has an exclusive right of use. Several enterprises may share a right of use to the same fixed place of business.[139] A distinction has to be made between a joint use of for example a server and joint purchasing of an internet service from a service provider.[140]

Evidence satisfying the right of use test can be a sign with the company's name which is placed outside the residence of the directors,[141] in the building's lobby, or when the taxpayer is using a letterhead or business card identifying the building as the taxpayer's address,[142] or otherwise communicated externally.[143] In such a case the place is associated with the enterprise, but the underlying issue still remains to be settled, viz. does the enterprise have a right to use these premises for its own business purposes? Hence, if no signs exist, this is an argument in favour of denying a right of use,[144] but the existence of signs does not prove that a right of use exists.

2.7. The "business activity" test – is the activity a business activity?

In order to constitute a PE, the place of business must serve a foreign taxpayer's business activity as opposed to other income-generating activities ("the business activity" test). The "mere presence" in a country is not sufficient.[145]

However, there is no requirement that a PE should be autonomous or independent of the head office.[146] The local business activity may be fully integrated into the activity of the head office.

The activity needs to be a business activity under (a) the laws of the country which applies the treaty, and (b) under the treaty itself.

2.7.1. What is a business activity under the treaty?

It is clear that the business of e.g. shipping in international traffic (article 8), owning and leasing out real estate (article 6) or intangibles (article 12) in another country may generate income.

In order to constitute a PE, the leasing out of property needs to qualify as a "business activity".[147] This goes partly to the nature of the activity, and partly to

138 Venezuela.
139 Denmark and Canada.
140 Finland.
141 UK and Denmark.
142 Belgium and Canada.
143 Sweden.
144 Canada.
145 E.g. Ireland.
146 France.
147 Australia and Italy.

the location of the activity. Despite the view expressed in some reports,[148] the treaty should be interpreted autonomously and not on the basis of domestic laws to decide whether a business activity is conducted "in" a country or not. Thus, although an installation in space is a "place of business", it is not "in" a country,[149] even if it serves a virtual shopping mall on a server located abroad and is used by customers in a particular country.

In addition to the leasing out, it is normally required that the non-resident is active in a more extensive way.[150] A ship owner who leases his fishing boat to a fishing enterprise is not conducting the fishing activities, but the leasing business.[151] The boat is the place of business, but it is the lessee and not the lessor who is carrying on business through the place of business.

Provision of personnel working under the control and responsibility of somebody else (hiring-out of labour) does not amount to a business activity of the providing company.[152] Recruiting, management, etc., are not carried on in the state where the employees are working. Consequently, the hiring-out of labour does not meet the business activity test. However, if recruiting employees, etc., is carried on in the state where the employees are hired out, the business activity test may be met.[153]

2.7.2. Is the business activity the taxpayer's business?

Often the answer to the question of whose business activity is conducted can be found by establishing whose personnel are operating through the place of business.[154] The business of a broker should not be confused with the business of the investor.[155] The provision of services by the broker may be core business for the broker, as distinguished from the fund's business, but this was not the outcome of the Swedish case. Since the broker managed the activities of the fund, the fund was considered to have a PE.

The question of whether a PE is constituted for an enterprise which has subcontracted a business activity to somebody else in another country is a question of whether or not the foreign enterprise is present in the other country and doing business there.

This issue arises in different variations.

The first situation is when a foreign enterprise A agrees with another enterprise B that a part of A's business shall be conducted by B, for example the manufacturing of a particular flavouring sauce[156] (contract manufacturing) to be delivered to A and used by A in its own business, or that B shall serve a client of A within the jurisdiction of B.[157] The famous *maquiladoras* are examples of this

148 E.g. Norway.
149 Germany.
150 Hungary.
151 Argentina.
152 Hungary; possibly *con* Czech Republic.
153 Austria.
154 UK.
155 Cf. Sweden.
156 Germany.
157 Israel.

category, and constitute PEs subject to a mutual agreement between Mexico and the USA.[158]

The conventional starting point has been that situations like these do not constitute a PE, even if the place of business is owned or rented by A and leased to B. The same applies to the mere purchase of services in another country.[159] However, if the business activity performed becomes a joint business activity conducted through B's place of business, a PE may be constituted.[160]

Another situation is when the foreign enterprise A concludes a contract with a customer in another country, and subcontracts the performance of the contract and delivery under the contract to B in that country. The starting point here too is that such a situation does not create a PE, because the foreign enterprise is not physically, only legally, present in the other country to perform a business activity. The reports have different views in this respect.[161]

2.7.3. "Core business" versus "preparatory or auxiliary" activities (the negative list)

Business activities that fall under the "negative list" are excluded from creating a PE. Only "core" business activities may constitute a PE. Auxiliary activities are of a different nature as compared to preparatory activities in the sense that the auxiliary activities accompany the core business activity while the preparatory activities precede the core activity.

The argument is made that the terms "preparatory" or "auxiliary" activities should be interpreted broadly.[162]

An activity is a core business activity if it constitutes a material and authoritative ("essential") part of the enterprise's entire activity,[163] regardless of whether it is conducted by employees, a body of the company such as the managing director, the owner of the enterprise, or automatic equipment.[164]

It can generally be concluded that sales activities, including sales solicitation, and any crucial support with respect to the sales of an enterprise, are considered core business activities.[165] However, if the decision to conclude a contract is made abroad, and somebody at the local place of business signs the contract as a formality, an argument can be made that the signing is an auxiliary activity.[166]

Moreover, manufacturing[167] and the management[168] of the enterprise are generally considered to be core business activities. Furthermore, the contributions with respect to organizing a transportation enterprise's business in a country (timetables, unloading, etc.) have also been considered core business.[169]

158 Mexico.
159 *Con* Czech Republic and Taiwan.
160 Norway and Hungary.
161 Russia and Japan; *con* Norway and Korea.
162 Belgium.
163 Germany and UK.
164 *Con* France.
165 Belgium, Canada, Poland and Spain.
166 Russia.
167 E.g. Taiwan.
168 UK and Switzerland.
169 Finland.

If the activities performed through the place of business are identical to the activities performed by the head office, a core business is often found,[170] but this test does not work in the rare cases when a special purpose vehicle has a "head" office which is only doing auxiliary activities.

Often the understanding of what should be considered to be sales is quite broad,[171] and may create many disputes.[172] Activities that imply solicitation of products and services will be considered core business activities, even if no contracts are concluded or orders received through the fixed place of business. Receiving orders is often evidence of a core business activity, even if the other activities alone would have qualified for exemption.[173]

A combination of marketing services and identification of business opportunities have been considered core business,[174] but this outcome may be disputed.

For e-commerce the argument has been made that a core business activity exists when it is possible for the customer to place the order and pay electronically.[175]

It is difficult to pinpoint the difference between core business and preparatory and auxiliary activities. However, distinguishing between "preparatory" and "auxiliary" is not necessary.

Whether "preparations" for a sale, such as advertising, are "preparatory" or "auxiliary" is irrelevant, since both are exempt. Nevertheless, a preparatory activity is for example the setting up of a place of business, including planning, supervision, advisory services, training of personnel, etc.[176] Thus, if the preparations are interrupted and no business activity is carried out, a PE is not constituted. It has been argued that the term "preparatory" means the same as "preliminary",[177] but the significance of this distinction is also unclear.

Activities carried out before the core business activity (promotion, advertising, market research, collecting information, etc.)[178] and after such activity (delivery, invoicing, collection of claims, service, etc.) will often be considered auxiliary.[179] However, also minor ongoing back office activities not directly related to pre-sales or after-sales situations may be considered auxiliary.[180]

Testing of machinery and other quality control functions are sometimes not considered to be core business,[181] presumably because the activities are not considered related to the sale of such machinery. The distinction between market research, which is auxiliary, and solicitation, which is a core activity,[182] may also be difficult in practice.[183] A liaison office performing activities such as "information dissemination" may be considered to perform auxiliary business

170 The Netherlands and UK.
171 Cf. Taiwan, Sri Lanka and USA.
172 Cf. Denmark.
173 Sri Lanka.
174 Israel.
175 Finland.
176 Poland.
177 India.
178 USA.
179 Australia.
180 Cf. India.
181 Taiwan.
182 USA.
183 Switzerland.

activities,[184] but this will naturally depend on the scope of activities in each case. Packaging and displaying goods may under the circumstances be accepted as preparatory or auxiliary activities.[185]

The attempt to define "preparatory or auxiliary" as "sporadically and accidentally"[186] does not solve the problem entirely. Whether the activities give rise to substantial profits[187] is also a difficult argument to use in relation to the constitution of a PE. Although not convincing to this general reporter, auxiliary activities have been explained as activities that are not measurable and too remote from the profits of the enterprise to allow an allocation of income to it.[188]

The activities listed in the negative list, e.g. storage, display and delivery of goods or merchandise, are non-PE constituting activities if the place of business is used for these purposes by the enterprise itself. Hence, if the enterprise is providing services that are normally considered auxiliary, e.g. research, to third parties, these activities constitute a core business activity for the service provider, and may qualify as a PE.[189] A famous example is the German *Pipeline* decision.[190] Moreover, a core business has also been reported where collecting of information is an essential and material part of the business in relation to third parties.[191] Thus, auxiliary activities are performed for the head office only.

A distinction should be made between extraction of natural resources (oil, natural gas, etc.) for own (or somebody else's purpose) on the one side, and exploration activities for own purposes on the other side. Exploration for own purposes should be considered a preparatory or auxiliary activity with the consequence that no PE exists under treaties based upon the OECD model convention. However, exploration carried out for third parties qualifies as a core business activity (for the party carrying out the exploration, but of course not for the other party).

Although collection of a non-resident's receivables created by its own business is normally considered auxiliary, the opposite conclusion should be reached if the non-resident is purchasing receivables for collection.[192]

Another example of auxiliary activities is collection of information.[193] However, analysis, producing articles, translations, editing, or similar activities based on the information may be considered core business for a newspaper.[194]

Furthermore, performing exploration services for a foreign head office has been considered auxiliary.[195]

Moreover, it has been reported that activities which imply contact with customers concerning technical support have been considered auxiliary.[196]

184 India.
185 The Netherlands.
186 Mexico.
187 Australia.
188 Poland.
189 Belgium, Germany, Hungary, Poland and Russia.
190 Germany.
191 Korea.
192 Italy.
193 Finland.
194 Germany.
195 Cf. the Netherlands.
196 Finland.

Receiving and forwarding mail on behalf of an enterprise abroad is obviously not a core business activity.[197] Normally, no core business activity is conducted if the taxpayer is only renting an office in which he receives services such as the forwarding of messages, answering of telephone calls, etc.[198]

Purchasing of goods is an auxiliary activity, but of course not if the activity is combined with core business.[199]

The use of premises as social facilities, rest rooms or living quarters for employees in general does not meet the business activity test,[200] unless the provision of these services to other enterprises is the core business of the taxpayer. The provision of services like these to own employees cannot be considered an auxiliary business activity. Hence, such facilities cannot be considered to be a place where the "business" of the enterprise is carried on.

It has been reported that the volume of auxiliary business activities carried on through a fixed place of business has been considered relative to the volume of core business activities carried out outside the place of business, but within the same jurisdiction,[201] but such a view is also disputable.

It has long been accepted that a business activity that is not profitable *per se* may still constitute a PE and be allocated income,[202] based on the arm's length price of the services rendered. Furthermore, rendering of services similar to the core business of the enterprise but for promotional reasons to its domestic customers abroad may be considered a core business.[203]

Any combination of auxiliary activities does not amount to a core business activity.[204] A combination with a core business activity may constitute a PE, even if the core activity is performed outside the place of business (but within the same jurisdiction).

2.8. The "business connection" test – is the business conducted "through" the place of business?

2.8.1. The issue

The place of business which is at the taxpayer's disposal must serve (be "connected to") the business activity of the taxpayer, i.e. the business activity must be performed "through" the place of business. The word "through" has led to a discussion in some countries whether "through" means the same as "in" and "at". It seems that these terms are interchangeable in this respect.[205]

197 Belgium and Sweden.
198 Switzerland (addendum).
199 The Netherlands.
200 Austria.
201 Austria.
202 Italy.
203 Italy.
204 Canada.
205 E.g. India.

2.8.2. Same or different business activities?

An issue that is solved in different ways is whether a part of the taxpayer's business activity can be excluded from PE taxation if it is not carried on through the place of business. The normal position is that only a different (unrelated) business should be excluded. Repairing lighters and selling accessories was not considered a part of the business of selling lighters, and submitting spare parts to related entities for resale was solved in the same way,[206] but a related fact pattern has led to other conclusions in other countries.[207]

In the Hungarian Supreme Court's warehousing case the issue was whether also sales activities could be considered performed through the place of business in Hungary (a warehouse).[208] Although the sales were solicited and concluded by the head office outside Hungary, the invoices were issued by the branch, and the branch made a profit based on the deliveries (not only a profit for providing warehousing services). The Supreme Court concluded that the warehouse was a PE, because core business activities were performed there.

2.8.3. Preparatory and auxiliary activities through a place of business

Of course, an office does not constitute a PE if it is only serving auxiliary business activities in a country. In order to meet the business connection test, the office must somehow serve core business activities.

It can clearly not be required that the entire core business is carried out through the place of business;[209] it is not always required that a core business activity is carried out through the place of business at all.[210] The rationale of this practice is that it is sufficient for the business connection test that an auxiliary business activity is carried on through a place of business, and a core business activity, which is supported by the auxiliary activity, is carried on within the same jurisdiction (but outside the place of business). For example, sales activities are conducted outside the place of business, while display of the goods, or delivery of goods, takes place through the place of business. In such cases, the business connection test would normally be met.

Accounting, reporting and consolidating of annual financial statements as mentioned above should be considered auxiliary, and if these are the only activities performed in the country, no PE is constituted. However, developing purchase and production plans could be considered core management activities that constituted a PE.

A borderline case is the German decision concerning an export service agent for whom the court decided that he maintained a PE in his local office despite the fact that the essential parts of the contracts were concluded abroad.[211] In the

206 Canada.
207 Finland.
208 Hungary.
209 Italy and Norway.
210 Inconsistent Norway.
211 Germany.

agent's office, the contracts were confirmed, the accounting was centralized and the commission fees were calculated and paid.

It has been reported that the business activities conducted through the place of business do not have to be substantial if the activities outside the place, but within the same jurisdiction, are substantial.[212] Hence, the business connection test may be met if a sales agent has a home office through which auxiliary business activities are performed, if the home office qualifies under the other basic rule conditions, including the right of use test.

3. The special rule for construction sites in paragraph 3 of article 5 OECD model (the "construction clause")

[Sections 3–7 are by Jacques Sasseville]

Paragraph 3 of article 5 OECD model provides that "[a] building site or construction or installation project constitutes a PE only if it lasts more than twelve months". There are a few significant drafting differences in the equivalent provision of the UN model, which provides that "[t]he term 'permanent establishment' *also encompasses … a*) a building site*, a construction, assembly or installation project or supervisory activities in connection therewith*, *but only if such site, project or activities last more than six months, b) [service PE rule]*".

The interpretative guidance on the "construction clause" that is referred to in the branch reports follows to a large extent the interpretations in paragraphs 16 to 20 of the OECD commentary (some countries have expressly incorporated parts of these paragraphs in official explanatory documents related to treaties, in protocols to treaties and even in domestic law).[213]

3.1. An exception and deeming provision?

The first interpretation issue that arises from the construction clause is whether the rule can create a PE where none would otherwise exist (the "deeming effect").

It seems clear that the clause has an "exception effect" that will prevent a construction site that lasts less than the stipulated period of time from constituting a PE, regardless of whether or not it would constitute a PE under the basic rule. This "exception effect" derives quite naturally from the words "only if", which are found in both models.

The "deeming effect", however, is more controversial. There are two main practical aspects to this question. The first relates to the inclusion of the phrase "or construction or installation project" in the English version of the OECD rule.[214]

[212] Germany and the Netherlands.

[213] See Romania and Russia.

[214] Note, however, that the French version of the OECD model does not include any reference to a project and refers only to a *chantier* ("[un] chantier de construction ou de montage").

Assume, for example, that an installation project (e.g. the installation of ten telecommunication antennas) is completed on different sites that are far apart and do not have geographical coherence; assume further that each site lasts 2 months but that the project is carried out over a total period of 20 months. While it seems clear that, since the various sites do not have geographical coherence, there is no PE under the basic PE rule, the question is whether the construction clause of the OECD model will result in a PE because there is a single "installation project" that lasts more than 12 months[215] (the issue would not be a practical one under the UN model as subparagraph 3(b) would probably deem a PE to exist).

The second practical aspect relates to the more general issue of the extent to which business carried on through subcontractors at a particular location can be considered to be business of the main contractor. Branch reports reveal that there is general acceptance of the view, reflected in paragraph 19 of the OECD commentary, that the work of subcontractors may be allocated to the main contractor for the purposes of determining the existence of a PE of the latter under the construction clause (see below). If the construction clause, which does not refer to subcontractors, has the effect of adding a time condition applicable to some PEs, this suggests that the analysis of paragraph 19 simply reflects how the basic PE rule applies with respect to subcontractors.

The wording of the construction clause found in the OECD model is certainly not typical of a deeming provision.[216] Also, in the 1963 OECD draft convention, the construction clause was included in the positive list of paragraph 2, a practice that is still followed in many treaties, including all the treaties concluded by Italy.

The different wording of the UN model, however, strongly suggests that the clause has a deeming effect in that model. The UN model uses the phrase "also encompasses" and since subparagraph 3(b) of article 5 of the UN model (the service PE provision) clearly extends the PE definition, the same should be expected from the construction clause in subparagraph (a).

While the branch reports that have dealt with this issue have generally recognized the "exception effect" of the construction clause, no clear conclusion emerged from the branch reports as to whether or not the OECD construction clause had a deeming effect. As expected, branch reports from countries that tend to use the UN model version of the rule generally found it easier to recognize a "deeming effect".[217] Branch reports from countries that favour the OECD model version, however, revealed mixed views.[218]

3.2. Activities covered by the construction clause

The branch reports generally support the broad interpretation of the words "building", "construction" and "installation" that is given in paragraph 17 of the OECD commentary and according to which the construction clause covers activities such as the construction of roads, renovation (going beyond mere maintenance and decoration), dredging, laying of pipelines and installation of machinery or equipment in existing buildings not related to a new construction.

[215] See the discussion under section 3.3 below; see also para. 20 of the OECD commentary.
[216] Compare, for instance, with the wording of the agency PE rule.
[217] See South Africa.
[218] See Austria, Germany, Ireland and the United Kingdom.

For example, Austria's branch report refers to a number of rulings that confirm that demolition, dismantling a factory for the purposes of moving it to another location and the construction of a pipeline are covered and that no distinction should be made between the construction of a new building and the renovation of an existing building; Poland's branch report refers to a decision according to which the renovation of a sewage system is covered; the Netherlands' branch report refers to a court decision confirming that dredging is covered and Denmark's branch report refers to a ruling according to which the laying of a cable is covered.

The Czech Republic's branch report refers to an interpretation by the Ministry of Finance according to which, contrary to the view expressed in paragraph 17 of the OECD commentary, an installation project should be restricted to installation or assembly work which is related to construction activities. There is, however, substantial guidance in other reports supporting the commentary's position on this issue, including in branch reports from Belgium, Canada and Japan.

There is also guidance confirming that activities related to oil exploration and extraction (as opposed to the construction and installation of oil rigs) are not covered (Denmark's and Norway's branch reports). The special situation of the United States, however, should be noted since the construction clause found in the United States model and in many of its treaties expressly includes "an installation or drilling rig or ship used for the exploration of natural resources".

One issue that is dealt with in many reports and on which there is less conformity with the views currently expressed in the OECD commentary is the application of the construction clause to on-site planning and supervision. Supervision activities are expressly referred to in the UN version of the construction clause but not in the OECD version. While paragraph 17 of the OECD commentary currently indicates that "on-site planning and supervision are covered", this conclusion, adopted in 2003, differs from the view previously expressed, according to which a distinction had to be made between planning and supervision carried out by the building contractor (covered by the construction clause) and such activities carried out by another enterprise that did not carry out other activities with respect to the particular site (not covered). Some branch reports refer to guidance that endorses the position put forward in the pre-2003 OECD commentary (Australia in an explanatory memorandum to a treaty, a court decision in the Netherlands and the PE circular in Germany); Belgium's branch report refers to a court decision that suggests that Belgium goes further and would generally exclude supervision activities from the construction clause even if carried out by the general contractor.

3.3. The geographical meaning of "site" and "project"

Paragraphs 18 and 20 of the OECD commentary deal with the geographical interpretation of the concepts of "site" and "project". While the branch reports generally indicate support for the interpretation that a site must be a "coherent whole commercially and geographically" (paragraph 18) and that a single site or project exists when construction activities must be relocated as a project progresses, as for the construction of a road or the laying of a pipeline (paragraph 20), different views are expressed as regards a "project" that takes place at different locations

in a country (e.g. the example in the last two sentences of paragraph 20, which were only added in 2003).

The US branch report indicates that in the Senate Foreign Relations Committee Report to the 1963 Protocol to the USA–Sweden treaty the view was expressed that the construction of 12 gasoline stations, spread out over a long distance on a highway, could be one project. Austria's branch report refers to a ruling in which it was held that the work of a carpenter refurbishing the cabins of yachts and passenger cruise vessels executing his work on different vessels in the same harbour could also be one project. Germany's branch report refers to a number of decisions confirming the view that both geographical and commercial coherence is required. It explains that a previous administrative interpretation that proposed a definition of a single site based on a 50 km radius had been rejected by the courts. It also gives the example of the building up of a radio or computer network as a case where different sites can be combined to be considered an entire project.

3.4. Computation of the required period of time

Paragraphs 18 to 19(1) of the OECD commentary deal with a number of issues that may arise in the computation of the period of time referred to in the construction clause.

Again, the guidance referred to in the branch reports generally supports the interpretations included in these paragraphs. The commentary's view that the site exists from the date on which the contractor begins his work (including preparatory work, e.g. installation of a planning office for the construction) is echoed in the guidance referred to in many reports.

The commentary's general interpretation to the effect that a site continues to exist until work is completed or abandoned is supported by the guidance found in a number of reports (e.g. Poland, Austria and Belgium).

Branch reports include relatively little guidance concerning temporary interruptions (this is dealt with in paragraph 19 of the OECD commentary) although Germany's branch report refers to a decision that modified that country's approach as regards temporary interruptions.

A number of reports include guidance on the issue of contract-splitting which is discussed in the last part of paragraph 18 of the commentary: these include the reports from Belgium, Spain and Norway which refer to decisions that have dealt with the combination of different contracts for the purposes of the application of the construction clause.

Paragraph 19 of the OECD commentary indicates that where a main contractor subcontracts parts of a project, "the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor" and goes on to say that the subcontractor has a PE if his activities on the site last more than 12 months. The guidance on this issue that is referred to in the reports generally endorses that interpretation. It should be noted, however, that while the OECD commentary deals with the case of the general contractor who subcontracts parts of a project it does not directly address the situation where the general contractor's employees do not carry on any activity on the site. Australia's report refers to a ruling where the Australian tax authorities took the

position that a foreign company had a PE in such a case involving installation work since it bore the ultimate legal responsibility and risk for the construction and installation project. In their PE circular, the German tax authorities have taken the position that if the whole construction work is subcontracted and no supervision is carried out, there is no PE for the general contractor (although the report notes that German decisions have held that the activity of a subcontractor has to be considered as the activity of the general entrepreneur).[219] That position may explain the ongoing case involving the German and Hungarian tax authorities that is referred to in Hungary's branch report. The case concerns a German company which concluded a contract for the construction of a plant in Hungary and subcontracted the construction work to a Hungarian company and the supervision of that work to other companies. While the Hungarian tax authorities confirmed the existence of a PE, the German tax authorities are said to have taken a different position, arguing that the German main contractor did not have a PE in Hungary since all the construction activities had been subcontracted.

Finally, two reports (Chile and the Czech Republic) refer to a surprising interpretation of the construction clause according to which a PE would only be considered to exist for the period subsequent to the expiry of the required duration. Spain's branch report, however, refers to a decision which reached the more logical conclusion that a PE exists from the date of the beginning of the work.

4. The "agency PE" rule

Paragraph 5 of the PE definition found in the OECD and UN models[220] includes the "agency PE" rule while paragraph 6 of the OECD model (which corresponds to paragraph 7 of the UN model) includes an exception applicable to certain independent agents. There are, however, some important differences between these OECD and UN rules.

The branch reports show that the agency PE rule raises a number of interpretative issues. While many of those are dealt with in paragraphs 31 to 39 of the OECD commentary, to which a number of reports have referred, the commentary leaves room for interpretation on some issues and does not address others. It is also clear from the cases referred to in the branch reports that the application of the agency PE rule is highly dependent on the facts of each case.

4.1. A deeming rule

The wording of the agency PE rule makes it clear that it is a rule that deems a PE to exist with respect to activities of an enterprise that would not otherwise be attributed to a PE as defined under the basic PE rule ("that enterprise shall be deemed to have a permanent establishment"). As explained in paragraph 35

[219] The Netherlands' branch report indicates that the Dutch Supreme Court has expressed a similar opinion.

[220] Para. 6 of the UN model also includes a special rule applicable to insurance enterprises which can be seen as an extension of the agency PE rule. That rule is discussed under section 5 below.

of the OECD commentary, this rule is therefore an alternative to the basic PE rule and if a PE already exists under the basic PE rule the agency PE rule is irrelevant.

Under the agency PE rule, the enterprise is deemed to have a PE "in respect of *any* activities which that person undertakes for the enterprise" (emphasis added). Paragraph 35 of the OECD commentary confirms that the activities that will therefore be attributed to the deemed PE are not restricted to the activities related to the conclusion of contracts in the name of the foreign enterprise.[221] While a number of branch reports have loosely described the agency PE rule as a rule that makes the agent a PE of the foreign enterprise, particularly in the case of subsidiaries, this does not correspond to the wording of the rule.

4.2. Persons with respect to whom paragraph 5 applies

The main condition for the existence of a deemed agency PE is that a person has and regularly exercises an authority to conclude contracts in the name of a foreign enterprise. Since such a person concluding contracts in the name of a foreign enterprise would normally correspond to an agent under the relevant commercial law, a PE deemed to exist under paragraph 5 is colloquially referred to as an "agency PE" even though, strictly speaking, the paragraph does not expressly require that the person be an agent. This point must be kept in mind when dealing with the UN version of the rule since the part of the UN rule that applies to a person who maintains a stock of goods or merchandise for delivery could conceivably apply to a person who would not constitute an agent under the relevant agency law.

As indicated in some reports, the person referred to in the agency PE rule may be an individual or a company and would include, but would not be restricted to, employees.

One issue that is raised in a few branch reports is whether that person and the foreign enterprise must be different persons or, in other words, whether an agency PE may be found to exist in the case of an enterprise carried on as a sole proprietorship by reason of the activities of the sole proprietor himself. The majority view that emerges from the branch reports is that an agency PE could not be found in such a case. This is supported by court decisions referred to in the reports from Austria, Germany and Italy. The view is also shared by the Belgian and Korean reporters.

Germany's branch report similarly addresses the issue of whether the activities of a director of a company can trigger an agency PE for the company. It refers to some conflicting decisions on that issue. According to the Austrian branch report, however, a director of a company working in an employment relationship could trigger the application of the agency PE rule.

Another issue that is dealt with in some reports is whether the activities of a partner may trigger an agency PE rule for the other partners. Germany's branch

[221] The agency PE rule of the OECD model does not apply, however, if all the activities of the person to which para. 5 applies, including the conclusion of contracts in the name of that enterprise, do not go beyond the list of activities included in the negative list of para. 4.

report makes the point that while a partner of a partnership does not automatically qualify as an agent of the other partners, if the partnership itself is found to have an agency PE, each partner will be considered to have a PE for purposes of taxation of his share of the business profits derived by the partnership. A similar view is expressed by the reporters for Luxembourg and Austria.

Paragraph 32 OECD commentary provides that the relevant persons "need not be residents of, nor have a place of business in, the State in which they act for the enterprise". Austria's branch report refers to a ruling that confirms that view.

4.3. The authority to conclude contracts in the name of the enterprise

The key condition for the application of the agency PE rule of the OECD model is that the person who acts locally for the foreign enterprise must have and habitually exercises an "authority to conclude contracts in the name of the enterprise".

Paragraph 33 of the OECD commentary provides that

> "[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 guidance that is referred to in the branch reports supports the conclusion that an agency PE may be found even where the agent does not formally conclude the contract and that no formal granting of a power of representation is required: see, for instance, the branch reports for Austria, Finland, Korea, Sweden, Belgium, the Netherlands, Denmark and Germany.

An important issue that is discussed in many reports is the exact meaning of the phrase "in the name of". As explained in section 4.5 below, this issue is crucial in analysing commissionnaire arrangements.

Belgium's branch report suggests that the words "in the name of" refer to the civil concept of direct representation. The administrative guidance referred to in the United Kingdom's branch report similarly suggests that differences in the agency law of common law and civil law jurisdictions may affect how the agency PE rule will apply in these jurisdictions. According to that administrative guidance, unlike civil law jurisdictions that recognize the distinction between direct and indirect representation, the agency law of common law jurisdictions would normally consider that a foreign principal was bound by a contract concluded by an agent acting on behalf of the principal and authorized to do so. The United Kingdom administrative statement goes on to explain that this would be the case even if the agent literally signed its own name on the contract; the guidance notes that to the extent that the principal would legally be bound under agency law, an agency PE could therefore be found to exist in such a case (which confirms the statement included in paragraph 32(1) OECD commentary).

A different view, however, is expressed in some reports that suggest that the phrase "in the name of" could refer to situations where the principal is economically, even if not legally, bound by the contract. For example, South Africa's

reporter indicates (without referring to any specific guidance on this issue) that if "the agent is legally bound to the client and the principal contracts to indemnify the agent it is submitted that the contracts are concluded in the name of the principal because the principal is economically bound to the client" (see also the various references included in section 4.5 below).

Paragraph 33 OECD commentary provides that "[t]he authority to conclude contracts must cover contracts relating to operations which constitute the business proper of the enterprise". France's branch report refers to a court decision[222] that provides an interesting illustration of the application of that statement. The decision dealt with a Swiss company that was engaged in the business of renting vacation houses on behalf of their owners and which solicited and obtained mandates from various property owners for that purpose. The Swiss company had a French subsidiary which was a real-estate agent and dealt with the clients to whom the houses were rented. Among various activities, that subsidiary executed the rental agreements with the clients, assisted them and cleaned and maintained the houses. While the court found that the French subsidiary was not independent from its Swiss parent, it held that there was no agency PE since the contracts concluded by the subsidiary with the clients who rented the houses did not belong to the business proper of the parent, which was involved in the search and negotiation of mandates from various owners to rent out these houses.

The branch reports include some guidance on the meaning of "habitually exercises": see, for example, the branch reports from Korea, Norway, the Netherlands and Austria. Germany's branch report indicates that in Germany a certain degree of permanence is an essential element of an agency PE (especially if the agent is not resident of and has no business installations in the country) and notes that as a guideline, a period of six months has been found applicable.

Many cases referred to in the branch reports did not address specifically the preceding interpretative issues but focused on the very factual question of whether, in a given set of circumstances, it could be considered that an agent had exercised an authority to conclude contracts in the name of the foreign enterprise. One case related to the interpretation of the phrase "exercises an authority to conclude contracts in the name of the enterprise" that deserves special attention, however, is the *Philip Morris* decision, which is referred to in Italy's branch report. In that decision it was held that the participation of officers or representatives of an Italian subsidiary in the negotiation or conclusion of contracts, even without a formal power of representation, indicated an authority to conclude contracts in the name of the foreign members of the group. As noted in the report, however, paragraph 33 OECD commentary was amended after that decision to clarify that while participation in the negotiations might be a relevant fact in trying to establish whether a person has exercised an authority to conclude contracts, it was not sufficient in itself to conclude that this is the case.

[222] *Interhome*, CE no. 224.407 (20 June 2003).

4.4. The independent agent exception

4.4.1. Meaning of "agent of an independent status"

The main practical issue related to the application of the exception included in paragraph 6 of the PE definition of the OECD model (paragraph 7 in the UN model) is whether an agent qualifies as "any other agent of an independent status".

The branch reports include considerable guidance on the interpretation of the concept of independence.

For instance, a number of branch reports have discussed the importance, in determining whether an agent is independent, of whether or not the agent acts exclusively for one principal. The general view that emerges from the reports that have addressed that issue is that exclusivity would be a very important factor in determining whether or not an agent is independent. The decision of *Taisei Fire and Marine Insurance Co.*,[223] which is referred to in the US branch report, provides a good illustration. Court decisions and rulings that suggest that the fact that an agent acts exclusively for one principal is a sign of dependence are also referred to in the branch reports for the Netherlands, India, Austria, Italy, France and Spain.

Paragraph 38(6) OECD commentary puts forward the view that while exclusivity is an important factor, "this fact is not by itself determinative". Canada's branch report refers extensively to a recent court decision that supports that view. That case dealt with a US insurance company that sold insurance in Canada through a network of sales representatives. In its decision the court relied on a number of factors in order to conclude that the representatives had independent status notwithstanding the fact that these representatives were all acting exclusively for the US company.

One specific area where the issue of independence seems to have arisen in practice is the situation of fund managers who manage locally investment assets of foreign funds. Guidance on this issue includes the following:[224]

- Ireland's branch report refers to domestic legislation that has been adopted in order to clarify the circumstances in which an Irish agent performing management activities with respect to financial trade would be considered an independent agent for the purposes of domestic law.
- Japan's branch report refers to a list produced by the tax administration that includes four different factors that will be examined to decide whether a Japanese fund manager may be considered independent from the fund for which the manager acts.
- Sweden's branch report refers to a ruling where a Finnish insurance company concluded an agreement with a Swedish group company for that company to manage the Finnish company assets in Sweden. The ruling found that since the Swedish company would carry on its activities under the same conditions as those applicable to external parties used by the Finnish

[223] 104 TC 535 (1995).

[224] Australia's branch report raises the issue but does not refer to any guidance, saying that the issue is "currently open to discussion and debate in Australia".

company, it would be acting as an independent agent acting in the ordinary course of its business.

As is the case for the question of whether a person has habitually exercised an authority to conclude contracts, the issue of whether an agent is independent is essentially a factual determination and a number of cases dealing with that issue are referred to in the branch reports.

4.4.2. Acting in the ordinary course of their business

A number of branch reports include guidance on the second condition required for the application of the "independent agent" exception, i.e. that the agents referred to in that exception be "acting in the ordinary course of their business".

Austria's branch report refers to a few rulings suggesting that, in determining what is the "ordinary course" of the business of an agent, reference should be made to the ordinary business of agents of the same or similar type, which is the suggestion made in paragraph 38(8) OECD commentary. Germany's branch report similarly refers to decisions that support the view that what is the "ordinary course of business" of an agent must be determined by comparison with the activities of an agent of the same branch of business or profession as understood in the marketplace; it also refers to decisions where the courts have asked for a report of the Chamber of Industry and Commerce on this issue. The Netherlands' branch report also cites two Supreme Court decisions as supporting the view that whether certain activities are performed in the ordinary course of business must be analysed "from the perspective of the industry segment in which the representative operates".

On the other hand, Russia's branch report refers to an interpretation of the tax authorities according to which if the income from agency activities constitutes the main income of a person, this may indicate that the person is acting in the main course of its business. The US decision in *Taisei*[225] would also suggest that one should look at the business activities of the agent itself to determine what is the "ordinary course" of its own business.

4.5. Commissionnaire arrangements

In the past few years, the agency PE rule has received a lot of attention in relation to so-called "commissionnaire"[226] arrangements and some branch reports referred to guidance related to such arrangements.

Detailed guidance on this issue is found in a circular of the federal tax administration that is extensively reviewed in Switzerland's branch report. The circular refers to various arrangements where sales related functions and risks in an international group are centralized within a single company (the "principal company") and where various local entities sell goods in their own name but on account of the principal company as agents (commissionnaire). The circular takes the position that "such distribution companies are to be qualified as

[225] Above, note 222.

[226] The term "commissionaire" is only used in the French version of para. 6 OECD model. The equivalent term in the English version is "commission agent", which appears broader.

PEs for the principal company" according to the agency PE rule of the OECD model. The report goes on to suggest that the circular adopt the views that "the PE qualification does not require that the actions of the agent legally bind the foreign principal" and "takes a strictly economic viewpoint whereby an Agency PE is deemed where the economic risks and benefits are with the Principal Company".

France's branch report discusses extensively the issue of commissionnaire arrangements in light of a recent court decision, *Zimmer Ltd*,[227] which was still under appeal at the time this report was drafted. That case concerned a UK company that had transformed its French subsidiary from a buy–sell distributor to a commissionnaire. In its decision, the court found that even though a commissionnaire, under French law, does not legally bind the foreign principal since it is a form of indirect representation agent, there was an agency PE since

> "the circumstance whereby Zimmer SAS, owing to its status as [commissionaire], acted in its own name and could not therefore effectively conclude contracts in the name of its principal is without effect on the power of that company to bind its principal in commercial transactions pertaining to the said principal's own activities…"

Other guidance on commissionnaire arrangements may be found in the branch reports from Austria, Belgium, Mexico and the United Kingdom.

5. The rule concerning related companies (paragraph 7 of article 5 OECD model)

Paragraph 7 of the OECD model, which is identical to paragraph 8 of the UN model, provides

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

A similar rule was already found in the Mexico (1943) and London (1946) models and the commentary to these models indicated that the rule "follow[ed] the principle that a subsidiary constitutes a distinct legal entity and should therefore be taxed separately". The original need for such a rule is indirectly provided by Germany's branch report which indicates that until 1934 a subsidiary was automatically considered to be a PE under German law.

The branch reports contain little guidance that deals directly with the interpretation of the provision itself. This is not surprising as few countries, if any, would

[227] Paris Administrative Court of Appeal, no. 05PA02361 (2 February 2007). The report also refers to comments on this issue made by the advocate general in *Interhome*.

take the position that a subsidiary was automatically a PE of its parent (or vice versa).

A number of reports have endorsed the guidance found in paragraphs 40 to 42[228] of the OECD commentary and, in particular, the statement found in paragraph 41(1) according to which the determination of the existence of a PE must be done separately for each company of a group.

In discussing this final part of the PE definition dealing with related companies, many reports have addressed issues related to a parent–subsidiary relationship that are not addressed by that paragraph. The best example is Italy's branch report, which discusses the *Philip Morris* decision. This decision, however, does not directly deal with the last paragraph of the PE definition but, rather, with the issue of whether the activities carried on by the subsidiary could create a PE. While there is little doubt that the interpretative principles formulated by the court, and in particular, the reference to a company being "deemed to be a multiple PE of foreign companies belonging to the same group", are difficult to reconcile with the generally agreed interpretations of the PE article, it should be noted that the court did not rule that the subsidiary was a PE simply because of its status as a subsidiary but rather because of the activities that it carried on for other related companies. As such the facts of the case are reminiscent of those of a few other cases in which PEs were found by other courts, e.g. in agency, cost-tolling or excessive control situations (see below).

Other parent–subsidiary relationship issues that are addressed in the reports but are not related to paragraph 7 of the PE definition include:

- cases where the separate legal existence of a subsidiary is disregarded (the US branch report correctly notes that the case law dealing with shell or sham companies that are disregarded is beyond the scope of this topic);
- cost-tolling arrangements;
- effect of the agency PE rule (a number of reports have referred to the parent–subsidiary relationship in relation to the issue of independence for the purpose of the agency PE rule; see, for instance, the branch reports from Austria, India, Korea, Romania, Sweden and the United States);
- place of management PE;
- partnership or joint venture arrangements between parent and subsidiary.

6. Interpretation of common variations of the PE definition

The PE definition found in the UN model differs from that found in the OECD model in a number of ways. The UN model also differs from the OECD model through its use of the concept of "fixed base", which the OECD model abandoned in 2000 noting that "there were no intended differences between the concepts of permanent establishment … and fixed base".[229]

[228] See, in particular, the *Pioneer* decision referred to in Mexico's branch report and ruling DD7/033-227-ML/06/446 (29 February 2007, referred to in Poland's branch report).

[229] Para. 1(1) of the OECD commentary.

A number of other common variations are also found in bilateral treaties. These primarily include rules that deem the use of "substantial equipment" to constitute a PE (substantial equipment PE rule) and rules that deem activities carried on in relation to offshore exploration or extraction of natural resources to constitute a PE (offshore PE rule).

There is relatively little guidance available on the interpretation of these variations. The commentary of the UN model includes some explanations, often focusing on the different views expressed by experts from developed and developing countries.[230] The following provides a summary of the additional interpretative guidance on these variations[231] that can be found in the branch reports.

6.1. The service PE rule

Paragraph 3 of article 5 of the UN model includes an additional type of PE by providing that:

> "The term 'permanent establishment' also encompasses …
> b) the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve-month period."

When discussing this service PE rule, a number of branch reports have referred to the variation of that rule that has recently been added to the commentary on article 5 of the OECD model.[232]

Chile's, the Czech Republic's and India's branch reports note that the service PE rule, with some variations, is a feature of many (all, for Chile) treaties concluded by these countries but that the usual omission of the "same or connected projects" requirement has the effect of giving it a much wider scope.

Chile's branch report refers to the guidance deriving from some rulings. For instance, it suggests, based on ruling no. 2521 (2007), that the provision would not prevent a PE from existing under the general rule of paragraph 1 even if the time condition for the service PE rule was not met (e.g. in the case of services of a recurrent nature). The report also indicates that one of the rulings indicates that activities performed by subcontractors may be included. That conclusion, however, was based on the specific wording of the provision which included a rule regarding contract splitting by associated companies.[233]

The Czech Republic's branch report refers to two conflicting views as to the relationship between the service PE rule and the basic PE rule:[234] the first view considers that the service PE rule is a deeming rule while the second view would

[230] See, for example, paras. 6, 8, 10, 13, 17, 18 and 27 of the commentary on art. 5 of the UN model.

[231] The section does not cover, however, variations that have already been discussed above (e.g. the different drafting of the construction clause and the agency PE rule in the UN model).

[232] Para. 42(23) of the commentary. Guidance on how that rule should be interpreted is found in paras. 42(24) to 42(48) of the commentary.

[233] Ruling no. 2890 (2005).

[234] The report also notes that no judicial decision has yet been rendered on this issue.

reduce its role to that of an exception to the basic rule on the assumption that the basic PE rule could apply to find a PE based solely on the basis of the period during which the services were provided in the Czech Republic (a suggestion that the general reporters find rather surprising). As noted by the report, however, it seems that the latter view is now being put forward on the basis of a different view of what constitutes a "fixed place of business", which is a different matter.

India's branch report refers to the guidance provided by the Indian Supreme Court in *Morgan Stanley*,[235] where it was held that employees of a foreign company (i.e. a related company in that case) working on the premises of an Indian company could not be said to constitute a service PE since they performed stewardship and quality control activities for the foreign company. Indeed, it seems clear that in such a case, there is no furnishing of services by the foreign company through these employees. The ruling also held, however, that if employees are seconded by the foreign company to work for the Indian company but remain employees of the foreign company, a service PE will be created if the relevant time period is exceeded.

The concept of "same or connected projects", which is found in the UN model and in its variation included in the OECD commentary, is one issue that has created some uncertainty. Paragraphs 42(40) and 42(41) of the OECD commentary provide some guidance on this issue. As noted in both the Canadian and the US branch reports, further guidance can be found in the Diplomatic Notes and in the US Treasury Technical Explanation related to the 2007 Protocol to the United States–Canada treaty, which includes a service PE rule based on the variation found in the OECD commentary.[236]

6.2. The insurance PE rule

The UN model also includes an additional provision that deems an insurance enterprise to have a PE in a state (except with respect to reinsurance) if "it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status".[237]

Germany's branch report indicates that this rule, which is found in many German treaties, has been interpreted by the German tax administration to mean that if a foreign insurance company has a branch in Germany according to the German Insurance Supervisory Act, it should have a PE but that if there is no such branch under insurance law "the general principles for agencies are applicable", a result that is somewhat surprising given the wording of the insurance PE rule that is clearly intended to go beyond the agency PE rule.

Chile's branch report refers to a ruling[238] where it was held that for a PE to be deemed to exist under that rule, the activities referred to must be performed in Chile by a person present there but do not need to be performed by a resident or by a person having an authority to conclude contracts.

235 (2006) 284 ITR 260.

236 See also Chinese Taipei's branch report which includes some guidance on this issue as regards activities of investment bankers.

237 Art. 5, para. 6 UN model.

238 Ruling no. 986 (2007).

Canada's branch report refers to a recent decision that provides an interesting illustration of an interpretation *a contrario* based on the insurance PE clause. In that decision, the Tax Court of Canada relied on the absence of the insurance PE clause in the Canada–USA treaty to support its conclusion that the US insurer did not have a PE in Canada.

6.3. The concept of fixed base

The OECD commentary's view that no practical distinction should be made between a "fixed base" and a "permanent establishment" has been confirmed by some countries (e.g. the Diplomatic Notes to the 2007 Protocol to the Canada–United States treaty; the legislation prepared for the approval, by Luxembourg, of the 1962 Luxembourg–Austria treaty; a decision in Canada[239] in which "fixed place" was referred to as a "location through which [the taxpayer] carried on his business", which is similar to the wording of the basic PE rule).

6.4. The substantial equipment PE rule

The most relevant guidance available on the substantial equipment PE rule comes from Australia, which has included that rule in a number of its treaties. Some additional guidance can be derived from the interpretation of the rule as included in the 1942 USA–Canada treaty (replaced in 1984) as well as from the use of a similar rule in Canada's domestic rules for allocation of the tax base between provinces.

A first issue on which guidance has been provided is the meaning of "substantial". In *McDermott Industries (Aust) Pty Ltd* v. *FCT*,[240] the Australian Full Federal Court expressed the view that floating oil rigs and construction cranes would be examples of substantial equipment. In Taxation Ruling TR 2007/10, the Australian Tax Office has expressed general guidance on what "substantial" means, concluding that it would be extremely rare for ships or aircraft not to be substantial equipment due to their size alone.[241] As noted in the US branch report, the US IRS took the view that, for the purpose of the rule in the 1942 USA–Canada treaty, equipment used in theatrical performances (i.e. scenery, costumes and technical equipment) did not constitute "substantial equipment". In *Sunbeam Corp. (Canada) Ltd* v. *MNR*,[242] a Canadian decision dealing with the rule found in the domestic PE concept (which deems a PE to be constituted by "the use of substantial machinery or equipment in a particular place"), the Canadian Supreme Court expressed the view that the word "substantial" was intended to mean "substantial in size".[243] The Canadian tax authorities have subsequently expressed the view that for the purposes of this rule, the issue of whether machinery or

239 *The Queen* v. *Dudney*, 2000 DTC 6169.

240 2005 ATC 4398.

241 Based on the guidance provided in the decision and ruling, the Australian Tax Office ruled, in ATO ID 2007/20, that packing machines and their attachments (associated but separate units of equipment forming an integral part of the overall packing machine) did not constitute "substantial equipment".

242 62 DTC 1390 (1962).

243 At p. 1394.

equipment is substantial is determined in part by its size, quantity and value and whether it contributes substantially to the gross income that the corporation earned in that place.[244]

The Australian ruling TR 2007/10 mentioned above clarifies various other aspects of the provision as found in the Australia–USA and Australia–UK treaties, which deem a PE to be constituted where the foreign enterprise "maintains substantial equipment for rental or other purposes … for a period of more than 12 months" (e.g. the ruling states that the period of 12 months should be computed by analogy to paragraph 6(1) of the OECD commentary).

While these two treaties use the word "maintains" before "substantial equipment", it is more common to find the words "uses" or "operates" in the substantial equipment rule. The practical significance of this difference is illustrated by the *McDermott*[245] decision. That case dealt with the provision as found in the Australia–Singapore treaty, which reads "substantial equipment is in that other Contracting State being used or installed by, for or under contract with the enterprise". The facts of the case indicate that a resident of Singapore was leasing barges on a bareboat basis to the taxpayer, an Australian company, which used them in Australia. It was argued by the taxpayer, which was assessed for failure to withhold tax on the lease payments, that the Singapore lessor had a PE in Australia on the basis of the rule even though the equipment was used by someone else, i.e. the Australian company. The court accepted the taxpayer position that granting the right to use the equipment to someone else under a lease triggered a PE under the rule (which allowed the taxpayer to avoid the withholding tax requirements on the lease payments, which would otherwise have constituted royalties under that treaty).[246]

This result appears to conflict with the one reached earlier by the Canadian Federal Court in *Canadian Pacific Ltd* v. *The Queen*,[247] although this may be partly explained by the different wording of the rules (and in particular, the inclusion of the phrase "by, for or under contract with the enterprise" in the rule examined in *McDermott*).

6.5. The offshore PE rule

Norway's branch report contains some guidance on the interpretation of the offshore PE rule, which has been included in most Norwegian treaties since the late 1970s. The report refers to three court decisions (one of which is still pending) dealing with the interpretation of an exception to the offshore PE rule that deals with transport activities.

The US branch report notes that even in treaties that do not contain the modification the IRS has taken the view that exploration activities can create a PE.

244 Para. 6 of Interpretation Bulletin IT-177R2.

245 Above, note 239.

246 The treaty between Australia and Japan, which was signed after the *McDermott* decision, uses the phrase "where an enterprise … operates substantial equipment". Subpara. 5(a) of the protocol to that treaty clarifies that this new wording prevents the result achieved in *McDermott*.

247 76 DTC 6120 (Federal Court Trial Division). The decision was reversed by the Federal Court of Appeal on other grounds (see 77 DTC 5383).

The Netherlands' branch report refers to a decision of the Dutch Supreme Court[248] in which it was held that a PE deemed to exist by virtue of a specific offshore PE rule had to be considered to be a PE not only for the purposes of article 7 but also of article 15(2)(c) OECD model, which deals with the taxation of employees, a result that seems logical.

7. Guidance related to non-treaty uses of the PE or similar concepts

7.1. Can guidance from the domestic law PE concept be imported from, and exported to, the treaty concept?

As shown below, in almost all jurisdictions covered by the branch reports, the PE concept, or a similar concept, is used for one or more aspects of domestic tax law. In most jurisdictions, therefore, the concept of PE needs to be interpreted for purposes other than tax treaties. The question thus arises as to whether the guidance available for the interpretation of the domestic law PE concept may be used to interpret the treaty concept and vice versa.

Clearly, variations from the treaty definitions will be relevant in determining to what extent interpretative guidance can be exported to, or imported from, the domestic law concepts and one would need to take account of these differences, which were noted in a number of reports (e.g. Japan, Korea, Luxembourg, Mexico, Switzerland and the United Kingdom).

With that caveat, most reports that have dealt with the question expressed the view that guidance could indeed be derived from domestic law uses of the PE or PE-equivalent concept. The branch reports from Sweden and the United Kingdom noted that the legislator has made conscious efforts to align the domestic law definition to that of the OECD model. Austria's branch report indicates that Austrian courts and administrative practice "tend to interpret the domestic law definition very similarly to the Austrian tax treaty PE definition and vice versa". Support for that view is also expressed in the branch reports from Luxembourg, the Netherlands, Switzerland and the United States. As a matter of fact, many decisions and administrative guidance referred to in various sections of the branch reports dealt with the domestic law PE concept, which was naturally considered as offering guidance on the interpretation of the treaty concept.[249]

The influence, however, seems to be even stronger in the opposite direction as many reports have noted that the domestic law definition could be interpreted in light of the guidance available on the treaty definition (see, for example, the branch reports from Denmark, Finland, the Netherlands, Spain, Sweden, the United Kingdom and Venezuela).

Some countries have actually directly referred to the OECD model in their domestic legislation. For example, South Africa has referred legislatively to the

[248] No. 35 749, BNB 2002/125 (12 October 2001), confirming a decision of the Court of Appeal of Amsterdam.

[249] Austria, Canada, Germany and the Netherlands.

OECD model by adopting a domestic law definition of PE according to which a PE means "a permanent establishment as defined from time to time in Article 5 of the OECD Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development".

7.2. Domestic law uses of the PE and PE-equivalent concept

The issue of the cross-influence of the treaty and domestic law concepts of PE is extremely practical as almost all branch reports have reported one or more domestic law uses of the PE concept or of a similar concept.

Many jurisdictions use the PE concept, or an equivalent concept, for a domestic tax purpose that is very similar to its treaty use, i.e. as a threshold for determining the liability to tax of foreign enterprises for the purpose of direct taxes. This is a common approach in Europe, as indicated in branch reports from Austria, the Czech Republic, Denmark, Estonia, Finland, Germany, Italy, Luxembourg, the Netherlands, Poland, Portugal, Serbia, Spain, Sweden, Switzerland and the United Kingdom (since 2003). Argentina, Brazil, Peru, Uruguay and Venezuela also use the PE concept for the purposes of determining the tax liability of foreign enterprises, although the branch reports from these countries stress that broad domestic source rules mean that the practical effect of the existence of a PE is limited, that effect usually being to allow taxation on net income rather than taxation at a lower rate on gross payments originating from the country.

The domestic tax law of the United States uses the concept of "office or fixed place of business" in order to subject to US tax foreign source income of non-US persons that is attributable to such an office or fixed place of business situated in the USA.

Some countries use the PE concept for the regional allocation of the tax base. This is done in Switzerland (where the PE concept has been a feature of intercantonal tax allocation for over 130 years) and in Canada. Hungary and Luxembourg use the PE concept for the purposes of the allocation of the municipal business tax among municipalities. Germany does the same for the allocation of its trade tax among its municipalities (as did Austria until 1993) and Germany's branch report indicates that the interpretation of the PE concept for trade tax purposes is important for the interpretation of the treaty definition.[250] A similar use of the PE concept is described in Brazil and Venezuela's branch reports.

There is also widespread use of the PE concept for value added tax (VAT, referred to as goods and services tax in some countries). This is the case, for example, in Australia, Canada, the Czech Republic, France, Finland, Hungary, Italy, Korea, Luxembourg, the Netherlands, Portugal, Russia, Serbia, Spain and Switzerland. Since European VAT principles have been harmonized within the framework of the European Union, and in particular the VAT Directive,[251] one would have expected the PE or PE-equivalent concepts used in various European VAT laws to be similar. The European reports that have dealt with the issue,

[250] The report notes, however, that the agency PE rule does not exist under the PE definition for trade tax purposes.

[251] Directive 2006/112/EC (28 November 2006), which replaced the Sixth VAT Directive of 1977 as amended over the years.

however, have shown differences in the interpretation of the concept. One obvious problem is that, judged from a treaty perspective, the different language versions of the VAT Directive use inconsistent terminology to refer to the concept, so that the treaty expression is used in some cases but not in others. For example:

Table 2

Language	Article 43 VAT Directive	Treaties
English	fixed establishment	permanent establishment
French	établissement stable	établissement stable
German	Niederlassung	Betriebsstätte
Spanish	establecimiento permanente	establecimiento permanente

Ireland's and Luxembourg's branch reports make the important point that since their domestic VAT concept must be interpreted in light of the guidance provided by the European Court of Justice, which is said to require "the presence of the minimum human and technical resources necessary for the supply of the services", the interpretation of the VAT concept is therefore less relevant for the interpretation of the treaty PE concept. A similar view is reflected in the reports from Austria, Finland, France, Germany, the Czech Republic and Hungary. Italy's branch report, however, refers to two Supreme Court decisions as support for the view that the

> "stable position of both Italian judiciary and tax authorities is that the interpretation of the conditions for the existence of a PE for VAT purposes can be done on the basis of the criteria set by Art. 5 of the OECD Model in conjunction with the VAT Directives, as interpreted by the European Court of Justice …"

The extent to which guidance can be derived from VAT to interpret the treaty PE concept (and vice versa) also varies outside the EU (while Norway's branch report suggests that this should not be the case, the branch reports from Australia and Canada give examples of the influence of the PE income tax and treaty definitions in interpreting the same concept for VAT purposes).

Many other uses of the PE, or PE-equivalent, concept have been referred to in branch reports. One that seems particularly important as it affects many countries is the use of the concept in the European Union Parent–Subsidiary, Interest and Royalties and Merger directives (which are referred to in the branch reports from Ireland, Portugal and Romania).

Branch Reporters
Colin Campbell*
Terry McDowell**

Summary and conclusions

The concept of permanent establishment (PE) is used in Canadian tax treaties and for domestic income and value-added tax (GST) purposes, to allocate income among the provinces and to establish residence for GST purposes. The concept of PE as a "fixed place of business" and the "agency establishment" concept are contained in the domestic provisions.

For both treaty and domestic purposes, Canadian courts and tax authorities use the OECD model and commentary. Consequently, Canadian jurisprudence and administrative policy are closely aligned with the OECD commentary. The technical explanations (TE) of the Canada–United States tax treaty and protocols thereto are also a source of guidance.

Canadian authorities have not generally analysed whether a "place of business" exists apart from the elements of fixity and permanence associated with the PE concept. The existence of a specific physical location or "habitation" is necessary rather than only a network of agents or other similar sales organization. Thus, a ship or other vehicle cannot, under the general definition, be a PE because it is not a "place".

In determining whether a particular place of business is that of a taxpayer, recourse will be had to:

- identification of the premises (for example, signage) with the business of the enterprise;
- payment of expenses of the premises by the enterprise;
- whether contracts were concluded there; and
- keeping goods for sale or delivery on the premises;

as well as the degree of control exercised over the premises (or an agent if the premises are those of an agent).

Where an enterprise carries on more than one business, the place must be identified with the particular business. The business of renting real estate will constitute the real estate a place of business.

The Canadian tax authorities have taken the position that premises leased by an enterprise for use by employees of an unrelated service provider to service Canadian customers (but not conclude contracts) would be a place of business of the enterprise.

* Partner, Davies Ward Phillips & Vineberg LLP, Toronto
** Partner, Ernst & Young, Toronto

"Place of business" implies a degree of fixity which, as noted, would not be possessed by a ship. The use by a sports team of locker room facilities at the stadiums of other teams does not have sufficient fixity or permanence to constitute a PE.

The use by an enterprise of a fixed place for short periods of time will generally not have the degree of permanence to constitute a PE (use of a booth at a fixed location for three weeks in each year over a 15-year period has been found to constitute a PE).

For a place of business to be a PE, the enterprise must have the right to use it for carrying on the business, not merely, for example, for providing services to a particular customer or client – both physical control and exclusive or unlimited access and right of use are required.

Use of a client's premises is unlikely to constitute a PE.

There are no judicial or administrative statements on other aspects of carrying on business "through" a place of business.

There are no judicial or administrative statements on the listed examples in paragraph 2 of article 5.

An installation project is distinct from, and need not be related to, a construction site or project. Installation of machinery or equipment will be an installation project which will commence with the first activity in Canada and continue until all aspects of the project, including start-up, testing and staff training, have been completed. This will also be the case where contractors carry out all or part of the project. Installation of machinery is distinct from its fabrication where the contract encompasses both.

The combination of two or more enumerated activities will not by itself constitute a PE.

A dependent agent's authority to conclude contracts in Canada must extend to contracts relating to operations constituting the business of the enterprise rather than the agent's business.

To be an agent of independent status the agent must be independent both legally and economically. Legal independence is evidenced by intention of the agents, lack of control or ownership by the enterprise of their business, absence of reimbursement for cost of assets and responsibility of agents for their own employees. Economic independence is evidenced by compensation based on commission with no minimum or maximum levels, freedom to solicit business from others, absence of a requirement to act exclusively for the enterprise and economic risk borne by the agents. Exclusive dealing with, or the supply of product by, the enterprise is not determinative.

A Canadian subsidiary habitually exercising authority to conclude contracts in the name of its parent may constitute a PE depending on the terms of the agency agreement and the operations of the subsidiary.

The concept of fixed base is similar to that of PE. The TE to the fifth protocol suggests that both geographical and commercial coherence will be required to deem projects to be the same or connected.

There are no judicial or administrative statements on the rules relating to insurance activities in the UN model.

The mere use of leased railway rolling stock will not constitute a PE of the lessor.

Machinery or equipment need not be owned by the enterprise for it to be a PE. Whether it is substantial will be determined by its size, value and its contribution to gross income.

1. Introduction: sources of guidance

One source of guidance in Canada for the interpretation of the treaty definition of PE is the jurisprudence considering Canadian bilateral tax treaties, together with statements of administrative policy by the Canada Revenue Agency (CRA), which include interpretation bulletins, non-binding technical interpretations and binding advance income tax rulings. While technical interpretations and rulings are important sources for determining administrative practice, they are published in a form which removes information which might identify the taxpayer. This may reduce their utility in cases where relevant factual information is redacted out. The CRA considers the existence of a PE to be primarily a factual determination to be made at the tax services office level. Because these decisions are not normally publicly available, their usefulness is very limited. In jurisprudence and administrative policy, significant weight is generally given to the OECD commentary and, to a lesser extent, to the UN model commentary.

The concept of PE is also used for domestic income tax purposes. Canada is a federal state and both the federal and provincial governments have power to impose taxes on income and capital. From the mid-20th century, federal and provincial income taxes on corporations have been partially integrated. In eight of the ten provinces and in the three territories, the CRA collects corporate income tax on their behalf calculated on a uniform tax base. Federal income tax is reduced in respect of income earned in a province to make "room" for provincial tax. The PE concept is used to determine whether income is earned in a province for these purposes and the regulations made under the Income Tax Act (Canada) (the Act and the regulations respectively) contain a definition of PE similar in important respects to that in the OECD model. In order to avoid double taxation, each provincial income tax statute uses the PE concept to allocate income betwen the provinces (using formula apportionment rather than the separate enterprise fiction). These definitions of PE are identical in the provinces which use the CRA to administer corporate income tax, substantially similar in the two provinces which administer their own provincial corporate income tax and are similar in important respects to that in the OECD model. The concept of PE is also used for value-added tax purposes, including goods and services tax (GST), and Quebec sales tax, to deem a non-resident to be resident in relation to activities conducted at that PE. The jurisprudence and statements of administrative policy relating to these domestic PE concepts are additional sources of guidance.

A significant portion of Canadian jurisprudence concerns the PE definition in earlier iterations which diverges from the wording in the OECD model to a greater extent than the current provisions in the regulations. Some caution must therefore be exercised in looking at these decisions.

A further source of guidance, perhaps unique to Canada, are the TEs prepared by the United States Treasury Department in respect of the Canada–United States income tax convention (1980) and the five protocols thereto. In each case, Canada reviewed and commented on the TE and the Canadian Department of Finance indicated by press release Canada's agreement that the TE accurately reflected understandings reached in the negotiations with respect to the interpretation and application of the relevant provisions.

2. Basic definition of a PE

2.1. "Place of business"

2.1.1. Jurisprudence

The leading case on the meaning of PE is the decision of the Supreme Court of Canada in *Sunbeam Corp. (Canada) Ltd* v. *MNR*.[1] The case involved the definition of PE in the regulations allocating income between Quebec and the other provinces where the taxpayer had a PE in Quebec and a PE outside Quebec. Where a corporation had a PE in Quebec (and was liable to Quebec corporation income tax), it was entitled to a reduction in its federal income tax. For these purposes the regulations defined PE as follows:

> "411(1) For the purpose of this Part,
> (a) 'permanent establishment' includes branches, mines, oil wells, farms, timber lands, factories, workshops, warehouses, offices, agencies, and other fixed places of business;
> (b) where a corporation carries on business through an employee or agent who has general authority to contract for his employer or principal or has a stock of merchandise from which he regularly fills orders which he receives, the said agent or employee shall be deemed to operate a permanent establishment of the corporation;
> (c) the fact that a corporation has business dealings through a commission agent, broker or other independent agent or maintains an office solely for the purpose of merchandise shall not of itself be held to mean that the corporation has a permanent establishment;
> (2) The use of substantial machinery or equipment in a particular place at any time in a taxation year shall constitute a permanent establishment in that place for the year."

The taxpayer in *Sunbeam* manufactured electrical appliances and other equipment outside Quebec and distributed them in Quebec through sales representatives who sold the products to wholesale distributors. The Court found that there was no agency PE because the sales representatives had no authority to contract

[1] 62 DTC 1390, [1963] SCR 45, aff'g 61 DTC 1053 (Ex. Ct. Can.), rev'g 58 DTC 417 (ITAB) (*sub nom. No. 536* v. *MNR*) (*Sunbeam* (SCC) and (Ex. Ct. Can.), *No. 536* (ITAB)).

for the taxpayer and no stock of merchandise from which to fill orders. Although the corporation had no office in Quebec, the sales representatives maintained offices in their own residences but were not compensated by the taxpayer for doing so. The Court found that the taxpayer had no PE in Quebec, stating:

> "[M]y opinion is that the word 'establishment' contemplates a fixed place of business of the corporation, a local habitation of its own. The word 'permanent' means that the establishment is a stable one, and not of a temporary or tentative character."[2]

The Court further found that the words in the definition other than "branches" and "agencies" referred only to forms of real property, that the fixed place of business must be that of the taxpayer for it to be a PE and that the offices of the employees in their own premises did not constitute such a fixed place of business, either as a branch, an office or an agency.

The decision in *Sunbeam* has been followed in a number of other cases. In *Hegeman-Harris Co. of Canada Ltd* v. *MNR*,[3] a decision of the Tax Review Board, it was not seriously disputed that the taxpayer, a real estate construction and management company, had a PE in Quebec. At issue was whether it also had a PE in the United States, the existence of which would erode its federal tax reduction in respect of Quebec corporation income tax. The corporation carried on a construction management business in the United States through employees who supervised specific projects, living temporarily where the project was located. The board found that there was no fixed place of business in the USA, "including an office, a branch, a mine, an oil well, a farm, a timber land, a factory, a workshop or a warehouse".[4]

In *Fiebert* v. *MNR*,[5] a decision of the Tax Court of Canada, the taxpayer was a United States resident who spent time in Canada managing the business of a Canadian corporation. The taxpayer argued that his residence in the United States was a PE of the Canadian corporation so that a portion of his income received from the corporation was exempt from tax in Canada under the 1942 Canada–United States income tax convention. The evidence indicated that, while the taxpayer's residence address was used as an address for the corporation and the residence contained a workshop to test equipment manufactured by the corporation, the taxpayer was not reimbursed for office expenses and there was no identifying sign for the corporation on the residence. The Court relied on and approved the judgment of the US Tax Court in *Consolidated Premium Iron Ores Ltd* v. *Commissioner of Internal Revenue*,[6] where the US Tax Court stated:

> "The term 'permanent establishment' normally interpreted suggests something more substantial than a license, a letterhead and isolated activities. It implies

2 *Sunbeam* (SCC), *ibid*. at 1393, Martland J.
3 79 DTC 886 (TRB).
4 *Ibid*. at 892.
5 86 DTC 1017 (TCC).
6 *Consolidated Premium Iron Ores Ltd* v. *Commissioner of Internal Revenue*, 57 DTC 1146 at 1162 (TC US), aff'd 59 DTC 1112 (US 6th Cir.).

> the existence of an office, staffed and capable of carrying on the day-to-day business of the corporation and its use for such purpose, or it suggests the existence of a plant or facilities equipped to carry on the ordinary routine of such business activity. The descriptive word 'permanent' in the characterization 'permanent establishment' is vital in analyzing the treaty provisions. It is the antithesis of temporary or tentative. It indicates permanence and stability."[7]

On this basis, the Court found that there was no PE in the United States.

The decision of the US Tax Court in *Consolidated Premium Iron Ores* was also referred to in the decision of the Income Tax Appeal Board in *Sunbeam* (under the name *No. 536* v. *MNR*).[8] In addition to distributing goods through sales representatives, the corporation rented space in a warehouse in Quebec to maintain a supply of products for delivery. The Board found that the warehouse was a "warehouse" within the meaning of the definition of PE in the regulations notwithstanding that the corporation only rented a portion of it, relying in part on the statement in *Consolidated Premium Iron Ores* quoted above.

In the decision of the Exchequer Court in *Sunbeam*, it was found that the taxpayer was required to have had "some measure of control"[9] over the warehouse for it to "have a warehouse" within the meaning of the regulation without reference to the *Consolidated Premium Iron Ores* case.

In each of two cases decided by the same judge in 2008, *American Income Life Insurance Company* v. *The Queen*[10] and *Knights of Columbus* v. *The Queen*,[11] the taxpayer was a US resident insurer that sold insurance through a hierarchy of sales representatives in Canada. General and supervisory agents recruited and directed field-level agents who in turn sold insurance to the public. Field-level agents used home offices for administrative functions but rarely to meet with clients and the offices were not signed or otherwise identified as offices of the taxpayer. All underwriting activities took place in the USA where policies and claims were administered.

The Crown relied on *Panther Oil & Grease Manufacturing Co. of Canada Limited* v. *MNR*,[12] discussed below, for the position that each taxpayer had a PE in Canada through which it carried on its business. The Court in *Knights of Columbus* followed the decision of the Supreme Court of Canada in *Sunbeam* and concluded:

> "A well-established selling organization is not sufficient to constitute a branch, and consequently, a permanent establishment. I take from *Sunbeam* that you do need a physical place, not the mere nebulous agency network. I put little reliance on the decision of *Panther Oil*."[13]

7 *Ibid*.
8 See *No. 536*, above note 1.
9 *Sunbeam* (Ex. Ct. Can.), above, note 1 at 1058.
10 2008 TCC 306, 2008 DTC 3631 (TCC).
11 2008 TCC 307, 2008 DTC 3648 (TCC).
12 57 DTC 494 (ITAB), aff'd 61 DTC 1222 (Ex. Ct. Can.).
13 Above, note 11 at 3660.

The Court also distinguished *Panther* on the basis that the regulation it considered had no requirement that the taxpayer's business be carried on through the PE (under the Canada–United States income tax convention (1980) and the OECD model).

The Court concluded in both cases that the home offices were "permanent" and were "places of business" but that they were places of business of the agents (all of whom were found to be independent contractors) for their businesses, not the businesses of the taxpayers. The Court found,[14] relying on the OECD commentary, that a place of business of a representative or agent of an enterprise could not be a place of business of the enterprise unless the enterprise had access to the place in its own right so that the place was "at its disposal" and that the taxpayers had no such right with respect to the home offices and were not carrying on their "core business" there.

In *American Income Life*, the Court enumerated a number of factors to consider in determining whether the business of an enterprise is being carried on through a particular fixed place of business, including:

- control by the enterprise over the premises;
- identification of the premises with the business of the enterprise;
- products kept on the premises;
- where the premises were those of an agent, the degree of control exercised over the agent;
- whether the enterprise paid for the expenses associated with the premises; and
- whether contracts were concluded from the premises.[15]

While the companion decision in *Knights of Columbus* did not contain a similar enumeration of factors, the Court presumably considered the same factors to determine whether the home offices of the sales agents were at the disposal of the enterprise.

Three other cases involving somewhat similar fact situations to those in *Sunbeam*, *Ronson Art Metal Works (Canada) Ltd* v. *MNR*,[16] *Panther* and *No. 506* v. *MNR*,[17] were decided by the Income Tax Appeal Board prior to *Sunbeam*.

In *Ronson*, the taxpayer corporation manufactured cigarette lighters and accessories and distributed them in Quebec through local sales representatives who dealt with distributors and large retailers. Sales representatives had no office or stock of merchandise and the board found these arrangements did not constitute a PE both because there was no office[18] and because the sales representatives had no authority to contract on behalf of the corporation. Subsequently, the corporation opened a lighter repair service in Montreal in rented space. The Income Tax Appeal Board found that this office was a PE but that its business was limited to the repair operation and sale of certain accessories and was not a PE of the principal business of selling lighters.

14 *Ibid*. at 3661.
15 *American Income Life*, above note 10 at 3640.
16 56 DTC 440 (ITAB).
17 58 DTC 258 (ITAB).
18 Above note 16 at 442 ("In my opinion, it is not possible to visualize an 'establishment' without evoking the concept of some premises from which a business is conducted").

In *Panther*, the corporation similarly manufactured goods outside Quebec and distributed them through sales representatives. The sales manager and some district sales managers maintained offices in their residences at which records were kept, correspondence handled and a stock of products for delivery to customers maintained. The sales manager's letterhead identified his residence as an office of the corporation. The Board found that these offices were PEs.[19]

In *No. 506*, the Income Tax Appeal Board considered whether a ship that operated on the St Lawrence River and the Great Lakes was a PE within the meaning of the regulations. In considering the definition of PE as including "branches, mines, oil wells, farms, timber lands, factories, workshops, warehouses, offices, agencies, and other fixed places of business", the board found that "[a] ship is not of the same genus as the foregoing terms and cannot be connected in the slightest degree with any one of them".[20]

The board also stressed the impermanence of a ship in transit in the context of a provision in the regulations which provided that the use of substantial machinery equipment "in a particular place" constituted a PE in that place:

> "A ship actually in transit is never in a particular place. Instead, it is in a position rather than in a place, and that position is not precisely determinable for more than an instant and then by reference to calculations of latitude and longitude. Only when a ship is in dock, and possibly when at anchor, can it be said to be in 'a particular place'. Pursuing, for a moment, the situation obtaining when a ship is in dock, if respondent's contention that a ship is a permanent establishment were accepted by the Board, the remarkable result would be that wherever either of the ships docked for a few hours would become the site of a 'permanent establishment' of the appellant, although the docking was for the time being only. Furthermore, the word 'ship' suggests movement, and being in transit and creating a permanent establishment are hardly compatible situations."[21]

2.1.2. Administrative policy

The CRA has stated its position, in paragraph 3 of Interpretation Bulletin IT-177R2,[22] that:

> "A fixed place of business may include a place, plant or natural resource used in the day-to-day business of the corporation. It does not mean that the place of business must exist for a long time or be located in a durable building; for instance, a temporary field office on a construction site could be a fixed place of business."

In paragraph 7 of IT-177R2, the CRA sets out its position that a rental property in Canada will be a PE of a corporation which owns and rents it:

19 See above note 12.
20 *No. 506*, above note 17 at 260.
21 *Ibid*.
22 Dated 4 May 1984, consolidated November 2003. Interpretation Bulletins represent the CRA's interpretation of the law and, while taken into account by a court, are not determinative.

> "It is a question of fact whether a rental operation constitutes the carrying on of a business or whether rents received constitute income from property. Generally, subject to the comments in the current version of IT-420, Non-Residents – Income Earned in Canada, rental income of a corporation will be considered to constitute income from a business. If a corporation has rental income from real estate that is income from a business, the corporation will have a permanent establishment in each province in which it has a rental property because each property will be considered a fixed place of business."[23]

The CRA has taken the position that carrying on a business through an "organized and structured sales force"[24] may constitute a "permanent place of business and thus a permanent establishment" of a foreign enterprise.[25] In making this determination, the CRA would consider the scope of activities in Canada, sales volume in Canada, location of real authority to bind the enterprise, location of inventory, time required to approve contracts and duration of the presence in Canada.

The CRA took a similar position in an internal interpretation[26] concerning a United States enterprise which marketed in Canada products produced outside Canada. To service Canadian customers, the enterprise contracted with an unrelated Canadian service provider for the use of employees who conducted their activities through offices leased by the enterprise. These employees provided product information and dealt with enquiries and complaints related to products or invoices. They did not have authority to conclude contracts on behalf of the enterprise. They also were involved to some extent in marketing and sales solicitation and worked under the supervision of the enterprise. Goods were shipped from warehouses in Canada operated by third parties and managed directly from the United States. The CRA concluded that the leased offices of the enterprise were fixed places of business and, because the contract employees were involved in sales solicitation, "there [was] at least a part of the essential activity of the business (the sales solicitation) that [was] carried on through the offices … even if this [was] the case only to a limited extent". Article V of the Canada–United States income tax convention (1980) (dealing with activities of a preparatory or auxiliary nature) was not applicable because the offices were not used solely for activities described therein.

In Technical Information Bulletin B-090,[27] dealing with the application of GST to electronic commerce, the CRA considered the PE definition in the GST legislation, which substantially incorporates paragraphs 1 and 2 in article 5 of the OECD model. The CRA stated that a "place of business" required physical space so that a website, consisting only of software and electronic data and not tangible property, did not have a location that could constitute a place of business. A website of a non-resident person in itself will therefore not constitute a PE for GST purposes. A server, however, is tangible property having a physical location and

23 See also the CRA, Document 59253 (E) (17 August 1990).

24 CRA Document 5M08340 (E), "Round Table on Federal Taxation: Association de Planification Fiscale et Financière 1994 Annual Meeting" translated by CRA (1994) at question 44.

25 *Ibid*.

26 CRA Document 2006-019443I7 (E) (20 November 2006).

27 Dated July 2002.

may constitute a place of business of a person if at the disposal of the person. A website hosted on a server of an independent service provider in Canada would generally not be considered to be at the disposal of the non-resident. The CRA also stated that while a server at the disposal of a non-resident can qualify as a PE even if no personnel are required to operate it, the functions carried out through the server must be an "essential and significant part"[28] of the business activity of the enterprise. The key part of the definition of PE for these purposes is that it must be a fixed place of business through which a person makes supplies; the issue therefore is whether supplies are made through the server.

2.2. "Fixed" place of business – location

2.2.1. Jurisprudence

As discussed above, the board in *No. 506* found that a ship which travelled through a particular jurisdiction could not constitute a PE because it would never have a fixed geographical location for more than a short period of time.

As discussed below under section 2.3.1, the Tax Court in *Fowler* v. *MNR*[29] found that a business of selling goods from a collapsible booth for three weeks each year in the same location at a fair over a continuous period of 15 years constituted a fixed place of business either as a "place of management", a "branch" or an "office".

The principles in the *Sunbeam* case were applied by the Ontario Court of Appeal in *Toronto Blue Jays Baseball Club* v. *Minister of Finance (Ontario)*.[30] In that case, the legislation in question was the Ontario Employer Health Tax Act, a payroll tax which excluded from the tax base remuneration paid to employees who reported to PEs outside of Ontario and did not involve a tax treaty. A PE, in respect of an employer, was defined to include "1(2) … any fixed place of business, including an agency, a branch, a factory, a farm, a gas well, a mine, an office, an oil well, timberland, a warehouse and a workshop". The taxpayer owned a baseball team and argued that the players' dressing rooms, coaches' rooms and training rooms at the stadia of out-of-town teams constituted in each case a PE outside Ontario. The Court referred to the passage in *Sunbeam* quoted above and the statement in the OECD commentary to the 1977 OECD model that a PE could 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".[31] Noting that the space and facilities in question were analogous to the rights of the occupant of a hotel room, the Court found that the connection of the sports teams with these locations and their control of them was "relatively so transitory that they cannot be considered to be fixed places of business".[32]

The Court also relied on a decision interpreting the term "establishment" in respect of a Quebec payroll tax in *Syntex Ltd* v. *Québec (Sous-ministre du*

28 *Ibid*. at 28.
29 90 DTC 1834 (TCC).
30 2005 DTC 5360 (Ont. CA).
31 *Toronto Blue Jays Club*, above note 30 at 5363.
32 *Ibid*. at 5364.

Revenu).[33] In that case, the Court found that the use of an office for the taxpayer's business, in itself, could not make it an "establishment". For that, the office had to belong to the employer. This involved an element of ownership, management and authority over the establishment.

2.2.2. Administrative policy

In a technical interpretation,[34] the CRA considered the position of a United States resident individual who, as an independent contractor, acted as the marketing manager for a United States enterprise carrying on a business of providing financial products and services. His activities in Canada included managing promotional activities for customers, meeting and providing information to sales representatives, preparing forecasts of sales, reports of sales activity and promoting client relations and hiring and training new sales agents. He worked with Canadian resident sales agents but did not perform any services in relation to their businesses. While the issue was whether he had a fixed base in Canada, the CRA applied the principles relating to a PE on the basis that there was little difference between the concepts of fixed based and PE, referring to the OECD commentary on the deletion of article 14 from the OECD model. The CRA relied on the statement in paragraph 5 of the OECD commentary on article 5 of the OECD model that "there has to be a link between the place of business and a specific geographical point" to constitute a PE to conclude that "it would be difficult to say that the Taxpayer had a fixed base in Canada if his business cannot be linked to a specific location in Canada". Taking into account what were very short visits to different locations, the CRA concluded that "we do not think that any of these locations has the required degree of fixity necessary to amount to a 'fixed base'". It also pointed out that the individual's visits to a particular location did not necessarily occur at the same place in that location and that there was no specific office or space available to him in any of those locations.

The CRA distinguished *Fowler* on the basis of lack of physical control of the space and the fact that the taxpayer conducted his business in different places each year, citing cases involving theatrical shows where performances were given in different places.

In GST/HST Policy Statement P-208R,[35] the CRA discussed the definition of PE for the purposes of GST. The CRA stated that a "place of business" must be lasting or intended to last for an indefinite or unspecified period and could not be of a purely temporary nature. A place of business could, however, last for a finite period because of the short duration of the particular business activity. The CRA also took the position that the requisite degree of permanence might exist where a person returned to the same location for the same business purpose on a recurring basis or moved within a particular geographic location or area in carrying out business activities (such as certain construction and installation projects) where the activity was part of a single project.

33 (1977) 1977 CarswellQue 172 (QC CP), aff'd [1981] RDFQ 1 (QC CA).
34 CRA Document 2002-0162287 (E), (2 January 2003).
35 Dated 23 March 2005.

2.3. "Fixed" place of business – duration

2.3.1. Jurisprudence

In *Fowler,* the Tax Court of Canada found that a recurring activity, albeit over a short time period, was not inconsistent with the existence of a PE as defined in the Canada–United States income tax convention (1980), the relevant provisions of which were identical to paragraphs 1 and 2 of article 5 of the OECD model. The individual taxpayer was a resident of the United States who sold goods for approximately three weeks of each year at the Pacific National Exhibition in Vancouver, relying on a non-exclusive licence to use a particular space on which he located, for the duration of the fair, a collapsible booth. When the fair was over, the booth was removed and transported to other locations outside Canada where the taxpayer carried on similar activities. Taking into account that he had attended the fair for a 15-year period and that an appreciable portion of his annual sales were attributable to that site, the Court concluded that the site was a PE and stated:

> "Conceptually the Vancouver sales were actually being conducted at, or from, a place of business having the same attributes as that of a 'place of management', as a 'branch' of the whole operation, or as an 'office'. The matters of mobility and the three-week time period are not in themselves overly material when taken into context. Indeed, it was the very nature of the business itself that mandated these aspects."[36]

The decision in *Fowler* has not been followed or relied on in any subsequent cases and is generally considered to be of limited authority.

By contrast, in the *Toronto Blue Jays Club* case discussed above, the Court found that the use of dressing rooms at the stadia of other teams was too transitory to constitute a PE, notwithstanding that such facilities would be used by the team a number of times each year.

2.3.2. Administrative policy

In the technical interpretation discussed under section 2.2.2 above, the CRA also relied on the OECD commentary to article 5 of the OECD model and the decision in *The Queen* v. *Dudney*[37] to conclude that "a place of business must also have a certain degree of permanency in order for it to amount to a 'fixed base'. In other words, the place of business must not be of a purely temporary nature." In that case, the taxpayer did not spend more than a few days in each location in Canada he visited so that:

> "[I]f we were to assume that he had a specific location made available to him in either one or all of those locations, we do not think that such a location would have the required degree of permanency to constitute a fixed base

[36] See above note 29 at 1838.
[37] 2000 DTC 6169 (FCA), leave to appeal to SCC refused, 27869 (2 November 2000).

within the meaning of the Convention. It would be difficult to say there is any permanency in any of those places when there is absolutely no evidence that the Taxpayer set up a specific office or room in any of these locations with the intention of using it on a regular basis for his annual meetings with his agents …"

2.4. "Fixed" place of business – right of use

2.4.1. Jurisprudence

In *No. 630* v. *MNR*,[38] the Tax Appeal Board considered whether the office premises of a partnership, which was also the office premises of each of the partners, was a PE of each of the partners. The taxpayer was a United States corporation and at the relevant time a member of several partnerships which had carried out substantial construction projects in Canada. The Board considered the definition of PE in the Canada–United States income tax convention (1942), the relevant portion of which provided as follows: "3(f) the term 'permanent establishment' includes branches, mines and oil wells, farms, timber lands, plantations, factories, workshops, warehouses, offices, agencies and other fixed places of business of an enterprise …"

The taxpayer did not deny the fact that the office of the partnership constituted a PE as defined. The board found that the PE of the partnership was also the PE of each of the partners and stated:

> "A partnership not being a separate entity, as has just been shown, how can it have a permanent establishment that is not, at the same time, the like establishment of the several partners? No satisfactory answer was proffered during the argument by counsel and I very much doubt that one could be forthcoming. It appears to me that the four partners, of which the appellant was one, had set up a headquarters, or whatever one may wish to term it, in Ontario, where the office premises used by the partnership were to be found. I have the greatest difficulty in considering that office not to be the office of the appellant also and, in fact, cannot do so. It appears to me that the office premises of the partners collectively, were also the office premises of any one partner. The evidence was that the four partners worked as though they constituted just one company."[39]

The question of whether a fixed place of a third party can be the PE of a taxpayer carrying on a business was considered by the Federal Court of Appeal in *Dudney*. In that case, the taxpayer was a US resident individual performing services in Canada as an independent contractor and the issue was whether he had a "fixed base regularly available to him" in Canada for the purposes of article XIV of the Canada–United States income tax convention (1980). The Court reviewed the OECD commentary to the 1977 OECD model which noted that article 14 of the 1977 OECD model was based on principles similar to those in article 7 dealing with business profits. After reviewing the OECD commentary, the Court noted:

[38] 59 DTC 300 (TAB).
[39] *Ibid*. at 302.

> "These commentaries indicate that an enterprise has a 'permanent establishment' where it has a 'fixed place of business,' an identifiable location with a certain degree of permanence in which the business of the enterprise is being carried on. By analogy, a particular location is a 'fixed base regularly available' to a person who provides independent personal services only if the business of that person is being carried on there."[40]

In *Dudney*, the individual worked in a room in the premises of the Canadian corporation to which it was providing services. The room was available only for providing the contracted services and access was restricted to business hours. There was nothing in the taxpayer's letterhead or business card or in the lobby of the building where the premises were located that indicated he worked there.

In approving the decision of the Tax Court that the taxpayer did not have a fixed base in Canada, the Federal Court of Appeal concluded:

> "In this case, the Tax Court judge was correct to consider these factors to be relevant and determinative. The evidence as a whole gives ample support for the conclusion that the premises of PanCan were not a location through which Mr Dudney carried on his business. Although Mr Dudney had access to the offices of PanCan and he had the right to use them, he could do so only during PanCan's office hours and only for the purpose of performing services for PanCan that were required by his contract. He had no right to use PanCan's offices as a base for the operation of his own business. He could not and did not use PanCan's offices as his own."[41]

The reasoning in *Dudney* (particularly because the Crown's leave to appeal to the Supreme Court of Canada was denied) should be persuasive in a case involving a business enterprise using third party premises in a similar manner and relying on provisions similar to articles 5 and 7 of the OECD model, particularly in light of the statement in the OECD commentary (on article 5 of the OECD model) that there are no intended differences between the concepts of PE and fixed base.[42]

The case of *Shahmoon* v. *MNR*[43] is somewhat similar. In that case, the taxpayer, an individual resident in the United States, visited Canada periodically in connection with real estate transactions, using the offices of a Canadian corporation associated with his family. In concluding that he had no PE in Canada, the Board noted that he paid no rent for the use of the premises and concluded that:

> "There are literally hundreds of people who are employed by American corporations who come into Canada and do business, but these people are certainly not considered to be Canadian residents or to have a permanent establishment if they attend at an office in this country to transact their business."[44]

40 *Dudney*, above note 37 at 6173.
41 *Ibid*.
42 OECD commentary on article 5, para. 1(1). See also *Wolf* v. *The Queen*, 2002 DTC 6853 (FCA), applying the decision in *Dudney* in a similar situation.
43 75 DTC 275 (TRB).
44 *Ibid*. at 277.

The *Knights of Columbus* and *American Income Life* cases discussed above in section 2.1.1 also identified control by the enterprise over the premises in question as one factor in determining the existence of a PE. In each case, the Court found that the enterprise did not have sufficient control over the offices of sales agents to constitute a PE.

2.4.2. Administrative policy

The CRA has stated, in paragraph 3 of IT-177R2, that a public warehouse, for example, used by a corporation "but that is neither owned by nor under some measure of its control" does not by itself constitute a PE.

In the technical interpretation referred to in sections 2.2.2 and 2.3.2 above,[45] the CRA also referred to the criterion for a fixed base that the person in question had physical control of the place where he worked, citing *Dudney* and a number of foreign court decisions. In the case at hand, the CRA found no indication that the taxpayer had "physical control over or exclusive or unlimited access to the space" in the premises in Canada that he used to meet agents. A further corollary was that, because the taxpayer's use of the premises was solely for the purpose of meeting and training agents, the taxpayer could not use them as a "base for the general operation of his own business".

In Policy Statement P-208R, the CRA stated that, to be a PE for GST purposes, a place of business had to be under the control of the person, either through the presence of a person who had authority to make decisions or in a situation where control could be carried out otherwise, for example through the use of automated equipment.[46]

2.5. "Fixed" place of business – client or related company

2.5.1. Jurisprudence

In the *Dudney* case referred to in section 2.4.1 above, the taxpayer's use of a room in a client's premises did not constitute a PE because he had no right to use the office as a base for his own business beyond the services provided to the particular client.

2.5.2. Administrative policy

There is no administrative guidance on the use of premises of a client or related company.

2.6. Other agents

There is no judicial or administrative guidance in on other aspects of carrying on business "through" a place of business.

[45] See CRA Document 2002-0162287, above note 34.
[46] See above note 35.

3. Listed examples

There is no judicial or administrative guidance on the listed examples of PE in paragraph 2 of article 5 of the OECD model.

4. Construction sites

4.1. Jurisprudence

There is no judicial guidance on the special rule for construction sites.

4.2. Administrative policy

The CRA considered the meaning of the term "installation project" in paragraph 3 of article 5 of each of the Canadian treaties with Germany and the Netherlands (the provisions of which are identical to paragraph 3 of article 5 of the OECD model) in an internal technical interpretation.[47] In each case, an enterprise of the other state entered into a contract to fabricate, erect and install equipment, test and adjust the equipment, start up and test the equipment with actual production, train staff and prepare instructional materials.

Relying on commentary of Professors Skaar and Vogel, the CRA adopted the position that an installation project does not have to be related to a construction project and that the installation of machinery or equipment would be an installation project for the purposes of this treaty provision:

> "Therefore, in the cases at hand, it is our view that the placing of equipment in a building for use would meet the definition of installation for the purposes of paragraph 3 of Article 5 of the Convention. Placing of equipment for use would include all the activities of assembling, commissioning and test run until the equipment is fully functional. The equipment would not be functional if it is only assembled without being tested for operation. In other words, it is our view that an installation project includes not only erection or assembling of the plant but also those activities such as commissioning and test run to render the plant operational and productive."

The contract provided for the fabrication of the equipment as well as its installation and the portion of the price allocated to installation was a small proportion of the total price. Relying on the fact that the term used in the OECD model was "installation project" and not "installation contract" and on the dictionary definition of "project" as a "plan, scheme, planned undertaking" or a "special plan or design", or an "undertaking", the CRA concluded that the assembly and erection activities to be carried out in Canada would be a project in themselves:

[47] CRA Document 9812531I7 (E) (14 January 1999).

> "This project includes assembling, planning, scheduling, managing, supervising, co-ordinating and training and is different from the functions of designing, developing, manufacturing and selling the equipment/plant which functions were performed in the non-resident suppliers' own countries."

It follows that the CRA will consider an installation project to commence when the first activity is undertaken in Canada and to continue until all activities provided under the contract, including post-installation start-up, testing and staff training, have been completed.

The CRA has also confirmed its view that the 12-month duration test normally applies to each site or project separately where an enterprise has several construction contracts at different sites.[48]

The CRA's view is that a construction site or installation project site of sufficient duration would constitute a PE of a person (for purposes of paragraph 3 of article V of the Canada–United States income tax convention (1980), which is substantially identical to paragraph 3 of article 5 of the OECD model) whether or not the person performed the actual activity or engaged subcontractors to do so on its behalf.[49] It also confirmed that planning and supervision by a contractor would form part of the activity allocable to the PE and that "if there [were] no supervisors or only part-time supervision at a particular site, that site would probably not constitute such a permanent establishment".

5. "Preparatory or auxiliary" activities

5.1. Jurisprudence

There is no judicial guidance on preparatory or auxiliary activities.

5.2. Administrative policy

In a non-binding technical interpretation,[50] the CRA considered subparagraphs (a), (b) and (c) of paragraph 3 of article 5 of the Canada–United Kingdom income tax convention, which are identical to subparagraphs (a), (b) and (c) of paragraph 4 of each of the OECD model and the UN model. The Canada–United Kingdom income tax convention does not contain the provision dealing with a combination of activities contained in paragraph 4(f) of the OECD and UN models. The CRA confirmed its view, however, that where an enterprise used facilities solely for the purpose of storage, display or delivery of goods and merchandise of the enterprise (as described in subparagraph (a)) and the goods or merchandise were maintained by the enterprise solely for the purpose of processing by another enterprise (subparagraph (c)), the combination of the use of the facilities and the maintenance of the goods or merchandise would in and of itself not constitute a PE.

48 CRA Document HBW4125U31 (E) (11 January 1990).
49 CRA Document 95-4858 (9 March 1983).
50 CRA Document 90-2530, "Canada–UK Income Tax Convention" (2 November 1990).

6. "Agency PE"

6.1. Jurisprudence

The provisions of the regulations defining PE for the purpose of determining credits relating to provincial taxes also contain, as noted above, an agency establishment provision similar, but not identical to, the provision of the OECD model as follows:

> "400(2)(b) where a corporation carries on business through an employer or agent who has general authority to contract for his employer or principal or has a stock of merchandise from which he regularly fills orders which he receives, the said agent or employee shall be deemed to operate a permanent establishment of the corporation;
> …
> (f) the fact that a corporation has business dealings through a commission agent, broker or other independent agent or maintains an office solely for the purpose of merchandise shall not of itself be held to mean that the corporation has a permanent establishment."

These provisions have been considered in a number of cases. For the most part, they contain little textual analysis but turn on findings of fact that an employee or dependent agent had authority to contract for the corporation.

In *Sunbeam* the Court found that the sales representatives neither had authority to contract for the employer (they solicited orders which were transmitted to the corporation's head office in Ontario for acceptance) nor a stock of merchandise from which orders were regularly filled and therefore there was no PE.

In *Ronson* the Income Tax Appeal Board found that the sales representatives of the taxpayer neither had authority to contract for the taxpayer nor a stock of merchandise from which orders were regularly filled and therefore there was no PE.

In *Panther Oil* the Court found that the taxpayer's sales employees had full authority to assess the credit rating of new customers and to accept orders and that almost all orders forwarded were honoured by the taxpayer's head office. The Court also found that the sales representatives were not independent agents but similar to employees, being required to devote all of their efforts to the taxpayer's interests. A PE was found to exist.

In *Canadian Thermos Products Ltd* v. *MNR*[51] the Tax Appeal Board found that the taxpayer corporation, which manufactured goods outside Quebec and had a full-time sales representative in Quebec, did not have a PE because the sales representative did not maintain an office and had no authority to contract for the taxpayer, all orders being forwarded to the head office which accepted or rejected them. In addition, the board found that the sales representative had no stock or merchandise from which he filled orders.

In *Chicago Blower (Canada) Ltd* v. *MNR*[52] the taxpayer manufactured goods in Manitoba and maintained local sales agencies both in Ontario and Quebec. In

[51] 61 DTC 169 (TAB).
[52] 66 DTC 471 (TAB).

each case the sales representatives had authority to make sales contracts without reference to the head office and each agency had stock and merchandise from which it filled orders. The Tax Appeal Board found that the taxpayer came "squarely within"[53] the agency branch of the definition and therefore had a PE in both provinces.

In *Enterprise Foundry (NB) Ltd* v. *MNR*[54] the Tax Appeal Board found that the taxpayer had an employee in Quebec who had general authority to make contracts as well as a stock of merchandise from which to fill orders and therefore had a PE in Quebec.

The *Knights of Columbus* and *American Income Life* cases principally involved the "agency PE" provision in paragraph 5 of article V of the Canada–United States income tax convention (1980), which provided as follows:

> "5. A person acting in a Contracting State on behalf of a resident of the other Contracting State – other than an agent of an independent status to whom paragraph 7 applies – shall be deemed to be a permanent establishment in the first-mentioned State if such person has, and habitually exercises in that State, an authority to conclude contracts in the name of the resident.
>
> Each taxpayer was a US resident corporation that provided life insurance in Canada through a sales staff consisting of field agents who solicited applications for insurance from members under the supervision of a number of general agents. The field agents used home offices for administrative purposes but rarely for meeting with clients. There were no signs or other indications that these offices were offices of the taxpayer. The underwriting, issuance and administration of polices and administration of claims was carried out entirely in the United States."

The Court found that neither the general agents nor the field agents exercised any authority to conclude contracts in Canada. The Court also considered the contracts pursuant to which the field agents were hired by the general agents. It relied on paragraph 33 of the OECD commentary to the current OECD model to find that the authority to conclude contracts had to cover contracts relating to operations which constituted the business proper of the enterprise (which were insurance contracts) but in any event found that the contracts were concluded in the United States.[55]

In *American Income Life*, the Court found that the general and field agents were agents of independent status within the meaning of paragraph 7 of article V of the Canada–United States income tax convention (1980). Although the Court had found, in considering the application of paragraph 1 of article V, that the general and field agents were independent contractors carrying on their own businesses and not the business of the taxpayers, this was not sufficient to find that they were agents of independent status. The Court relied both on paragraphs 38, 38(3) and 38(6) of the OECD commentary and the decision of the US Tax Court in *Taisei Fire and Marine Insurance Co. Ltd* v. *Commissioner of Internal Rev-*

53 *Ibid*. at 473.
54 64 DTC 660 (TAB).
55 See above notes 10 and 11.

enue[56] that to be an agent of independent status the agent must be independent both legally and economically.

The Court relied on the following factors to conclude that the agents in these cases enjoyed legal independence:

- the intention of the agents not to be legally dependent;
- the lack of control by the enterprise on how the agents carried on their business;
- the lack of ownership interest by the enterprise in the agents' business;
- the fact that the enterprise held no capital assets in Canada;
- that the enterprise did not reimburse the agents for the cost of assets;
- that the employees of the agents were the responsibility of the agents; and
- that the agents were not involved in making final decisions on coverage or claims.[57]

In finding that the agents in these cases were economically independent, the Court looked to the following factors:

- the agents' income was based on commission, had no minimum or maximum levels and therefore was dependent on their own abilities and efforts;
- the agents could solicit business from any person they chose;
- for the most part, the agents were not required to act exclusively for the enterprise;
- the agents bore all of the economic risk;
- the agents' exclusive dealings with the enterprise were not determinative; and
- the supply of product to the agents by the enterprise was not in itself sufficient to create economic dependence because profit depended primarily on the agent's efforts.[58]

The Court concluded:

> "Certainly, there was product and some support, but the economic success hinged on the agent's efforts in soliciting and in establishing networks of other agents, activities over which they had complete control."[59]

In *Masri* v. *MNR*,[60] the taxpayer's activity of selling real estate in Canada through real estate agents was found to be a United States enterprise for purposes of the Canada–United States income tax convention (1942), the relevant provision of which (article II, paragraph 3(a)) provided as follows:

> "The fact that an enterprise of one of the contracting States has business dealings in the other contracting State through a commission agent, broker or other independent agent or maintains therein an office used solely for the purchase of merchandise shall not be held to mean that such enterprise has a permanent establishment in the latter State."

56 104 TC 535 (US TC 1995).
57 *American Income Life*, above note 10 at 3645.
58 *Ibid*.
59 *Ibid*. at 3645–3646.
60 73 DTC 5367 (FCTD).

In concluding that the taxpayer had no PE in Canada for purposes of the Canada–United States income tax convention (1942), the Court stated:

> "Here, all management and executive decisions concerning appellant's business and, for that matter, the so-called partnership, were taken in New York; there were no employees in Canada; no office in Canada; no person resident in Canada having authority to contract or conduct business on behalf of the appellant or the partnership; all documentation regarding the acquisition and sale of the Canadian property was executed in New York; all instructions concerning the property came from New York; appellant and the partnership acted in Canada only through commission agents and brokers. Counsel for the respondent sought to attach significance to the fact that in the course of the Canadian land venture, the partners used the services of two town planners, a land surveyor, two brokers, two law firms and a notary. In my view, these circumstances strengthen my conviction that the appellant cannot be said to have a 'permanent establishment in Canada' because all of the above noted agents have one thing in common, they are independent agents, not employees, performing services on a fee for service basis."[61]

6.2. Administrative policy

Regulation 400(2)(b) provides, in a manner similar to paragraph 5(b) of article 5 of the UN model, that where a corporation carries on business through an employee or agent who has a stock of merchandise owned by his employer or principal from which he regularly fills orders, the corporation will be deemed to have a PE in that place notwithstanding that the employee/agent has no general authority to contract. In considering the term "has a stock of merchandise" in the regulation, the CRA has stated its view that the word "has" implies possession or control of the inventory.[62] It is unclear whether this is relevant to the interpretation of the term "habitually maintained" in the UN model.

In Technical Information Bulletin B-090, the CRA stated its view that an internet service provider hosting the website of a non-resident person on its servers in Canada will generally not be an agent of the non-resident, either because it does not have the authority to conclude contracts in the name of the non-resident or because it is an independent agent acting in the ordinary course of its business.

7. Application to related companies

7.1. Jurisprudence

There is no judicial guidance on a related company constituting a PE.

61 Above note 60 at 5373.
62 CRA Document 901752 (E) (4 September 1990).

7.2. Administrative policy

The CRA has stated that a Canadian subsidiary of a foreign corporation will generally not constitute a PE in Canada of the foreign corporation, potentially even where the Canadian subsidiary habitually exercised authority to conclude contracts in the name of its parent corporation.[63] The interpretation states that the result would turn on the specific facts including the terms of the agency agreement between the parent and subsidiary and the details of the subsidiary's operations in Canada.

8. Common variants

8.1. Provision of services

8.1.1. Jurisprudence

As noted above in section 2.4.1, the concept of fixed base has been interpreted in a similar manner to the concept of PE.

8.1.2. Administrative policy

The fifth protocol[64] to the Canada–United States income tax convention (1980) will amend the definition of PE in article V to deem an enterprise of a contracting state which provides services in the other state (and which does not otherwise have a PE in that other state) to provide the services through a PE in the other state in two circumstances:

- where services are performed by an individual present in the other state for a period or periods aggregating 183 days or more in any 12-month period and, during the period, more than 50 per cent of the gross active business revenues of the enterprise consists of income derived from those services; or
- where services are provided in the other state for 183 days or more in any 12-month period with respect to the same or a connected project for customers either resident in the other state or with a PE in the other state and the services are provided in respect of the PE.

The TE comments on a number of issues:

- "Gross active business revenues" means gross revenues that the enterprise should charge for active business activities regardless of domestic law revenue recognition rules or actual billings, but not including passive investment income.
- Services must be provided to a customer who is resident in, or maintains a PE in, the other state so that services provided by an enterprise of a state to a person in that state will not constitute a PE even if performed in the other state (unless the 50 per cent of gross active business revenue test is met).

[63] CRA Document 57984 (E), (7 July 1989).
[64] Signed 21 September 2007 (not in force) at time of writing.

- Projects will be considered to be connected if they constitute a "coherent whole, commercially and geographically",[65] from the point of view of the enterprise. Factors such as whether the projects would have been concluded pursuant to a single contract (absent tax planning), whether the work under different projects is the same work and whether the same individuals are providing the services will be relevant.

A ten-month installation project divided into two five-month projects to circumvent the duration rule will be considered to be commercially coherent and a single project. Contracts to install a computer system and to train employees to use unrelated computer software will not be commercially coherent and will not be aggregated. Tax advice by a law firm will probably not be aggregated with trade law advice.

Commercially coherent projects must also be geographically coherent to be connected. Thus, auditing projects at different branches of a bank located in different cities under a single contract will not be aggregated.

The 183-day presence requirement is calculated by reference to days in which an individual is present in the other country so that physical presence during a day is sufficient. Under the second branch of the test, reference is made to days during which services are provided so that a day, such as a weekend or holiday, during which no services are actually provided will not count.

Where multiple individuals are used to provide services, they will be considered to be a single whole for calculation purposes under both branches of the test. Thus, where 20 employees are present in the other country for 10 days, the enterprise will be considered present in that other country for 10 days, not 200 days.

8.2. Insurance

There is no judicial or administrative guidance on the deeming rules regarding insurance activities in the UN model.

8.3. Use of equipment and resource exploration or extraction

8.3.1. Jurisprudence

In *Canadian Pacific Ltd* v. *The Queen*,[66] the Court considered the provision in paragraph 3(f) of the Canada–United States income tax convention (1942) that states:

> "The use of substantial equipment or machinery within one of the contracting States at any time in any taxable year by an enterprise of the other contracting State shall constitute a permanent establishment of such enterprise in the former State for such taxable year."

[65] *Ibid*. at 12.
[66] 76 DTC 6120 (FCTD), rev'd on other grounds 77 DTC 5383 (FCA).

The Canadian taxpayer leased railway cars to US railways for use in the United States. The Court found that the "mere use"[67] of the freight cars in the United States by other railways did not constitute a PE of the Canadian lessor for the purposes of this definition.

In *Sunbeam,* the Court found that the word "substantial" in this context was intended to mean "substantial in size"[68] and that the provision was intended only to apply to machinery and equipment such as is used by contractors or builders in the course of their operations.

8.3.2. Administrative policy

The CRA has stated its view, in paragraph 6 of IT-177R2, that a corporation need not actually own machinery or equipment for it to be a PE. Whether the machinery or equipment is substantial is determined in part by its size, quantity and value and whether it contributes substantially to the gross income that the corporation earned in that place.

9. Non-treaty uses of PE concept

As noted above, the PE concept is used extensively in Canada for domestic purposes to allocate income between the Canadian provinces and territories for provincial and territorial income tax purposes. Core concepts of "fixed" place of business and the agency establishment are common both to treaty and domestic definitions of PE and, to that extent, courts and tax authorities have relied on jurisprudence and interpretations of each of the domestic and treaty PE concepts in interpreting the other.

67 *Ibid*. at 6135.
68 See above note 1 at 1394.

COMMENTARY ON ARTICLE 5

CONCERNING THE DEFINITION OF PERMANENT ESTABLISHMENT

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.

(Added on 29 April 2000)

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 (cf. Commentary on paragraph 4).

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.

(Added on 28 January 2003)

4.2 Whilst no formal legal right to use a particular place is required for that place to constitute a permanent establishment, the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise. These principles are illustrated by the following examples where representatives of one enterprise are present on the premises of another enterprise. A first example is that of a salesman who regularly visits a major customer to take orders and meets the purchasing director in his office to do so. In that case, the customer's premises are not at the disposal of the enterprise for which the salesman is working and therefore do not constitute a fixed place of business through which the business of that enterprise is carried on (depending on the circumstances, however, paragraph 5 could apply to deem a permanent establishment to exist).

(Added on 28 January 2003)

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

(Added on 28 January 2003)

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

(Added on 28 January 2003)

4.5 A fourth example is that of a painter who, for two years, spends three days a week in the large office building of its main client. In that case, the presence of the painter in that office

building where he is performing the most important functions of his business (i.e. painting) constitute a permanent establishment of that painter.

(Added on 28 January 2003)

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

(Added on 28 January 2003)

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

(Amended on 23 July 1992)

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.

(Added on 28 January 2003)

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.

(Added on 28 January 2003)

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.

(Added on 28 January 2003)

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.

(Added on 28 January 2003)

6. Since the place of business must be fixed, it also follows that a permanent establishment can be deemed to exist only if the place of business has a certain degree of permanency, i.e. if it is not of a purely temporary nature. A place of business may, however, constitute a permanent establishment even though it exists, in practice, only for a very short period of time because the nature of the business is such that it will only be carried on for that short period of time. It is sometimes difficult to determine whether this is the case. Whilst the practices followed by member countries have not been consistent in so far as time requirements are concerned, experience has shown that permanent establishments normally have not been considered to exist in situations where a business had been carried on in a country through a place of business that was maintained for less than six months (conversely, practice shows that there were many cases where a permanent establishment has been considered to exist where the place of business was maintained for a period longer than six months). One exception has been where the activities were of a recurrent nature; in such cases, each period of time during which the place is used needs to be considered in combination with the number of times during which that place is used (which may extend over a number of years). Another exception has been made where activities constituted a business that was carried on exclusively in that country; in this situation, the business may have short duration because of its nature but since it is wholly carried on in that country, its connection with that country is stronger. For ease of administration, countries may want to consider these practices when they address disagreements as to whether a particular place of business that exists only for a short period of time constitutes a permanent establishment.

(Amended on 28 January 2003)

6.1 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.

(Added on 28 January 2003)

6.2 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.

(Added on 28 January 2003)

6.3 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.

(Added on 28 January 2003)

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.

(Amended on 23 July 1992)

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."[1]

1 Reproduced in Report R(3)-1.

(Replaced on 23 July 1992)

10. The business of an enterprise is carried on mainly by the entrepreneur or persons who are in a paid-employment relationship with the enterprise (personnel). This personnel includes employees and other persons receiving instructions from the enterprise (e.g. dependent agents). The powers of such personnel in its relationship with third parties are irrelevant. It makes no difference whether or not the dependent agent is authorised to conclude contracts if he works at the fixed place of business (cf. paragraph 35 below). But a permanent establishment may nevertheless exist if the business of the enterprise is carried on mainly through automatic equipment, the activities of the personnel being restricted to setting up, operating, controlling and maintaining such equipment. Whether or not gaming and vending machines and the like set up by an enterprise of a State in the other State constitute a permanent establishment thus depends on whether or not the enterprise carries on a business activity besides the initial setting up of the machines. A permanent establishment does not exist if the enterprise merely sets up the machines and then leases the machines to other enterprises. A permanent establishment may exist, however, if the enterprise which sets up the machines also operates and maintains them for its own account. This also applies if the machines are operated and maintained by an agent dependent on the enterprise.

(Renumbered and amended on 23 July 1992)

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.

(Renumbered on 23 July 1992)

Paragraph 2

12. This paragraph contains a list, by no means exhaustive, of examples, each of which can be regarded, *prima facie*, as constituting a permanent establishment. As these examples are to be seen against the background 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. in such a way that such places of business constitute permanent establishments only if they meet the requirements of paragraph 1.

(Renumbered on 23 July 1992)

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.

(Renumbered on 23 July 1992)

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.

(Renumbered on 23 July 1992)

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.

(Renumbered on 23 July 1992)

Paragraph 3

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

(Amended on 28 January 2003)

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.

(Amended on 28 January 2003)

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.

(Renumbered and amended on 23 July 1992)

19. A site exists from the date on which the contractor begins his work, including any preparatory work, in the country where the construction is to be established, e.g. if he installs a planning office for the construction. In general, it continues to exist until the work is completed or

permanently abandoned. A site should not be regarded as ceasing to exist when work is temporarily discontinued. Seasonal or other temporary interruptions should be included in determining the life of a site. Seasonal interruptions include interruptions due to bad weather. Temporary interruption could be caused, for example, by shortage of material or labour difficulties. Thus, for example, if a contractor started work on a road on 1st May, stopped on 1st November because of bad weather conditions or a lack of materials but resumed work on 1st February the following year, completing the road on 1st June, his construction project should be regarded as a permanent establishment because thirteen months elapsed between the date he first commenced work (1st May) and the date he finally finished (1st June of the following year). If an enterprise (general contractor) which has undertaken the performance of a comprehensive project subcontracts parts of such a project to other enterprises (subcontractors), the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor on the building project. The subcontractor himself has a permanent establishment at the site if his activities there last more than twelve months.

(Renumbered on 23 July 1992)

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

(Added on 29 April 2000)

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.

(Amended on 28 January 2003)

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. The common feature of these activities is that they are, in general, preparatory or auxiliary activities. This is laid down explicitly in the case of the exception mentioned in subparagraph *e),* which actually amounts to a general restriction of the scope of the definition contained in paragraph 1. Moreover sub paragraph *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.

(Renumbered on 23 July 1992)

22. Subparagraph *a*) relates only to the case in which an enterprise acquires the use of facilities for storing, displaying or delivering its own goods or merchandise. Subparagraph *b*)

relates to the stock of merchandise itself and provides that the stock, as such, shall not be treated as a permanent establishment if it is maintained for the purpose of storage, display or delivery. Subparagraph *c*) covers the case in which a stock of goods or merchandise belonging to one enterprise is processed by a second enterprise, on behalf of, or for the account of, the first-mentioned enterprise. The reference to the collection of information in subparagraph *d*) is intended to include the case of the newspaper bureau which has no purpose other than to act as one of many "tentacles" of the parent body; to exempt such a bureau is to do no more than to extend the concept of "mere purchase".

(Renumbered on 23 July 1992)

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

(Renumbered on 23 July 1992)

24. It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity. Where, for example, the servicing of patents and know-how is the purpose of an enterprise, a fixed place of business of such enterprise exercising such an activity cannot get the benefits of subparagraph *e)*. A fixed place of business which has the function of managing an enterprise or even only a part of an enterprise or of a group of the concern cannot be regarded as doing a preparatory or auxiliary activity, for such a managerial activity exceeds this level. If enterprises with international ramifications establish a so-called "management office" in States in which they maintain subsidiaries, permanent establishments, agents or licensees, such office having supervisory and coordinating 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.

(Renumbered on 23 July 1992)

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.

(Amended on 28 January 2003)

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*).

(Renumbered on 23 July 1992)

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.

(Added on 28 January 2003)

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

(Amended on 28 January 2003)

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.

(Added on 28 January 2003)

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.

(Renumbered on 23 July 1992)

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

(Renumbered and amended on 23 July 1992)

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.

(Renumbered on 23 July 1992)

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 1and 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.

(Renumbered and amended on 23 July 1992)

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.

(Amended on 28 January 2003)

32.1 Also, the phrase “authority to conclude contracts in the name of the enterprise” does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise. Lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions.

(Added on 28 January 2003)

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

(Amended on 15 July 2005)

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

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

(Added on 28 January 2003)

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.

(Renumbered on 23 July 1992)

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.

(Renumbered on 23 July 1992)

Paragraph 6

36. Where an enterprise of a Contracting State carries on business dealings through a broker, general commission agent or any other agent of an independent status, it cannot be taxed in the other Contracting State in respect of those dealings if the agent is acting in the ordinary course of his business (cf. paragraph 32 above). Although it stands to reason that such an agent, representing a separate enterprise, cannot constitute a permanent establishment of the foreign enterprise, paragraph 6 has been inserted in the Article for the sake of clarity and emphasis.

(Renumbered and amended on 23 July 1992)

37. A person will come within the scope of paragraph 6, i.e. he will not constitute a permanent establishment of the enterprise on whose behalf he acts only if:

a) he is independent of the enterprise both legally and economically, and

b) he acts in the ordinary course of his business when acting on behalf of the enterprise.

(Renumbered and amended on 23 July 1992)

38. Whether a person is independent of the enterprise represented depends on the extent of the obligations which this person has vis-à-vis the enterprise. Where the person's commercial activities for the enterprise are subject to detailed instructions or to comprehensive control by it, such person cannot be regarded as independent of the enterprise. Another important criterion will be whether the entrepreneurial risk has to be borne by the person or by the enterprise the person represents.

(Amended on 28 January 2003)

38.1 In relation to the test of legal dependence, it should be noted that the control which a parent company exercises over its subsidiary in its capacity as shareholder is not relevant in a consideration of the dependence or otherwise of the subsidiary in its capacity as an agent for the parent. This is consistent with the rule in paragraph 7 of Article 5. But, as paragraph 41 of the Commentary indicates, the subsidiary may be considered a dependent agent of its parent by application of the same tests which are applied to unrelated companies.

(Added on 28 January 2003)

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

(Added on 28 January 2003)

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

(Added on 28 January 2003)

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

(Added on 28 January 2003)

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

(Added on 28 January 2003)

38.6 Another factor to be considered in determining independent status is the number of principals represented by the agent. Independent status is less likely if the activities of the agent are performed wholly or almost wholly on behalf of only one enterprise over the lifetime of the business or a long period of time. However, this fact is not by itself determinative. All the facts and circumstances must be taken into account to determine whether the agent's activities constitute an autonomous business conducted by him in which he bears risk and receives reward through the use of his entrepreneurial skills and knowledge. Where an agent acts for a number of principals in the ordinary course of his business and none of these is predominant in terms of the business carried on by the agent legal dependence may exist if the principals act in concert to control the acts of the agent in the course of his business on their behalf.

(Added on 28 January 2003)

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

(Added on 28 January 2003)

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

(Added on 28 January 2003)

39. According to the definition of the term “permanent establishment” an insurance company of one State may be taxed in the other State on its insurance business, if it has a fixed place of business within the meaning of paragraph 1 or if it carries on business through a person within the meaning of paragraph 5. Since agencies of foreign insurance companies sometimes do not meet either of the above requirements, it is conceivable that these companies do large-scale business in a State without being taxed in that State on their profits arising from such business. In order to obviate this possibility, various conventions concluded by OECD member countries include a provision which stipulates that insurance companies of a State are deemed to have a permanent establishment in the other State if they collect premiums in that other State through an agent established there — other than an agent who already constitutes a permanent establishment by virtue of paragraph 5 — or insure risks situated in that territory through such an agent. The decision as to whether or not a provision along these lines should be included in a convention will depend on the factual and legal situation prevailing in the Contracting States concerned. Frequently, therefore, such a provision will not be contemplated. In view of this fact, it did not seem advisable to insert a provision along these lines in the Model Convention.

(Renumbered on 23 July 1992)

Paragraph 7

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

(Renumbered on 23 July 1992)

41. A parent company may, however, be found, under the rules of paragraphs 1 or 5 of the Article, to have a permanent establishment in a State where a subsidiary has a place of business. Thus, any space or premises belonging to the subsidiary that is at the disposal of the parent company (see paragraphs 4, 5 and 6 above) and that constitutes a fixed place of business through which the parent carries on its own business will constitute a permanent establishment of the parent under paragraph 1, subject to paragraphs 3 and 4 of the Article (see for instance, the example in paragraph 4.3 above). Also, under paragraph 5, a parent will be deemed to have a permanent establishment in a State in respect of any activities that its subsidiary undertakes for it if the subsidiary has, and habitually exercises, in that State an authority to conclude contracts in the name of the parent (see paragraphs 32, 33 and 34 above), unless these activities are limited to those referred to in paragraph 4 of the Article or unless the subsidiary acts in the ordinary course of its business as an independent agent to which paragraph 6 of the Article applies.

(Amended on 15 July 2005)

41.1 The same principles apply to any company forming part of a multinational group so that such a company may be found to have a permanent establishment in a State where it has at its disposal (see paragraphs 4, 5 and 6 above) and uses premises belonging to another company of the group, or if the former company is deemed to have a permanent establishment under paragraph 5 of the Article (see paragraphs 32, 33 and 34 above). The determination of the existence of a permanent establishment under the rules of paragraphs 1 or 5 of the Article must, however, be done separately for each company of the group. Thus, the existence in one State of a permanent establishment of one company of the group will not have any relevance as to whether another company of the group has itself a permanent establishment in that State.

(Added on 15 July 2005)

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

(Replaced on 15 July 2005)

Electronic commerce

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

(Added on 28 January 2003)

42.2 Whilst a location where automated equipment is operated by an enterprise may constitute a permanent establishment in the country where it is situated (see below), a distinction needs to be made between computer equipment, which may be set up at a location so as to constitute a permanent establishment under certain circumstances, and the data and software which is used by, or stored on, that equipment. For instance, an Internet web site, which is a combination of software and electronic data, does not in itself constitute tangible property. It therefore does not have a location that can constitute a “place of business” as there is no “facility such as premises or, in certain instances, machinery or equipment” (see paragraph 2 above) as far as the software and data constituting that web site is concerned. On the other hand, the server on which the web site is stored and through which it is accessible is a piece of equipment having a physical location and such location may thus constitute a “fixed place of business” of the enterprise that operates that server.

(Added on 28 January 2003)

42.3 The distinction between a web site and the server on which the web site is stored and used is important since the enterprise that operates the server may be different from the enterprise that carries on business through the web site. For example, it is common for the web site through which an enterprise carries on its business to be hosted on the server of an Internet Service Provider (ISP). Although the fees paid to the ISP under such arrangements may be based on the amount of disk space used to store the software and data required by the web site, these contracts typically do not result in the server and its location being at the disposal of the enterprise (see paragraph 4 above), even if the enterprise has been able to determine that its web site should be hosted on a particular server at a particular location. In such a case, the enterprise does not even have a physical presence at that location since the web site is not tangible. In these cases, the enterprise cannot be considered to have acquired a place of business by virtue of that hosting arrangement. However, if the enterprise carrying on business through a web site has the server at its own disposal, for example it owns (or leases) and operates the server on which the web site is stored and used, the place where that server is located could constitute a permanent establishment of the enterprise if the other requirements of the Article are met.

(Added on 28 January 2003)

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

(Added on 28 January 2003)

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

(Added on 28 January 2003)

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

(Added on 28 January 2003)

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

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

(Added on 28 January 2003)

42.8 Where, however, such functions form in themselves an essential and significant part of the business activity of the enterprise as a whole, or where other core functions of the enterprise are carried on through the computer equipment, these would go beyond the activities covered by paragraph 4 and if the equipment constituted a fixed place of business of the enterprise (as discussed in paragraphs 42.2 to 42.6 above), there would be a permanent establishment.

(Added on 28 January 2003)

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

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

(Added on 28 January 2003)

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

(Added on 28 January 2003)

The taxation of services

42.11 The combined effect of this Article and Article 7 is that the profits from services performed in the territory of a Contracting State by an enterprise of the other Contracting State are not taxable in the first-mentioned State if they are not attributable to a permanent establishment situated therein (as long as they are not covered by other Articles of the Convention that would allow such taxation). This result, under which these profits are only taxable in the other State, is supported by various policy and administrative considerations. It is consistent with the principle of Article 7 that until an enterprise of one State sets up a permanent establishment in another State, it should not be regarded as participating in the economic life of that State to such an extent that it comes within the taxing jurisdiction of that other State. Also, the provision of services should, as a general rule subject to a few exceptions for some types of service (e.g. those covered by Article 8 and 17), be treated the same way as other business activities and, therefore, the same permanent establishment threshold of taxation should apply to all business activities, including the provision of independent services.

(Added on 17 July 2008)

42.12 One of the administrative considerations referred to above is that the extension of the cases where source taxation of profits from services performed in the territory of a Contracting State by an enterprise of the other Contracting State would be allowed would increase the compliance and administrative burden of enterprises and tax administrations. This would be especially problematic with respect to services provided to non-business consumers, which would

not need to be disclosed to the source country's tax administration for purposes of claiming a business expense deduction. Since the rules that have typically been designed for that purpose are based on the amount of time spent in a State, both tax administrations and enterprises would need to take account of the time spent in a country by personnel of service enterprises and these enterprises would face the risk of having a permanent establishment in unexpected circumstances in cases where they would be unable to determine in advance how long personnel would be present in a particular country (e.g. in situations where that presence would be extended because of unforeseen difficulties or at the request of a client). These cases create particular compliance difficulties as they require an enterprise to retroactively comply with a number of administrative requirements associated with a permanent establishment. These concerns relate to the need to maintain books and records, the taxation of the employees (e.g. the need to make source deductions in another country) as well as other non-income tax requirements.

(Added on 17 July 2008)

42.13 Also, the source taxation of profits from services performed in the territory of a Contracting State by an enterprise of the other Contracting State that does not have a fixed place of business in the first-mentioned State would create difficulties concerning the determination of the profits to be taxed and the collection of the relevant tax. In most cases, the enterprise would not have the accounting records and assets typically associated with a permanent establishment and there would be no dependent agent which could comply with information and collection requirements. Moreover, whilst it is a common feature of States' domestic law to tax profits from services performed in their territory, it does not necessarily represent optimal tax treaty policy.

(Added on 17 July 2008)

42.14 Some States, however, are reluctant to adopt the principle of exclusive residence taxation of services that are not attributable to a permanent establishment situated in their territory but that are performed in that territory. These States propose changes to the Article in order to preserve source taxation rights, in certain circumstances, with respect to the profits from such services. States that believe that additional source taxation rights should be allocated under a treaty with respect to services performed in their territory rely on various arguments to support their position.

(Added on 17 July 2008)

42.15 These States may consider that profits from services performed in a given state should be taxable in that state on the basis of the generally-accepted policy principles for determining when business profits should be considered to have their source within a jurisdiction. They consider that, from the exclusive angle of the pure policy question of where business profits originate, the State where services are performed should have a right to tax even when these services are not attributable to a permanent establishment as defined in Article 5. They would note that the domestic law of many countries provides for the taxation of services performed in these countries even in the absence of a permanent establishment (even though services performed over very short periods of time may not always be taxed in practice).

(Added on 17 July 2008)

42.16 These States are concerned that some service businesses do not require a fixed place of business in their territory in order to carry on a substantial level of business activities therein and consider that these additional rights are therefore appropriate.

(Added on 17 July 2008)

42.17 Also, these States consider that even if the taxation of profits of enterprises carried on by non-residents that are not attributable to a permanent establishment raises certain compliance and administrative difficulties, these difficulties do not justify exempting from tax the profits from all services performed on their territory by such enterprises. Those who support that view may refer to mechanisms that are already in place in some States to ensure taxation of services

performed in these States but not attributable to permanent establishments (such mechanisms are based on requirements for resident payers to report, and possibly withhold tax on, payments to non-residents for services performed in these States).

(Added on 17 July 2008)

42.18 It should be noted, however, that all member States agree that a State should not have source taxation rights on income derived from the provision of services performed by a non-resident outside that State. Under tax conventions, the profits from the sale of goods that are merely imported by a resident of a country and that are neither produced nor distributed through a permanent establishment in that country are not taxable therein and the same principle should apply in the case of services. The mere fact that the payer of the consideration for services is a resident of a State, or that such consideration is borne by a permanent establishment situated in that State or that the result of the services is used within the State does not constitute a sufficient nexus to warrant allocation of income taxing rights to that State.

(Added on 17 July 2008)

42.19 Another fundamental issue on which there is general agreement relates to the determination of the amount on which tax should be levied. In the case of non-employment services (and subject to possible exceptions such as Article 17) only the profits derived from the services should be taxed. Thus, provisions that are sometimes included in bilateral conventions and that allow a State to tax the gross amount of the fees paid for certain services if the payer of the fees is a resident of that State do not seem to provide an appropriate way of taxing services. First, because these provisions are not restricted to services performed in the State of source, they have the effect of allowing a State to tax business activities that do not take place in that State. Second, these rules allow taxation of the gross payments for services as opposed to the profits therefrom.

(Added on 17 July 2008)

42.20 Also, member States agree that it is appropriate, for compliance and other reasons, not to allow a State to tax the profits from services performed in their territory in certain circumstances (e.g. when such services are provided during a very short period of time).

(Added on 17 July 2008)

42.21 The Committee therefore considered that it was important to circumscribe the circumstances in which States that did not agree with the conclusion in paragraph 42.11 above could, if they wished to, provide that profits from services performed in the territory of a Contracting State by an enterprise of the other Contracting State would be taxable by that State even if there was no permanent establishment, as defined in Article 5, to which the profits were attributable.

(Added on 17 July 2008)

42.22 Clearly, such taxation should not extend to services performed outside the territory of a State and should apply only to the profits from these services rather than to the payments for them. Also, there should be a minimum level of presence in a State before such taxation is allowed.

(Added on 17 July 2008)

42.23 The following is an example of a provision that would conform to these requirements; States are free to agree bilaterally to include such a provision in their tax treaties:

> "Notwithstanding the provisions of paragraphs 1, 2 and 3, where an enterprise of a Contracting State performs services in the other Contracting State
>
> *a*) through an individual who is present in that other State for a period or periods exceeding in the aggregate 183 days in any twelve month period, and more than 50 per cent of the

gross revenues attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State through that individual, or

b) for a period or periods exceeding in the aggregate 183 days in any twelve month period, and these services are performed for the same project or for connected projects through one or more individuals who are present and performing such services in that other State

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

(Added on 17 July 2008)

42.24 That alternative provision constitutes an extension of the permanent establishment definition that allows taxation of income from services provided by enterprises carried on by non-residents but does so in conformity with the principles described in paragraph 42.22. The following paragraphs discuss various aspects of the alternative provision; clearly these paragraphs are not relevant in the case of treaties that do not include such a provision and do not, therefore, allow a permanent establishment to be found merely because the conditions described in this provision have been met.

(Added on 17 July 2008)

42.25 The provision has the effect of deeming a permanent establishment to exist where one would not otherwise exist under the definition provided in paragraph 1 and the examples of paragraph 2. It therefore applies notwithstanding these paragraphs. As is the case of paragraph 5 of the Article, the provision provides a supplementary basis under which an enterprise may be found to have a permanent establishment in a State; it could apply, for example, where a consultant provides services over a long period in a country but at different locations that do not meet the conditions of paragraph 1 to constitute one or more permanent establishments. 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 apply the provision in order to find a permanent establishment. Since the provision simply creates a permanent establishment when none would otherwise exist, it does not provide an alternative definition of the concept of permanent establishment and obviously cannot limit the scope of the definition in paragraph 1 and of the examples in paragraph 2.

(Added on 17 July 2008)

42.26 The provision also applies notwithstanding paragraph 3. Thus, an enterprise may be deemed to have a permanent establishment because it performs services in a country for the periods of time provided for in the suggested paragraph even if the various locations where these services are performed do not constitute permanent establishments pursuant to paragraph 3. The following example illustrates that result. A self-employed individual resident of one Contracting State provides services and is present in the other Contracting State for more than 183 days during a 12-month period but his services are performed for equal periods of time at a location that is not a construction site (and are not in relation to a construction or installation project) as well as on two unrelated building sites which each lasts less than the period of time provided for in paragraph 3. Whilst paragraph 3 would deem the two sites not to constitute permanent establishments, the proposed paragraph, which applies notwithstanding paragraph 3, would deem the enterprise carried on by that person to have a permanent establishment (since the individual is self-employed, it must be assumed that the 50% of gross revenues test will be met with respect to his enterprise).

(Added on 17 July 2008)

42.27 Another example is that of a large construction enterprise that carries on a single construction project in a country. If the project is carried on at a single site, the provision should not have a significant impact as long as the period required for the site to constitute a permanent establishment is not substantially different from the period required for the provision to apply. States that wish to use the alternative provision may therefore wish to consider referring to the same periods of time in that provision and in paragraph 3 of Article 5; If a shorter period is used in the alternative provision, this will reduce, in practice, the scope of application of paragraph 3.

(Added on 17 July 2008)

42.28 The situation, however, may be different if the project, or connected projects, are carried out in different parts of a country. If the individual sites where a single project is carried on do not last sufficiently long for each of them to constitute a permanent establishment (see, however, paragraph 20 above), a permanent establishment will still be deemed to exist if the conditions of the alternative provision are met. That result is consistent with the purpose of the provision, which is to subject to source taxation foreign enterprises that are present in a country for a sufficiently long period of time notwithstanding the fact that their presence at any particular location in that country is not sufficiently long to make that location a fixed place of business of the enterprise. Some States, however, may consider that paragraph 3 should prevail over the alternative provision and may wish to amend the provision accordingly.

(Added on 17 July 2008)

42.29 The suggested paragraph only applies to services. Other types of activities that do not constitute services are therefore excluded from its scope. Thus, for instance, the paragraph would not apply to a foreign enterprise that carries on fishing activities in the territorial waters of a State and derives revenues from selling its catches (in some treaties, however, activities such as fishing and oil extraction may be covered by specific provisions).

(Added on 17 July 2008)

42.30 The provision applies to services performed by an enterprise. Thus, services must be provided by the enterprise to third parties. Clearly, the provision could not have the effect of deeming an enterprise to have a permanent establishment merely because services are provided to that enterprise. For example, services might be provided by an individual to his employer without that employer performing any services (e.g. an employee who provides manufacturing services to an enterprise that sells manufactured products). Another example would be where the employees of one enterprise provide services in one country to an associated enterprise under detailed instructions and close supervision of the latter enterprise; in that case, assuming the services in question are not for the benefit of any third party, the latter enterprise does not itself perform any services to which the provision could apply.

(Added on 17 July 2008)

42.31 Also, the provision only applies to services that are performed in a State by a foreign enterprise. Whether or not the relevant services are furnished to a resident of the State does not matter; what matters is that the services are performed in the State through an individual present in that State.

(Added on 17 July 2008)

42.32 The alternative provision does not specify that the services must be provided “through employees or other personnel engaged by the enterprise”, a phrase that is sometimes found in bilateral treaties. It simply provides that the services must be performed by an enterprise. As explained in paragraph 10, the business of an enterprise (which, in the context of the paragraph, would include the services performed in a Contracting State) “is carried on mainly by the entrepreneur or persons who are in paid-employment relationship with the enterprise (personnel). This personnel includes employees and other persons receiving instructions from the enterprise (e.g. dependent agents).” For the purposes of the alternative provision, the individuals through

which an enterprise provides services will therefore be the individuals referred to in paragraph 10, subject to the exception included in the last sentence of that provision (see paragraph 42.43 below).

(Added on 17 July 2008)

42.33 The alternative provision will apply in two different sets of circumstances. Subparagraph *a*) looks at the duration of the presence of the individual through whom an enterprise derives most of its revenues in a way that is similar to that of subparagraph 2 *a*) of Article 15; subparagraph *b*) looks at the duration of the activities of the individuals through whom the services are performed.

(Added on 17 July 2008)

42.34 Subparagraph *a*) deals primarily with the situation of an enterprise carried on by a single individual. It also covers, however, the case of an enterprise which, during the relevant period or periods, derives most of its revenues from services provided by one individual. Such extension is necessary to avoid a different treatment between, for example, a case where services are provided by an individual and a case where similar services are provided by a company all the shares of which are owned by the only employee of that company.

(Added on 17 July 2008)

42.35 The subparagraph may apply in different situations where an enterprise performs services through an individual, such as when the services are performed by a sole proprietorship, by the partner of a partnership, by the employee of a company etc. The main conditions are that

- — the individual through whom the services are performed be present in a State for a period or periods exceeding in the aggregate 183 days in any twelve month period, and
- — more than 50 per cent of the gross revenues attributable to active business activities of the enterprise during the period or periods of presence be derived from the services performed in that State through that individual.

(Added on 17 July 2008)

42.36 The first condition refers to the days of presence of an individual. Since the formulation is identical to that of subparagraph 2 *a*) of Article 15, the principles applicable to the computation of the days of presence for purposes of that last subparagraph are also applicable to the computation of the days of presence for the purpose of the suggested paragraph.

(Added on 17 July 2008)

42.37 For the purposes of the second condition, according to which more than 50 per cent of the gross revenues attributable to active business activities of the enterprise during the relevant period or periods must be derived from the services performed in that State through that individual, the gross revenues attributable to active business activities of the enterprise would represent what the enterprise has charged or should charge for its active business activities, regardless of when the actual billing will occur or of domestic law rules concerning when such revenues should be taken into account for tax purposes. Such active business activities are not restricted to activities related to the provision of services. Gross revenues attributable to “active business activities” would clearly exclude income from passive investment activities, including, for example, receiving interest and dividends from investing surplus funds. States may, however, prefer to use a different test, such as “50% of the business profits of the enterprise during this period or periods is derived from the services” or “the services represent the most important part of the business activities of the enterprise”, in order to identify an enterprise that derives most of its revenues from services performed by an individual on their territory.

(Added on 17 July 2008)

42.38 The following examples illustrate the application of subparagraph *a*) (assuming that the alternative provision has been included in a treaty between States R and S):

— Example 1: W, a resident of State R, is a consultant who carries on her business activities in her own name (i.e. that enterprise is a sole proprietorship). Between 2 February 00 and 1 February 01, she is present in State S for a period or periods of 190 days and during that period all the revenues from her business activities are derived from services that she performs in State S. Since subparagraph *a*) applies in that situation, these services shall be deemed to be performed through a permanent establishment in State S.

— Example 2: X, a resident of State R, is one of the two shareholders and employees of XCO, a company resident of State R that provides engineering services. Between 20 December 00 and 19 December 01, X is present in State S for a period or periods of 190 days and during that period, 70% of all the gross revenues of XCO attributable to active business activities are derived from the services that X performs in State S. Since subparagraph *a*) applies in that situation, these services shall be deemed to be performed through a permanent establishment of XCO in State S.

— Example 3: X and Y, who are residents of State R, are the two partners of X&Y, a partnership established in State R which provides legal services. For tax purposes, State R treats partnerships as transparent entities. Between 15 July 00 and 14 July 01, Y is present in State S for a period or periods of 240 days and during that period, 55% of all the fees of X&Y attributable to X&Y's active business activities are derived from the services that Y performs in State S. Subparagraph *a*) applies in that situation and, for the purposes of the taxation of X and Y, the services performed by Y are deemed to be performed through a permanent establishment in State S.

— Example 4: Z, a resident of State R, is one of 10 employees of ACO, a company resident of State R that provides accounting services. Between 10 April 00 and 9 April 01, Z is present in State S for a period or periods of 190 days and during that period, 12% of all the gross revenues of ACO attributable to its active business activities are derived from the services that Z performs in State S. Subparagraph *a*) does not apply in that situation and, unless subparagraph *b*) applies to ACO, the alternative provision will not deem ACO to have a permanent establishment in State S.

(Added on 17 July 2008)

42.39 Subparagraph *b*) addresses the situation of an enterprise that performs services in a Contracting State in relation to a particular project (or for connected projects) and which performs these through one or more individuals over a substantial period. The period or periods referred to in the subparagraph apply in relation to the enterprise and not to the individuals. It is therefore not necessary that it be the same individual or individuals who perform the services and are present throughout these periods. As long as, on a given day, the enterprise is performing its services through at least one individual who is doing so and is present in the State, that day would be included in the period or periods referred to in the subparagraph. Clearly, however, that day will count as a single day regardless of how many individuals are performing such services for the enterprise during that day.

(Added on 17 July 2008)

42.40 The reference to an “enterprise […] performing these services for the same project” should be interpreted from the perspective of the enterprise that provides the services. Thus, an enterprise may have two different projects to provide services to a single customer (e.g. to provide tax advice and to provide training in an area unrelated to tax) and whilst these may be related to a single project of the customer, one should not consider that the services are performed for the same project.

(Added on 17 July 2008)

42.41 The reference to “connected projects” is intended to cover cases where the services are provided in the context of separate projects carried on by an enterprise but these projects have a commercial coherence (see paragraphs 5.3 and 5.4 above). The determination of whether projects are connected will depend on the facts and circumstances of each case but factors that would generally be relevant for that purpose include:

— whether the projects are covered by a single master contract;

— where the projects are covered by different contracts, whether these different contracts were concluded with the same person or with related persons and whether the conclusion of the additional contracts would reasonably have been expected when concluding the first contract;

— whether the nature of the work involved under the different projects is the same;

— whether the same individuals are performing the services under the different projects.

(Added on 17 July 2008)

42.42 Subparagraph *b*) requires that during the relevant periods, the enterprise is performing services through individuals who are performing such services in that other State. For that purpose, a period during which individuals are performing services means a period during which the services are actually provided, which would normally correspond to the working days of these individuals. An enterprise that agrees to keep personnel available in case a client needs the services of such personnel and charges the client standby charges for making such personnel available is performing services through the relevant individuals even though they are idle during the working days when they remain available.

(Added on 17 July 2008)

42.43 As indicated in paragraph 42.32, for the purposes of the alternative provision, the individuals through whom an enterprise provides services will be the individuals referred to in paragraph 10 above. If, however, an individual is providing the services on behalf of one enterprise, the exception included in the last sentence of the provision clarifies that the services performed by that individual will only be taken into account for another enterprise if the work of that individual is exercised under the supervision, direction or control of the last-mentioned enterprise. Thus, for example, where a company that has agreed by contract to provide services to third parties provides these services through the employees of a separate enterprise (e.g. an enterprise providing outsourced services), the services performed through these employees will not be taken into account for purposes of the application of subparagraph *b*) to the company that entered into the contract to provide services to third parties. This rule applies regardless of whether the separate enterprise is associated to, or independent from, the company that entered into the contract.

(Added on 17 July 2008)

42.44 The following examples illustrate the application of subparagraph *b*) (assuming that the alternative provision has been included in a treaty between States R and S):

— Example 1: X, a company resident of State R, has agreed with company Y to carry on geological surveys in various locations in State S where company Y owns exploration rights. Between 15 May 00 and 14 May 01, these surveys are carried on over 185 working days by employees of X as well as by self-employed individuals to whom X has sub-contracted part of the work but who work under the direction, supervision or control of X. Since subparagraph *b*) applies in that situation, these services shall be deemed to be performed through a permanent establishment of X in State S.

— Example 2: Y, a resident of State T, is one of the two shareholders and employees of WYCO, a company resident of State R that provides training services. Between 10 June 00 and 9 June 01, Y performs services in State S under a contract that WYCO has concluded with a company which is a resident of State S to train the employees of that company. These services are performed in State S over 185 working days. During the

period of Y's presence in State S, the revenues from these services account for 40% of the gross revenues of WYCO from its active business activities. Whilst subparagraph *a*)does not apply in that situation, subparagraph *b*) applies and these services shall be deemed to be performed through a permanent establishment of WYCO in State S.

— Example 3: ZCO, a resident of State R, has outsourced to company OCO, which is a resident of State S, the technical support that it provides by telephone to its clients. OCO operates a call centre for a number of companies similar to ZCO. During the period of 1 January 00 to 31 December 00, the employees of OCO provide technical support to various clients of ZCO. Since the employees of OCO are not under the supervision, direction or control of ZCO, it cannot be considered, for the purposes of subparagraph *b*), that ZCO is performing services in State S through these employees. Additionally, whilst the services provided by OCO's employees to the various clients of ZCO are similar, these are provided under different contracts concluded by ZCO with unrelated clients: these services cannot, therefore, be considered to be rendered for the same or connected projects.

(Added on 17 July 2008)

42.45 The 183-day thresholds provided for in the alternative provision may give rise to the same type of abuse as is described in paragraph 18 above. As indicated in that paragraph, legislative or judicial anti-avoidance rules may apply to prevent such abuses. Some States, however, may prefer to deal with them by including a specific provision in the Article. Such a provision could be drafted along the following lines:

> "For the purposes of paragraph [x], where an enterprise of a Contracting State that is performing services in the other Contracting State is, during a period of time, associated with another enterprise that performs substantially similar services in that other State for the same project or for connected projects through one or more individuals who, during that period, are present and performing such services in that State, the first-mentioned enterprise shall be deemed, during that period of time, to be performing services in the other State for that same project or for connected projects through these individuals. For the purpose of the preceding sentence, an enterprise shall be associated with another enterprise if one is controlled directly or indirectly by the other, or both are controlled directly or indirectly by the same persons, regardless of whether or not these persons are residents of one of the Contracting States."

(Added on 17 July 2008)

42.46 According to the provision, the activities carried on in the other State by the individuals referred to in subparagraph *a*) or *b*) through which the services are performed by the enterprise during the period or periods referred to in these subparagraphs are deemed to be carried on through a permanent establishment that the enterprise has in that other State. The enterprise is therefore deemed to have a permanent establishment in that other State for the purposes of all the provisions of the Convention (including, for example, paragraph 5 of Article 11 and paragraph 2 of Article 15) and the profits derived from the activities carried on in the other State in providing these services are attributable to that permanent establishment and are therefore taxable in that State pursuant to Article 7.

(Added on 17 July 2008)

42.47 By deeming the activities carried on in performing the relevant services to be carried on through a permanent establishment that the enterprise has in a Contracting State, the provision allows the application of Article 7 and therefore, the taxation, by that State, of the profits attributable to these activities. As a general rule, it is important to ensure that only the profits derived from the activities carried on in performing the services are taxed; whilst there may be certain exceptions, it would be detrimental to the cross-border trade in services if payments received for these services were taxed regardless of the direct or indirect expenses incurred for the purpose of performing these services.

(Added on 17 July 2008)

42.48 This alternative provision will not apply if the services performed are limited to those mentioned in paragraph 4 of the Article 5 which, if performed through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph. Since the provision refers to the performance of services by the enterprise and this would not cover services provided to the enterprise itself, most of the provisions of paragraph 4 would not appear to be relevant. It may be, however, that the services that are performed are exclusively of a preparatory or auxiliary character (e.g. the supply of information to prospective customers when this is merely preparatory to the conduct of the ordinary business activities of the enterprise; see paragraph 23 above) and in that case, it is logical not to consider that the performance of these services will constitute a permanent establishment.

(Added on 17 July 2008)

Observations on the Commentary[1]

1 At the time of approval of paragraphs 42.11 to 42.13 above by the Committee, France, Spain, Sweden, Switzerland and the United States, which among others agree with the Committee's conclusions set out in these paragraphs and do not share the views of some States expressed in paragraphs 42.14 to 42.17, have asked that their position on this issue be expressly stated in the OECD Model Tax Convention.

43. *Italy* does not adhere to the interpretation given in paragraph 12 above concerning the list of examples of paragraph 2. In its opinion, these examples can always be regarded as constituting *a priori* permanent establishments.

(Amended on 23 July 1992)

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.

(Amended on 28 January 2003)

45. Regarding paragraph 38, *Mexico* believes that the arm's length principle should also be considered in determining whether or not an agent is of an independent status for purposes of paragraph 6 of the Article and wishes, when necessary, to add wording to its conventions to clarify that this is how the paragraph should be interpreted.

(Amended on 28 January 2003)

45.1 (Deleted on 15 July 2005)

45.2 *Italy* and *Portugal* deem as essential to take into consideration that — irrespective of the meaning given to the third sentence of paragraph 1.1 — as far as the method for computing taxes is concerned, national systems are not affected by the new wording of the model, i.e. by the elimination of Article 14.

(Added on 29 April 2000)

45.3 The *Czech Republic* has expressed a number of explanations and reservations on the report on Issues "Arising Under Article 5 of the OECD Model Tax Convention". In particular, the Czech Republic does not agree with the interpretation mentioned in paragraphs 5.3 (first part of the paragraph) and 5.4 (first part of the paragraph). According to its policy, these examples could

also be regarded as constituting a permanent establishment if the services are furnished on its territory over a substantial period of time.

(Added on 28 January 2003)

45.4 As regards paragraph 17, the *Czech Republic* adopts a narrower interpretation of the term “installation project” and therefore, it restricts it to an installation and assembly related to a construction project. Furthermore, the Czech Republic adheres to an interpretation that supervisory activities will be automatically covered by paragraph 3 of Article 5 only if they are carried on by the building contractor. Otherwise, they will be covered by it, but only if they are expressly mentioned in this special provision. In the case of an installation project not in relation with a construction project and in the case that supervisory activity is carried on by an enterprise other than the building contractor and it is not expressly mentioned in paragraph 3 of Article 5, then these activities are automatically subject to the rules concerning the taxation of income derived from the provision of other services.

(Added on 28 January 2003)

45.5 In relation to paragraphs 42.1 to 42.10, the *United Kingdom* takes the view that a server used by an e-tailer, either alone or together with web sites, could not as such constitute a permanent establishment.

(Added on 28 January 2003)

45.6 *Spain* has expressed a number of reservations on the Report “Clarification of the permanent establishment definition in e-commerce”. *Greece* and *Spain* have some doubts concerning the opportunity of introducing paragraphs 42.1 to 42.10 of the Commentary in the Model at this time. Since the OECD continues the study of e-commerce taxation, these States will not necessarily take into consideration the aforementioned paragraphs until the OECD has come to a final conclusion.

(Amended on 17 July 2008)

45.7 *Germany* does not agree with the interpretation of the "painter example" in paragraph 4.5 which it regards as inconsistent with the principle stated in the first sentence of paragraph 4.2, thus not giving rise to a permanent establishment under Article 5 paragraph 1 of the Model Convention. As regards the example described in paragraph 5.4, Germany would require that the consultant has disposal over the offices used apart from his mere presence during the training activities.

(Added on 15 July 2005)

45.8 *Germany* reserves its position concerning the scope and limits of application of guidance in sentences 2 and 5 to 7 in paragraph 6, taking the view that in order to permit the assumption of a fixed place of business, the necessary degree of permanency requires a certain minimum period of presence during the year concerned, irrespective of the recurrent or other nature of an activity. Germany does in particular not agree with the criterion of economic nexus — as described in sentence 6 of paragraph 6 — to justify an exception from the requirements of qualifying presence and duration.

(Added on 15 July 2005)

45.9 *Germany*, as regards paragraph 33.1 (with reference to paragraphs 32 and 6), attaches increased importance to the requirement of minimum duration of representation of the enterprise under Article 5 paragraph 5 of the Model Convention in the absence of a residence and/or fixed place of business of the agent in the source country. Germany therefore in these cases takes a particularly narrow view on the applicability of the factors mentioned in paragraph 6.

(Added on 15 July 2005)

45.10 *Italy* wishes to clarify that, with respect to paragraphs 33, 41, 41.1 and 42, its jurisprudence is not to be ignored in the interpretation of cases falling in the above paragraphs.

(Added on 15 July 2005)

45.11 *Portugal* wishes to reserve its right not to follow the position expressed in paragraphs 42.1 to 42.10.

(Added on 17 July 2008)

Reservations on the Article

46. *Australia* reserves the right to treat an enterprise as having a permanent establishment in a State if it carries on activities relating to natural resources or operates substantial equipment in that State with a certain degree of continuity, or a person — acting in that State on behalf of the enterprise — manufactures or processes in that State goods or merchandise belonging to the enterprise.

(Amended on 17 July 2008)

47. *Australia*, *Greece*, *Korea*, *New Zealand*, *Portugal* and *Turkey* reserve their positions on paragraph 3, and consider that any building site or construction or installation project which lasts more than six months should be regarded as a permanent establishment.

(Amended on 15 July 2005)

48. The *United States* reserves the right to add "a drilling rig or ship used for the exploration of natural resources" to the activities covered by the 12 month threshold test in paragraph 3.

(Replaced on 29 April 2000)

49. *Spain* reserves its position on paragraph 3 so as to be able to tax an enterprise having a permanent establishment in Spain, even if the site of the construction or installation project does not last for more than twelve months, where the activity of this enterprise in Spain presents a certain degree of permanency within the meaning of paragraphs 1 and 2. Spain also reserves its right to tax an enterprise as having a permanent establishment in Spain when such an enterprise carries on supervisory activities in Spain for more than 12 months in connection with a building site or construction or installation project also lasting more than 12 months.

(Renumbered and amended on 23 July 1992)

50. *Greece* reserves the right to treat an enterprise as having a permanent establishment in Greece if the enterprise carries on planning, supervisory or consultancy activities in connection with a building site or construction or installation project lasting more than six months, if scientific equipment or machinery is used in Greece for more than three months by the enterprise in the exploration or extraction of natural resources or if the enterprise carries out more than one separate project, each one lasting less than six months, in the same period of time (i.e. within a calendar year).

(Added on 23 July 1992)

51. *Greece* reserves the right to include paragraph 2 of Article 5as it was drafted in the 1963 Draft Convention.

(Amended on 23 October 1997)

52. Considering the special problems in applying the provisions of the Model Convention to offshore hydrocarbon exploration and exploitation and related activities, *Canada*, *Denmark*,

Ireland, *Norway* and the *United Kingdom* reserve the right to insert in a special article provisions related to such activities.

(Amended on 28 January 2003)

53. *Norway* reserves the right to include connected supervisory or consultancy activities in paragraph 3 of the Article.

(Amended on 17 July 2008)

54. *Portugal* reserves the right to treat an enterprise as having a permanent establishment in Portugal if the enterprise carries on an activity consisting of planning, supervising, consulting, any auxiliary work or any other activity in connection with a building site or construction or installation project lasting more than six months, if such activities or work also last more than six months.

(Amended on 17 July 2008)

55. *Turkey* reserves the right to treat a person as having a permanent establishment in Turkey if the person performs professional services and other activities of independent character, including planning, supervisory or consultancy activities, with a certain degree of continuity either directly or through the employees of a separate enterprise.

(Amended on 17 July 2008)

56. *New Zealand* reserves the right to insert provisions that deem a permanent establishment to exist if, for more than six months, an enterprise conducts activities relating to the exploration or exploitation of natural resources or uses or leases substantial equipment.

(Amended on 17 July 2008)

57. *Greece* reserves the right to insert special provisions relating to offshore activities.

(Added on 21 September 1995)

58. *Mexico* and the *Slovak Republic* reserve their position on paragraph 3 and consider that any building site or construction, assembly, or installation project that lasts more than six months should be regarded as a permanent establishment.

(Amended on 28 January 2003)

59. *Mexico* and the *Slovak Republic* reserve the right to tax an enterprise that carries on supervisory activities for more than six months in connection with a building site or a construction, assembly, or installation project.

(Amended on 28 January 2003)

60. The *Czech Republic* and the *Slovak Republic*, whilst agreeing with the “fixed place of business” requirement of paragraph 1, reserve the right to propose in bilateral negotiations specific provisions clarifying the application of this principle to arrangements for the performance of services over a substantial period of time.

(Amended on 28 January 2003)

61. *Poland* reserves the right to replace “construction or installation project” with “construction, assembly, or installation project”.

(Added on 23 October 1997)

62. *Korea* reserves its position so as to be able to tax an enterprise which carries on supervisory activities for more than six months in connection with a building site or construction or installation project lasting more than six months.

(Added on 23 October 1997)

63. *Canada* reserves the right in subparagraph 2 *f*) to replace the words “of extraction” with the words “relating to the exploration for or the exploitation”.

(Added on 29 April 2000)

64. *Mexico* reserves the right to tax individuals performing professional services or other activities of an independent character if they are present in Mexico for a period or periods exceeding in the aggregate 183 days in any twelve month period.

(Added on 29 April 2000)

65. *Mexico* reserves the right to exclude subparagraph *f*) of paragraph 4 of the Article to consider that a permanent establishment could exist where a fixed place of business is maintained for any combination of activities mentioned in subparagraphs *a*) to *e*) of paragraph 4.

(Added on 28 January 2003)

SELECTED PROVISIONS CONCERNING SERVICES PEs

Canada-United States Tax Convention, Article V(9)

9. Subject to paragraph 3, where an enterprise of a Contracting State provides services in the other Contracting State, if that enterprise is found not to have a permanent establishment in that other State by virtue of the preceding paragraphs of this Article, that enterprise shall be deemed to provide those services through a permanent establishment in that other State if and only if:

   (a) Those services are performed in that other State by an individual who is present in that other State for a period or periods aggregating 183 days or more in any twelve-month period, and, during that period or periods, more than 50 percent of the gross active business revenues of the enterprise consists of income derived from the services performed in that other State by that individual; or

   (b) The services are provided in that other State for an aggregate of 183 days or more in any twelve-month period with respect to the same or connected project for customers who are either residents of that other State or who maintain a permanent establishment in that other State and the services are provided in respect of that permanent establishment.

***

Alternative OECD Services PE Rule (paragraph 42.23 of the Commentary on Article 5, added in 2008)

Notwithstanding the provisions of paragraphs 1, 2 and 3, where an enterprise of a Contracting State performs services in the other Contracting State

a) through an individual who is present in that other State for a period or periods exceeding in the aggregate 183 days in any twelve month period, and more than 50 per cent of the gross revenues attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State through that individual, or

b) for a period or periods exceeding in the aggregate 183 days in any twelve month period, and these services are performed for the same project or for connected projects through one or more individuals who are present and performing such services in that other State

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

***

United Nations Model Tax Convention, Article 5(3)(b)

3. The term "permanent establishment" also encompasses:

   . . .

   (b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve-month period.

***

United Nations Model Tax Convention, Article 14(1)

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

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

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