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Editors

Prof. Dr Ekkehart Reimer
Heidelberg University

Prof. Dr Alexander Rust
WU Vienna

Authors

Johannes Becker
Heidelberg University

Michael Blank
University of Erlangen-Nuremberg

Prof. Dr Axel Cordewener
Flick Gocke Schaumburg

Daniela Endres
University of Erlangen-Nuremberg

Prof. Dr Roland Ismer
University of Erlangen-Nuremberg

Prof. DDr Georg Kofler
University of Linz

Katharina Riemer
Ministry of Economics and Finance
Baden-Württemberg

Dr Matthias Valta
Heidelberg University

Dr Alexander Blank
Rödl und Partner

Prof. Dr Luc De Broe
Catholic University of Leuven; Laga

Prof. Dr Ana Paula Dourado
University of Lisbon

Prof. Dr Werner Haslehner
University of Luxembourg

Prof. Dr Eric C.C.M. Kemmeren
Tilburg University

Prof. Dr Ekkehart Reimer
Heidelberg University

Prof. Dr Alexander Rust
WU Vienna

Kamilla Zembala
Heidelberg University

Wolters Kluwer
Law & Business

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distinction proposed in paragraph 9.1 was neither intended by the wording of Article 5 nor logical.

45. ***India*** does not agree with the interpretation in the last two sentences of paragraph 26.1 of the Commentary on Article 5 according to which even undersea cables and pipelines lying in the territorial jurisdiction of a source country cannot be considered as permanent establishment of an enterprise.

46. Regarding paragraph 38, ***Colombia*** 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.

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A. General Issues

I. Overview and Main Features

Article 5 OECD and UN MC is the last but most elaborate of the articles which contain **general definition of terms** relevant throughout many different treaty articles (*infra* m.no. 4 et seq.). The article determines the threshold that functions as the **essential demarcation line** between short-term or ephemeral activities in the source State and 'permanent establishments' (PEs) (i.e., solidified sources of income which serve as a (primary or secondary) basis for the taxpayer in a State other than his or her State of residence). To a large extent, a PE does not only resemble the concept of residence in appearance but may also trigger similar, though not identical legal consequences. Since the early 1920s, the PE threshold has been commonly used in DTCs to determine whether a particular kind of income shall or shall not be taxed in the country from which it originates.[1] 1 2

1. Cf. no. 1 OECD MC 2008 Comm. on Art. 7; and Vogel, 3rd edn, Art. 5 at m.no. 4.

3 In doing so, the PE threshold reconciles requirements of international justice (prerogative of source-based taxation) and practical prudence (prerogative of residence-based taxation). It serves to simplify and facilitate taxation of cross-border activities. At the same time, it is in line with trends to encourage liberalization of international trade.[2] Thus, the PE principle was adopted to accomplish three main objectives:[3]

- **assigning tax revenue** to the source State;
- **maintaining practicability** by establishing a minimum threshold (i.e., by preventing pure and unconditional source-based taxation where the contact of the taxpayer to the source State is only occasional or peripheral (cf. no. 42.11 et seq. OECD MC Comm. on Article 5)); and
- placing the PE on **equal footing** with a local (i.e., resident) entrepreneur for the purposes of various articles, thus providing neutrality between the different forms of a secondary establishment available to foreign investors.

II. Delimitation to Other Articles

4 The definition of 'permanent establishment' in Article 5 applies throughout the OECD and UN MC.[4] Both for Article 7 OECD and UN MC and for all other treaty articles, it is immaterial whether there *is* a PE or whether the PE is only *deemed* to exist by way of a fiction in the OECD and UN MC (notably, in Article 5(5)) OECD MC or in bilateral DTCs which contain, for example, specific rules on service PEs (*infra* m.nos 398 et seq., 420 et seq. and no. 42.46 OECD MC Comm. on Art. 5). Any systematic and teleological interpretation of terms used in Article 5 OECD and UN MC can be inspired and guided ('in the light of its object and purpose': Article 31(1) VCLT) by the **functions** which the PE concept fulfils in the context of these other Articles.

1. Article 7

5 Above all, the PE concept serves as the key principle on the assignment of the **right to tax business profits**. Only if the requirements of Article 5 OECD and UN MC are met (Cf. no. 1 OECD MC 2008 Comm. on Art. 7), any items of income which are allocated to the PE under Article 7(2) and (3) OECD MC and 7(2-5) UN MC may be taxed in the **source State** (Article 7(1), 2nd sentence OECD and UN MC) instead of the State of residence, and the latter shall grant relief from double taxation (Article 23A or B OECD and UN MC).

6 In turn, Article 5 OECD and UN MC itself receives a significant momentum from Article 7 OECD and UN MC and the other articles on PEs. Both on the level of interpretation and on a treaty policy level, the fact that a PE is set on equal footing with a distinct and functionally separate enterprise under Article 7 OECD and UN MC suggests that Article 5 OECD and UN MC assigns the PE status only to those places, establishments and activities which could also be **imagined as** places, establishments or activities of an **independent and separate company**.

2. Articles 13 and 22

7 Similarly, capital gains from the alienation of movable assets allocated to a PE are assigned to the PE State for **primary taxation** under Article 13(2) OECD and UN MC (*infra* Article 13 at m.nos 2 et seq. and 64 et seq.). In a parallel manner, **capital taxation** (including property taxation and wealth taxation) of PE assets follows the same standards, according to Article 22(2) OECD and UN MC (*infra* Article 22 at m.nos 2 et seq. and 52 et seq.).

2. Vogel, 3rd edn, Art. 5 at m.no. 5.
3. Reimer, E., in: R/S/O, Part 1 at m.no. 35 et seq.
4. Vogel, 3rd edn., Art. 5 at m.no. 8.

3. Other Distributive Rules

8 Many of the other distributive rules follow the PE concept too. The prerogative of the State where a PE is located to tax any items of income which is attributable to this PE (rather than to the head office or to another PE) has been adopted by the distributive rules on taxation of income from immovable property (Article 6(4) OECD and UN MC, though with primary relevance for the determination of profits on the level of Article 7(2) OECD and UN MC; see Article 6 at m.nos 7 et seq. and 240 et seq.), on dividends (Article 10(4) OECD and UN MC; see Article 10 at m.no. 128 et seq.), on interest (Article 11(4) OECD and UN MC; see Article 11 at m.no. 106 et seq.), on royalties (Article 12(3) OECD and 12(4) UN MC; see Article 12 at m.no. 198 et seq.), and on other income (Article 21(2) OECD and UN MC; see Article 21 at m.no. 48 et seq.). All of these Articles show that a PE is conceived as a substantial base which can **substitute the functions of a resident person** and that a non-resident person can therefore be taxed in a similar manner as a resident person.

9 Similarly, Article 11(5) OECD and UN MC provides that **interest payments** are deemed to arise in country A if they are paid by a person who is a resident of A or, alternatively, if they are borne by, and effectively connected to, a PE in A (irrespective of where the person which maintains that PE is resident – the person may even be a resident of a third State).[5] Likewise, Article 15(2)(c) OECD and UN MC assigns taxation of **employment income** to the State where the employee is resident, and it places a PE which the employer maintains in the source State on equal footing with the employer's residence in that either of the two is sufficient to exclude taxation in the State of residence, and shift the primary right to tax to the State where the employment has been exercised (Cf. no. 42.12 OECD MC Comm. on Art. 5).

4. Article 24

10 Along the same lines, Article 24(3) OECD and UN MC contains a guarantee that PEs of non-resident taxpayers **must not be discriminated** against in favour of enterprises run by resident taxpayers (*infra* Article 24 m.no. 53 et seq.).

III. Structure of the Article

11 Article 5 OECD and UN MC shows a multi-level structure and can be read from more than one starting point. The text starts with a **classical definition** (paragraph 1) which is followed by **positive** (paragraph 2) and **negative** (paragraphs 3 and 4) examples. To some extent, these examples illustrate the exact meaning of the definition in paragraph 1. In part, however, they go beyond this definition and contain further specifications. The concluding paragraphs 5 to 7 OECD MC and respectively 5 to 8 UN MC provide guidance on the characterization of **persons other than the taxpayer as PEs of the taxpayer** (paragraph 5: dependent agents, paragraph 6 OECD resp. paragraph 7 UN MC: independent agents, paragraph 7 OECD resp. paragraph 8 UN MC: subsidiaries and other associated companies).

5. Unlike the OECD MC, various DTCs contain a similar rule with regard to royalties.

B. Article 5(1) OECD and UN MC

I. The Models

1. Rule

12 By way of a **comprehensive definition** applicable throughout both Models ('for the purposes of this Convention'), Article 5(1) OECD and UN MC defines the term 'permanent establishment' as a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. 'Place'

a. Purpose of the Term

13 Above all, Article 5(1) OECD and UN MC requires a **place of business**. While the term 'business' is broad, vague and of little relevance for the PE definition (for details, see *supra* m.no. 10 et seq. and Article 7 at m.no. 58 et seq.), the crucial element is the term '**place**'. Still today, this basic requirement is the **cornerstone of the PE definition** even though it has never been an indispensable precondition in all cases. Significant exceptions have been listed in the OECD and UN MC itself, most notably with regard to building sites, construction projects and installation projects (Article 5(3) OECD and 5(3)(a) UN MC; see *infra* no. 173 et seq.), and dependent agents (Article 5(5) OECD and UN MC; see *infra* nos 305 et seq.). Further exceptions have been suggested in the OECD MC Comm. with regard to service PEs (see *infra* no. 405 et seq.).

14 In conjunction with the attribute 'fixed' (fixe; see *infra* no. 33 et seq.), the requirement of a place reflects the strong link between the land and the taxing powers of the State. This **territorial link** serves as the basis not only for the distributive rules which are tied to the existence of a PE (see *supra* m.no. 5 et seq.) but also for a considerable number of other distributive rules (Articles 6, 8(1) and (2), 13(1) and (3) and (4), 15(3), 22(1) and (3) OECD and UN MC) and, above all, for the assignment of a person to either Contracting State on the basis of residence (Article 1, read in conjunction with Article 4 OECD and UN MC).[6]

15 All these situs attachments[7] have several objects and purposes in common. First, they guarantee that **taxes are not imposed by the source State** unless the preconditions of any jurisdiction to prescribe[8] under public international law have been met. Secondly, they **facilitate simple** cross-**border activities** of the taxpayer by preventing any taxation by the source State in cases where the taxpayer enters into business relations with customers in the Contracting State, but does not maintain any deeper connections to this State. The taxpayer might not speak the local language, is not subject to local administrative law and might not even use any infrastructure or the private law system of that State. Thirdly, the situs requirement makes it superfluous for the source State to **control and audit non-resident entrepreneurs** if they do not have more than an ephemeral relation to the territory of the source State. Otherwise, the Contracting States would have to introduce far-reaching withholding duties on the resident recipients for any goods or services provided by

6. For the underlying concepts, see Lehner, M. & Waldhoff, C. in: Kirchhof *et al.*, *Einkommensteuergesetz Kommentar* (loose-leaf edn, March 2010), §1 at m.no. A 160 et seq.
7. Cf. Vogel, 3rd edn., Art. 5 at m.no. 22.
8. On the meaning of this term, as opposed to the 'jurisdiction to enforce', and on the 'general link' doctrine see Sauer, H., *Jurisdiktionskonflikte In Mehrebenensystemen* (2008); Bertele, J., *Souveränität und Verfahrensrecht* (1998) at 100 et seq.

non-resident taxpayers, and/or to maximize their efforts to procure an automatic exchange of information that would go far beyond what is realistic today. Withholding and information exchange are subject to considerable constraints from a practical perspective, as well as with regard to fundamental rights and regional non-discrimination provisions (e.g., within the EU).

b. Definitions

A place is a certain amount of space (no. 4.1 OECD MC Comm. on Art. 5) within the soil or on the soil. This understanding of place as a **three-dimensional zone** rather than a single point on the earth can be derived from the French version ('installation fixe') as well as the term 'establishment'. As a rule, this zone is based on a certain area in, on, or above the surface of the earth. Rooms or technical equipment above the soil may qualify as a PE only if they are fixed on the soil (for details, see *infra* m.no. 45 et seq.). This requirement, however, stems from the term 'fixed' rather than the term 'place', given that a place (or space) does not necessarily consist of a piece of land. On the contrary, the term 'establishment' makes clear that it is not the soil as such which is the PE but that the PE is constituted by a tangible facility as distinct from the soil. This is particularly evident from the French version of Article 5(1) OECD MC which uses the term 'installation' instead of 'place'. 16

The term 'place' is used to define the term 'establishment'.[9] Therefore, 'place' includes all **tangible assets** used for carrying on the business (for this connection, see *infra* m.no. 40 et seq.), but one such tangible asset can be sufficient.[10] The characterization of such assets under private law as real property rather than personal property (in common law countries) or immovable rather than movable property (in civil law countries) is not authoritative. It is rather the context (including, above all, the terms 'fixed'/'fixe'; see *infra* no. 45 et seq.), as well as the object and purpose of Article 5 OECD and UN MC itself (*supra* m.no. 2 et seq.), in the light of which the term 'place' needs to be interpreted. This approach, which follows from the general rules on treaty interpretation (*supra* Introduction m.no. 70 et seq.), gives a certain leeway for including movable property in the understanding of 'place' and, therefore, to assume a PE once such property has been 'fixed' (*infra* m.no. 45 et seq.) to the soil. 17

For example, a work bench in a caravan, restaurants on permanently anchored river boats, steady oil rigs, or a transformator or generator on board a former railway wagon qualify as places (and may also be 'fixed'; see *infra* m.no. 45 et seq.). 18

In contrast, **purely intangible property** cannot qualify in any case. In particular, rights such as participations in a corporation, claims, bundles of claims (like bank accounts), any other type of intangible property (patents, software, trademarks etc.) or intangible economic assets (a regular clientele or the goodwill of an enterprise) do not in themselves constitute a PE.[11] They can only form part of a PE constituted otherwise (see Article 7 at m.no. 58 et seq.). Likewise, an internet website (being a combination of software and other electronic data) does not constitute tangible property and, therefore, does not constitute a PE (No. 42.2 OECD MC Comm. on Art. 5). 19

Neither does the mere **incorporation of a company** in a Contracting State in itself constitute a PE of the company in that State. Where a company has its seat, according to its by-laws and/or registration, in State A while the POEM is situated in State B, this company will usually be liable to tax on the basis of its worldwide income in both Contracting States under their respective domestic tax law. Under the A-B treaty, however, the company will be 20

9. Vogel, 3rd edn., Art. 5 at m.no. 23.
10. Confer Reichsfinanzhof *RStBl.* 840, 841 (1935): Germany's DTC with Switzerland 1931; Dorn, H., 3 *StuW* 97, 107 (1926): 97, 107; Vogel, 3rd edn, Art. 5 at m.no. 23.
11. See Skaar, A., *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991) at 121 et seq.; Vogel, 3rd edn, Art. 5 at m.no. 23. It goes without saying, however, that intangible property may well be regarded as a part of the operating assets of the PE. On this aspect, see *infra* Art. 7 at m.no. 89 et seq.; and the literature on Art. 12(3) OECD MC.

regarded as a resident of State B only (Article 4(3) OECD and UN MC). In the absence of both actual facilities and a dependent agent in State A, income of this company will be taxable only in State B under the 1st sentence of Article 7(1) OECD and UN MC.

21 There is no minimum size of the piece of land.[12] Where the qualifying business activities consist (in full or in part) of human activities by the taxpayer, his employees or representatives, the mere **space needed for the physical presence** of these individuals is not sufficient (if it were sufficient, Article 5(5) OECD MC and Article 5(5)(a) UN MC and the notion of agent PEs were superfluous). This can be illustrated by the example of a salesman who regularly visits a major customer to take orders, and conducts meetings in the purchasing director's office. The OECD MC Comm. has convincingly denied the existence of a PE, based on the implicit understanding that the relevant geographical unit is not just the chair where the salesman sits, but the entire office of the customer, and the office is not at the disposal of the enterprise for which the salesman is working (no. 4.2 OECD Comm. on Article 5).

3. 'Business' and 'Enterprise'

22 To meet the PE definition, the English text of Article 5(1) OECD and UN MC requires a '**business**'. This term is used twice – first in connection with place ('place of business'), secondly with regard to the activity carried on through this POB ('business of an enterprise'). In contrast, the French text employs two different terms, that is, 'installation … d'affaires' and 'une entreprise' (plus the neutral term 'son activité').

a. Purpose of the Terms

23 Neither the duplication of 'business' in the English text nor the parallel use of 'business' ('affaires' in French) and 'enterprise' ('entreprise' in French) have **any particular meaning**, however (cf. Article 3(1)(c) OECD MC). Even when one looks at both terms as a whole, their relevance should not be overestimated. A place is a place of business whenever this place is suitable for business activities like the one which the taxpayer (or his employees) exercise there. In other words, if the activities exercised through this place form part of the business of an enterprise (French: if 'une entreprise exerce tout ou partie de son activité [par l'intermédiaire de cette installation fixe d'affaires]') actually, a separate and anticipated test whether or not the place as such is a place 'of business' becomes logically superfluous.

24 In substance, the main function of the terms 'business' and 'enterprise' (English; or 'affaires' and 'entreprise' in French) is to **exclude passive investments** from the scope of Article 5 (for details, see *infra* m.no. 31 et seq.; and *infra* Article 7 at m.no. 61 et seq.). Income from passive investments (many common law countries use the term 'property income') is income which the taxpayer enterprise yields from financial assets (usually, currency or claims in money, shares, jouissance rights, patents, trademarks etc.) which he does not use directly[13] or in an operative manner, but which form part of a repository, temporary or permanent, of spare liquidity.

25 The English term '[place] of business' and the French '[installation] d'affaires' do not exclude the attribution of passive income to a PE where this PE has been established otherwise (i.e., through an activity), and where such passive income is **effectively connected** to the PE and its activities. This follows stringently from the existence of Articles 10(4), 11(4) OECD and UN MC, Article 12(3) OECD MC and Article 12(4) UN MC.[14]

12. For the example of an internet server, see *infra* m.no. 54.
13. For the meaning of this language (as used in Art. 6(3) OECD MC), see Reimer, E., in: V&L (5th edn), Art. 6 at m.no. 173 et seq. (sub 'Nutzungsüberlassung').
14. Cf. Avery Jones, J.F., et al., 48 *BTR* 224 et seq. (2003) at 224 et seq. = 57 *BIFD* 273 et seq.

As a second function, 'business' and 'enterprise' are used to exclude active income which 26
the taxpayer yields on a merely **occasional and low-scale basis**. Where the taxpayer derives benefits in course of a private affair (without substantial investments in assets or work, without equipment, facilities etc.), the receipts may remain below the threshold of a typical business. If they are taxable at all under domestic law, double taxation can be avoided only on the basis of Article 21(1) OECD and UN MC.

The business or enterprise requirement imposes **no limits on the type, equipment, or** 27
furniture of the place concerned. The list of typical PEs in Article 5(2) and (3) OECD and UN MC is not exclusive, and under Article 5(1) OECD and UN MC, even empty rooms or estates,[15] unpainted walls,[16] or the living accommodation of a travelling salesman,[17] can qualify as POBs if business activities can be carried on there. The main reason for this broad interpretation of the term '[place] of business' is the consistency of Article 5(1) OECD and UN MC with the prerequisites of an agent PE under Article 5(5) OECD MC and Article 5(5)(a) UN MC, where no fixed place, room, office desk or any other equipment is required either. It is therefore misleading to demand that the facility must have features characteristic of a place of 'business'. However, where a facility can be used for private or non-operative activities only, it disqualifies as a PE. This is why social facilities such as rest homes, or living quarters of employees do not constitute PEs under Article 5(1) OECD and UN MC.[18]

As indicated above, there is little use in distinguishing between 'business' and 'enterprise' 28
with regard to the **scope of activities** concerned.[19] However, in most instances the OECD MC seems to use 'enterprise' to designate the institution and its status,[20] whereas 'business' denotes the activities exercised by the entrepreneur and his personnel.[21] This distinction suggests that profits which an enterprise yields through the use of property rather than through an activity do not constitute business profits.[22] This language is not fully consistent, though.[23] In all, the terminological distinction between 'business' and 'enterprise' is misleading. There are good reasons to abandon it in the not too far future.[24]

15. Vogel, 3rd edn, Art. 5 at m.no. 23.
16. Cf. the painter example in no. 4.5 OECD MC Comm. on Art. 5 if one transfers the example from a large office building into a private castle. It should be noted, though, that the painter example is questionable in other respects (see m.nos 109, 124 et seq. for details).
17. See the decision of the German Bundesfinanzhof, 4 *BFH/NV* 119 (1988).
18. See, e.g., Finanzgericht München, 16 *EFG* 55, 56(1968); and Vogel, 3rd edn, Art. 5 at m.no. 34, for detailed references to precedent decisions of the Bundesfinanzhof.
19. See also the *Technical Explanations* to Art. 3(1)(d) US MC of 15 November 2006. Confirmed for a continental European (civil law) viewpoint by Avery Jones, J.F., et al., 'Treaty Conflicts in Categorizing Income as Business Profits Caused by Differences in Approach between Common Law and Civil Law', 48 224 et seq. *BTR* (2003)= 57 *BIFD* 237 et seq. (2003).
20. Cf. the wording of rules like Art. 2(2) ('wages or salaries paid by enterprises'), Arts 3(1)(e), 8(1) to (3), 13(3) and 15(3) (the enterprise has a POEM), Art. 5(4)(a) (goods and merchandise belong to an enterprise), Art. 5(5) OECD MC (an agent acts on behalf of an enterprise), and Art. 9 OECD MC (associated enterprises). Further research is provided by van Raad, K., 'The term 'enterprise' in the Model Taxation Conventions – seventy years of confusion', *Essays Int. Tax.* 317, 22 *Intertax* 491 et seq. (1994).; and by Avery Jones, J.F., et al., 48 *BTR* 224 et seq. (2003) = 57 *BIFD* 243 (2003).
21. Cf. the wording of Art. 3(1)(c), Arts 5(1) and 7(1) and (2) OECD MC (the enterprise carries on business). For further analysis, see Avery Jones, J.F., et al., 48 *BTR* 224 et seq. (2003) at 224 et seq. = 57 *BIFD* 273 et seq. (2003).
22. References to Australian and Canadian case law has been provided by Avery Jones, J.F., et al., 48 *BTR* 224 et seq. (2003) = 57 *BIFD* 273 et seq. (2003).
23. Also an enterprise can be 'carried on': Art. 3(1)(d) OECD MC.
24. As convincingly suggested by van Raad, K., *Essays Int. Tax.* 317 (1994) = 22 22 *Intertax* 491 et seq. (1994).

b. Definitions

29 After almost fifty years of OECD works on DTCs, the text of the MC aides in the interpretation of the terms 'business' and 'enterprise'. Moreover, there is a high degree of worldwide consensus on the meaning of both terms in a tax treaty context.[25] Both terms can be **interpreted autonomously** today, and no recourse needs to be made to domestic law of either Contracting State.[26]

30 A 'business' and an 'enterprise' is every **independent income-generating activity**, including commerce, trade and industry, agriculture, forestry and every other 'direct use' of immovable property (cf. Article 6(3) and (4) OECD and UN MC),[27] transportation (cf. Article 8 OECD and UN MC) and all other independent services (Article 3(1)(h) OECD MC; formerly, Article 14 OECD MC). Moreover, independent directors (cf. Article 16 OECD and UN MC), self-employed entertainers and sportspersons (cf. Article 17 OECD and UN MC) are enterprises which carry on a business. It is true that these rules neither require nor permit an application of Article 5 OECD and UN MC with regard to the ongoing (current) activity-related income of the taxpayer. The PE principle might, however, apply to capital gains (Article 13(2) OECD and UN MC) as well as to the taxation of capital (Article 22(2) OECD and UN MC).

31 By contrast, the **renting-out or leasing-out** of property or know-how, the holding of shares, or the granting of loans (and, therefore, the receipt of rental or leasing payments, dividends, interest or royalties) do not in themselves constitute a business or an enterprise.[28] These **passive investments** may, however, become **part of a business or enterprise** which has been constituted otherwise, that is, by virtue of one of the above-mentioned activities (e.g., Articles 10(4), 11(4) OECD and UN MC, Article 12(3) OECD MC and Article 12(4) UN MC; see *supra* m.no. 8 et seq., and *infra* Article 7 at m.no. 62).

25. A landmark decision has been issued by the High Court of Australia in *Thiel v. Fed. Comr. of Taxation*, [1990] 171 CLR 338, [1990] 90 ATC 4717, Mason CJ and Brennan and Gaudron JJ. Since then, this reasoning has been further elaborated by the Federal Court of Australia (most notably, in *Lamesa Holdings BV*, [1997] 77 FCR 597), and the Supreme Court of Canada (*Crown Forest Industries Ltd. v. Canada*, [1995] 2 SCR 802).

26. This has been suggested convincingly by Vogel, K., in: V&L (5th edn), Art. 3 at m.no. 41, with particular regard to the modifications of Art. 3(1) OECD MC that have been made when Art. 14 OECD MC was deleted in the year 2000. While Vogel still considers recourse to domestic law may be made under Art. 3(2) at the borders of the concepts of 'business' and 'enterprise', we plead argue in favour of a fully autonomous interpretation of both terms. As Avery Jones, J.F., et al., 48 *BTR* 224 et seq. (2003) = 57 *BIFD* 273 et seq. have shown in full detail, domestic classifications depend on the legal form of the taxpayer (as a company, a partnership, an individual etc.), in many jurisdictions. Given the need for a uniform understanding of the terms employed in Arts 5 and 7 OECD MC (*infra* Art. 7 at m.no. 19 et seq.), such recourse to domestic law is highly disadvantageous for both the Contracting States and the taxpayer. It would be a significant loss of legal certainty. Potential disadvantages which might come up if no recourse shall be made to domestic law (see Avery Jones et al., *loc. cit.*, for details) can easily be avoided through other instruments, including the use of the credit method (Art. 23B (1) OECD MC), switch-over clauses or subject-to-tax clauses by the State of residence.

27. A different view has been held by Vogel, K., in: V&L (5th edn), Art. 3 at m.no. 41a, who suggests a carve-out of agriculture and forestry from the scope of Art. 7 OECD MC. In our view, however, there is little need for such strict conceptual complementarity of Arts 6 and 7. It is rather helpful to keep the door open for the application of rules like Art. 7(2) to (6) OECD MC to agricultural and forestry enterprises (see *infra* m.no. 169; for a more detailed analysis Reimer, E., in: V&L, Art. 6 at m.no. 199 et seq.). Some DTCs have explicitly included agricultural, grazing or forestry activities into the scope of their PE Article (see, e.g., the DTC between Australia and Switzerland). For the notion of direct use, see Reimer, E., *loc. cit.*, at m.no. 154 et seq.

28. See, e.g., BFH *BStBl.* III 133 et seq. (1959); BFH *BStBl.* II 18 et seq. (1979); Baker, P, Art. 5 at m.no. 4 with further references; for the letting of aerial installations, see the Austrian Bundesministerium der Finanzen, in 4 *SWI* 3 (1994).

The fact that the **tenant/lessee** of real property maintains and exercises his business there is not sufficient for a characterization of the property as the business/enterprise of the **landlord/lessor.** Even if an entrepreneur leases out his whole operable office, an ongoing factory, a workshop etc. to a new entrepreneur who does not bring any of its own assets or know-how, but only uses the facilities which he has rented, these facilities do not necessarily continue to qualify as the business/enterprise of the owner. Rather, the issue should be decided by careful consideration of all circumstances of the case. Relevant criteria are the assignment of entrepreneurial authority, the allocation of entrepreneurial risks, the actual or potential duration of the leasing relationship, and the criteria on which the remuneration has been based. 32

Where the landlord retains **authority to make managerial** decisions, in full or in part, or where he has reserved the right to veto certain managerial decisions of the tenant (as opposed to decisions which concern the alienation of the leased assets), it is presumed that the activity constitutes an ongoing business/enterprise of the landlord. In this respect, the business/enterprise test coincides with the control test (being part of the functional integration requirement; see *infra* m.no. 124 et seq. for details). 33

Likewise, the landlord's acceptance of a share of the **entrepreneurial risk** (e.g., by accepting variable lease payments depending on the tenant's profits) indicates an ongoing status of the landlord as an entrepreneur. While a minority participation in the profits or a clearly subordinate relevance of profit-sharing elements (as opposed to fixed elements of the rental fee) does not constitute a strong presumption, the shift of the entire risk to the landlord will clearly prove that he (rather than the tenant) continues to be the entrepreneur. 34

Moreover, a **shorter leasing period** is less likely to qualify as a merely passive investment, and it is more likely to continue to constitute a business of the owner. Further indicators are **on-site services** provided by the lessor in addition to, or in connection with, the leased assets. For this reason, renting-out or leasing-out of scaffolding equipment constitutes a POB of the lessor if the lessor accepts responsibility for reconfiguring the scaffolding to accommodate the changes made to the building and for dismantling it following the project's completion.[29] In these situations, the same place can be a **PE of both** the landlord/lessor and the tenant/lessee (*supra* Article 3 at m.no. 49 et seq.; and *infra* m.no. 119). 35

Similarly, **holiday cottages**, apartments and other immovable property, even if rented out to the same tenant on a long-term basis, can constitute a PE if the owner, in addition to the pure leasing, provides services like, for example, cleaning, renewing towels, or providing meals. 36

It should be noted, however, that in all of the cases mentioned in the preceding paragraphs (m.no. 31 et seq.), taxation by the source State does **not depend on the PE threshold**, as Article 6(1) OECD and UN MC prevails over Article 7(1) OECD and UN MC anyway (Articles 6(4) and 7(4) OECD MC, and Article 6(4) and 7(6) UN MC). But Article 6 OECD and UN MC does not provide rules on the quantitative aspects of profit assignment to either State. In this regard, recourse may be made to Article 7(2) to (4) OECD MC and Article 7(2) to (5) UN MC if and only if the real property constitutes a PE of the owner/landlord/lessor. 37

In a parallel manner, where a holding company does not only function as a legal depository, but actually exercises **control of the subsidiaries** in the way that the operative business of all or some of these subsidiaries is steered or influenced by the management of the holding company, this company conducts a business of its own. 38

In this respect, the concepts of 'business' and 'enterprise' under Article 5(1) OECD and UN MC are broader with regard to the degree of activity (as opposed to a merely passive investment), than activity concepts under bilateral DTCs clauses in the context of **Article 23** 39

29. NB, however, the application of minimum time requirements, subject to Art. 5(3) OECD MC. See the decision by the Austrian Bundesministerium der Finanzen of 10 June 1994, Aus der Arbeit der BMF-Fachabteilungen, in 4 *SWI* 244 (1994).

OECD and UN MC or under many **domestic CFC regimes**.[30] While holding companies usually do not qualify under these rules, they do 'carry on' the 'business of an enterprise' under Article 5(1) OECD and UN MC (although Articles 10 to 12 may derogate the application of Article 7 OECD and UN MC where such companies do not run an operative business on their own but operate through their subsidiaries).

40 It has been widely acknowledged that the business of an enterprise can be carried out **without any on-site human intervention**.[31] This view can be based on the use of 'through which' instead of 'in which' in Article 5(1) OECD MC, as amended in 1977 (see *infra* m.no. 124). Therefore, automatic pumping stations, a vending machine of a railway company, the check-in computer of a non-resident airline, a gaming machine (no. 10 OECD MC Comm. on Art. 5) and any similar unmanned facility do perform 'activities' and will usually qualify under Article 5(1) OECD and UN MC as a PE of the enterprise which runs them[32] (but subject to restrictions established by Article 5(4) OECD and UN MC).

41 Nevertheless, many courts have held that the mere transportation of oil or other substances through a **pipeline** or similar installation as well as the conduction of electricity through cables would not qualify as the carrying-on of an activity, and would thus not constitute a PE. This statement might be based on Article 5(4) OECD and UN MC. It cannot, however, be based on Article 5(1) OECD and UN MC in general and the activity requirement in particular. Rather, the aforementioned facilities have much in common with typical PEs, as listed in Article 5(2) OECD and UN MC.

42 While the terms 'permanent' and 'stable' require a considerable degree of continuity of the activities performed through the fixed place (see *infra* m.no. 65 et seq.), both a 'business' and an 'enterprise' can be constituted by a one-off business transaction, that is, **one unique single activity**.[33] The verb carrying-on does not imply any recurrent aspect either.

43 The sector of industry, or the type of business, in which the POB is involved need not be identical to that of the head office and/or other PEs. It is not required that the POB is a functionally integrated part of the enterprise as a whole. Without prejudice to the domestic characterization of the POB and its activities, a POB can therefore qualify as a PE under tax treaty law even if it serves a **wholly different market** than all other PEs of the same enterprise.

44 Similarly, the POB need not be successful or profitable (no. 3 OECD MC Comm. on Art. 5). The POB does not have to serve the overall purpose of the enterprise. Even **superfluous or disadvantageous** (unprofitable, troublesome or outdated) facilities continue to form part of the enterprise as long as they have not been withdrawn, and have been assigned to the private (as opposed to business) sphere of the taxpayer.

4. 'Fixed'

a. Purpose of the Term

45 Both the English and the French version of the OECD MC employ the term 'fixed'/'fixe' in order to stress the firm link between the establishment and the territory of the source State.[34] A similar connotation is contained in the French term 'stable', while the English term 'permanent' seems to address issues of time rather than issues of place. It is true, however, that the term 'fixed'/'fixe' contains a temporal element, too. A tangible item is certainly not

30. For example, IRC s. 553, or §8 AStG.
31. See, e.g., no. 42.6 OECD MC Comm. on Art. 5. Critical: Shalhav, S., 31 *Intertax* 136 (2003).
32. Directly or through a dependent agent; see no. 10 OECD MC Comm. on Art. 5.
33. High Court of Australia in *Thiel v. Fed. Comr. of Taxation*, [1990] 171 CLR 338, [1990] 90 ATC 4717, Mason CJ and Brennan and Gaudron JJ.
34. A thorough analysis of this requirement is provided by Schaffner, J., *How fixed is a permanent establishment?* (2013).

'fixed'/'fixe' if an observer, on the basis of a diachronic perspective, sees that the object does not rest permanently in the same place. Thus, there seems to be a **significant semantic overlap** between **geographical fixation** and **temporal permanence**.

However, these overlaps will not, at least not necessarily, support the hypothesis that the 46
two terms are redundant, and that at least one of the two requirements is superfluous. Taking rules seriously means interpreting them in a **non-redundant** way. The critical hypothesis can be falsified indeed. On the one hand, facilities can rest permanently at a given place even if they have not been fixed there, simply because nobody has removed them (e.g., a business vehicle inside a car park, even if no one has applied the brakes). On the other hand, facilities can be firmly connected to the soil, but after a short while, they can be removed (e.g., a scaffold fixed on the wall of a house, or a tent on a camping ground). In the first example of the car, the POB is permanent, but probably not fixed; in the second examples of the scaffolding and the tent, the POB was fixed, but not permanent.

In addition, there is a **grammatical asymmetry**. Unlike 'stable', the terms 'fixed'/'fixe' do 47
not directly refer to the terms 'establishment'/'établissement'. In the context, they rather restrict the range of potential places (installations). The existence of the term 'fixed' can be regarded as an indicator that neither the term 'place' as such nor the separate requirement of permanence do not necessarily imply a steady connection of the establishment to the soil (see *supra* m.no. 66). It follows that the use of 'fixed'/'fixe' has an exceeding meaning, that is, that it requires a **firm connection** of the facility **to the soil**.

The OECD MC Comm. provides a less strict interpretation. According to OECD's 48
interpretation, the equipment constituting the place of business need not 'be actually fixed' to the soil on which it stands (no. 5 OECD MC Comm. on Article 5). This broader interpretation opens the door to include **'moving targets'** in the definition of PEs.

Indeed, this language in the OECD MC Comm. is not beyond doubt. It seems to imply that 49
there is also a 'deemed fixation'– which is incompatible with the wording of the OECD MC itself, since both the English and the French version employ the words 'fixed'/'fixe' in addition to 'place'/'installation'. The term 'fixed'/'fixe' would be superfluous if it were to be reduced to a meaning which is included in the term 'place' anyway. But even if one could maintain a residual meaning of 'fixed'/'fixe' which exceeds the meaning of 'place' in one respect or the other, the term 'fixed'/'fixe' would lose its clear-cut, almost mechanical comprehensibility.

The need for a uniform interpretation of the PE definition, not only among OECD States, 50
but worldwide, can only be fulfilled if all teleological and fairness aspects which might suggest an inclusion of deemedly fixed POBs (and eventually the interpretative deletion of 'fixed'/'fixe') are left aside. The language of the law requires a **'fixed place'**, and any construction or interpretation allowing **semi-fixed POBs** creates unjustified inconsistencies and uncertainties.

b. Definition

A place is fixed if it shows a **link** to a specific, distinct **geographical point** (no. 5 OECD MC 51
Comm. on Article 5) and if this link functions as a connection which avoids any dislocation of the establishment. In this respect, geographical fixation is closely related, but not identical, to the requirement of permanence (see *infra* m.no. 65 et seq. for details).

The **connecting factor** can be a separate item like a massive concrete fundament, with 52
fixation as its only purpose, but it may also be a non-separable part of the establishment such as the ground and the walls of a cellar, the brakes of a vehicle, or the anchor and ropes of a

restaurant or museum boat permanently moored to a riverside[35] (see, however, the additional requirement of permanence: *infra* m.no. 65 et seq.).

53 In contrast, **floating facilities** at sea have no such link to a geographical point.[36] This is also the case for ships' berths, and it is certainly the case when a ship is not permanently moored.[37] Ships which are permanently moored to the bank (serving as museums, restaurants, hotels etc.) are, in contrast, 'fixed' in the sense of Article 5(1) OECD and UN MC. Similarly, oil rigs firmly anchored to the sea bed are sufficiently linked with a specific geographical point, whereas floating oil rigs which are moved every few months are not.[38]

54 Even though the OECD MC Comm. goes too far when stating that it is enough if the equipment remained on a particular site,[39] it is true that the requirement of fixation does **not necessarily require** particular **mechanical tools**. Equipment may qualify if items of this type are usually used at one place for a sufficiently long period of time under the requirement of permanence (*supra* m.no. 65 et seq.), and where a relocation is restricted to occasions like change of ownership, a change of function, a change of the principal etc. (cf. *infra* m.no. 58). It follows that mobile homes or house trailers which have been parked at the same caravan site for the above-mentioned period of time can be regarded as 'fixed' under Article 5(1) OECD and UN MC. The same holds true for typical internet servers (cf. no. 42.4 OECD MC Comm. on Article 5).

c. Relative Standards

55 Even if the OECD MC and most, if not all, bilateral DTCs favour source State taxation rather than home State taxation for business income as the general principle, the PE threshold is justified by the (main) idea that 'moving targets', due to their ambulatory character, can hardly be identified, addressed and assessed by the tax authorities of the host country. This basic idea legitimates the use, and a rather **strict interpretation** of, the terms 'fixed' and 'stable'.

56 Admittedly, under the aspects of fairness and the consistency of rules, as tested against aspects of equality, the strict (restrictive) interpretation of the term 'fixed' appears inappropriate in situations where the taxpayer **roams through the source State** and, in so doing, shows equally strong (or even stronger) ties to this State, as compared to the carrying-on of business through only one, but non-roaming (fixed) POB. However, these aspects cannot overrule the wording of Article 5(1) OECD and UN MC.

57 They give rise to use the rules on an object-and-purpose related interpretation (Article 31(1) VCLT) in order to mitigate the **filter function** of 'fixed'/'fixe' to a considerable extent. Like for the terms 'permanent' (*infra* m.no. 65 et seq.) and 'control' (*infra* m.no. 102 et seq.), this can be achieved by adapting the standards of 'fixed' flexibly to the characteristics and particularities of the enterprise concerned, that is, by adopting relative standards.

58 It follows that any **relocation of the equipment** remains irrelevant (i.e., it does not remove its characterization as 'fixed') if further use at the previous place is physically impossible or fully impractical (e.g., drilling equipment needs to be moved from one place after the relevant natural resources have been exploited there, and the equipment should now be used at another

35. Likewise, Williams, R.L. & Huston, J.C., 'Agency Permanent Establishments – The Black Hole of Tax Treaties', *TPI* (US) 19 (1992) and id. 22, 25 (1992); see also Skaar, A., *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991) at 373.
36. Bundesfinanzhof *BStBl.* II 361 (1974): Germany's DTC with Denmark.
37. Österreichisches Bundesministerium der Finanzen, 2 *SWI* 356 (1992); disagreeing for boats used in organized river excursions: Conseil d'État, req. n. 94.137, *Droit Fiscal commentaire* 1472 (1992): DTC France/UK.
38. Gerechtshof 's-Gravenhage, Rolno. 4287/87–M–1, BNB 1992/51: DTC Netherlands/UK.
39. Nos 5 and 42.4 OECD MC Comm. on Art. 5; and my remarks *supra* m.no. 48 et seq.

place). Likewise, relocation is irrelevant if the taxpayer has alienated or abandoned the equipment and the new owner prefers using it at a different place.

d. Relocation and Roaming of POBs

59 These relative standards gain tremendous relevance in all cases where, on the basis of one economic relationship, two or more homogeneous activities are carried on through **one single facility at different places** (for moving activities in general, and 'diagonal contraction' of two or more POBs into one PE, see *infra* m.no. 147 et seq.). Here, the taxpayer enterprise runs one POB after the other (e.g., workshops which are equipped with the same machines) at different locations in or on the soil. Where these activities form part of one single project or venture, the different POBs might be regarded as one, with the requirement 'fixed' being interpreted in a modified way.

60 This trend becomes apparent in a series of decisions in the area of oil and gas exploration and exploitation on the Continental Shelf, largely from Scandinavia (but also from the United States, Canada and the UK), where the precondition mentioned above had been fulfilled.

61 It is obvious, however, that the question of when **one single project** or venture may be assumed needs to be shaped more precisely. Although there is no single categorical criterion, the coherence of the activities can be assessed on the basis of an indefinite set of indicators. There is no strict rule on whether one criterion alone is sufficient. Vice versa, it is not necessary that each of them is being met in every case. Rather, they should be balanced and evaluated from an economic perspective. Four of these indicators are particularly strong (with some of them being almost compelling) and deserve being mentioned explicitly:

1) If the **activities require**, by their nature, a relocation from time to time, that is, if it would not make any sense, from a neutral (non-tax) business viewpoint, to remain in the first location for a longer period of time, one should assume that a slight move is a necessary part of what constitutes one single project or venture.

2) One single project or venture is likely if the taxpayer performs the activities at the different locations for the **benefit of the same principal**.

3) The more **complex, sophisticated, and larger** the facilities are, and the more expensive it would be to transfer them over a longer distance, the more these activities can be characterized as 'one single project or venture', even though they are carried on at different (but adjacent) locations. Under this criterion, drilling rigs will qualify as 'fixed' even when they are moved, from time to time, within a certain region of the sea.[40]

4) One single project or venture is unlikely if the taxpayer does **not** have **exclusive** control over the facilities, but where two or more taxpayers are involved (for details, see *infra* m.no. 116 et seq.).

62 The first consequence of this more flexible interpretation of the term 'fixed' is that the move shall be disregarded, and the facilities are deemed to remain stable at the place where they originally were. This **fiction** does not make the requirement of fixation obsolete, as it does not give up the necessity that a fixation of the facilities is required at every single place at which these facilities operate.

63 On a second level of reasoning, however, one may well ask if this requirement, too, should be abandoned – which would mean that the questionable distinction which has been made between **floating oil rigs** and **permanently anchored oil rigs** becomes obsolete, too. This would mean that, under the above-mentioned preconditions, a relationship or connection to a geographical area – instead of a fixed point – suffices to meet the fixation test.

40. Skaar, A., *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991) at 125 et seq., 151 et seq.

64 Admittedly, the distinction between fixed and floating oil rigs is unsatisfactory from an economic viewpoint. But doing away with this distinction would no longer be compatible with the ordinary meaning of the term 'fixed' (cf. Article 31(1) VCLT). Rather, it would **make this term redundant** – every 'place' would almost automatically qualify as a 'fixed place'. In the absence of special treaty clauses which extend the PE concept to floating oil rigs[41] or future modifications of the OECD and UN MC, floating oil rigs do not qualify as a PE. Taxation may be assigned to the source State under Articles 6 or 13(1) OECD and UN MC, however.[42]

5. 'Permanent'

a. Purpose of the Term

65 In addition to geographical fixation, the qualification of a place of business as a 'permanent' establishment is subject to the condition of **temporal stability**. The French term 'stable' (although it does not form part of the definition *strictu sensu*, but belongs to the expression which is being defined) implies both aspects. Moreover, both the French and the English version imply temporal stability by using the terms 'fixed'/'fixe', as geographical stability has ancillary function for, and makes little sense without, temporal stability (cf. no. 6 OECD MC Comm. on Article 5).

66 The two terms, however, are not equivalent. One can imagine geographical fixation without permanence (if, e.g., a fixation is being removed after a very short time) as well as permanence without geographical fixation (if, e.g., the taxpayer stands or sits at a certain place and simply does not go away). Under the ordinary meaning of the terms used in Article 5(1) OECD and UN MC, a PE can exist only where both requirements have been met cumulatively (see *supra* m.no. 46 et seq.).

b. Definition

67 Although there is no clear time limit so far, several attempts have been made to interpret the term 'permanent' as containing a **definite time period**. By way of a preliminary approximation, the OECD MC Comm. States that a place of business does not qualify as 'permanent' if it is of a purely temporary nature (no. 6 OECD MC Comm. on Article 5). However, the special **twelve-month** threshold for construction sites and similar projects in Article 5(3) OECD MC would have been superfluous if short-term (i.e., not more than twelve months) facilities could not have constituted a PE under Article 5(1) OECD MC.[43] It follows that the OECD MC itself (unlike the Commentary) is obviously ready to accept that POBs constitute a PE even if they are of a temporary nature only, and even if they have lasted for less than twelve months.[44]

68 It is much more plausible that the OECD MC Comm, refers to common experience of the member countries, according to which a period of **six months** (or any shorter period) is normally not sufficient to make a place of business become a PE. In contrast, places which are maintained for more than six months will qualify as a PE (no. 6 OECD MC Comm. on Article 5).

41. Cf. the reservations to Art. 5 OECD MC made by Canada, Denmark, Ireland, Norway and the United Kingdom (no. 52 OECD MC Comm. on Art. 5) as well as New Zealand (no. 56 OECD MC Comm. on Art. 5).
42. For details, see Reimer, E., in: V&L (5th edn), Art. 6 at m.no. 44 et seq.
43. Cf. Skaar, A., *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991) at 216.
44. Cf. Skaar, A., *id.*, at 344.

It is true that OECD has phrased this view **more weakly than necessary**.[45] This **indefiniteness** has several reasons. Formally, it is due to a lack of unanimity of the representatives of the OECD Member States in the Committee of Fiscal Affairs. In substance, they have been reluctant to fix the six month period in order to maintain a certain leeway for the particularities of each case at issue (cf. *infra* m.no. 84 et seq., 90 et seq.). Moreover, a six-month period would be a mismatch to the threshold in Article 5(3) OECD MC (twelve months). Lastly, an exact time requirement might not do justice to situations where special circumstances urge the taxpayer to abandon a fixed POB ahead of time or, vice versa, maintain it longer than originally scheduled (on this point, see *infra* m.no. 75). It is for these reasons that both OECD and distinguished scholars have proposed a **relative standard** for the permanence test under Article 5(1) and (2) (no. 6 OECD MC Comm. on Article 5).[46] 69

However, any difference between the two contracting States on whether or not there is a PE in one State induces significant difficulties. There is a strong need to make the threshold as clear as possible. Thoughtful treaty negotiators might therefore **insert a fixed time threshold into the wording** of Article 5(1) OECD MC. In doing so, they are free to adopt the twelve-month period contained in Article 5(3) OECD MC or to use shorter periods like, for example, the 183-day period suggested in the 2008 OECD MC Comm. proviso on service PEs (no. 42.23 OECD MC Comm. on Article 5) and clauses like Article 15(2)(a) OECD MC. 70

In contrast, where the DTC does not contain any explicit time rule, specification depends on a careful interpretation of the clause corresponding to Article 5(1) OECD MC in the light of its object and purpose (Article 31(1) VCLT, see Introduction part 1 at m.no. 82 et seq.). Based on teleological and systematic considerations, a consistent solution should take into account the **functional equivalence of the PE concept to concepts of residence** (Article 4(1) OECD MC) and comparable thresholds in other distributive rules. Both in the domestic law of many countries (in their domestic PE definitions and/or in their definitions of residence, ordinary residence, domicile, habitual abode etc.), and in clauses like Article 15(2)(a) OECD MC, a **six-month** (or 183-day) period has functioned as a decisive threshold for many years. 71

Also with regard to Article 5 OECD MC itself, there is a strong tendency both within and beyond the OECD that a **six-month limit constitutes a landmark** at which primary taxation crosses the divide from the State of residence to the source State. Along this line, States have often reduced the time limits on building sites and construction or installation projects (Article 5(3) OECD MC) by half by adopting a six-month period as well. Bilateral DTCs have employed a six-month standard for special types of deemed PEs (see *infra* m.no. 427 for an example). Likewise, the above-mentioned paragraphs of the OECD MC Comm. reflect a considerable (though not full) degree of consensus about the six-month threshold. For these reasons, the interpretation of the permanence requirement in Article 5(1) OECD MC should follow the 183-day rule for all sectors of business. There are only rare cases which make it compelling to deviate from this absolute standard, and to apply relative standards (see *infra* m.no. 95 et seq.). 72

Like under Article 5(3) OECD MC (see *infra* m.no. 231; cf. also m.no. 337), this time requirement shall be subject to an **ex post perspective**. It is only the number of days during which the other preconditions of Article 5(1) OECD MC have actually been fulfilled (and during which Article 5(4) OECD MC has not applied) which shall be taken into account. In our view, this applies in both directions: 73

1) Where the taxpayer has actually **exceeded the 183-day threshold**, it is immaterial whether there were adverse circumstances or unforeseeable incidents. This has also been acknowledged by the OECD MC Comm. (no. 6.3 OECD MC Comm. on Article

45. Still critical is, however, Vogel, 3rd edn, Art. 5 at m.no. 28 et seq., who seems to refrain from fixing any duration requirements but suggests a test based on the specific circumstances of each single case. Cf. also Skaar, A., id. at 220, 226.
46. Skaar, A., *id.* at 209 et seq.

5).[47] Indeed, the OECD MC Comm. uses the word 'retrospective' in this connection. It should not be misunderstood as to say that, as soon as a retrospective view shows that the 183-day rule has now expired, a PE is created ex nunc. Given the need for utmost legal certainty, the POB should rather constitute a PE retroactively, that is, from the first day from which the other preconditions of Article 5(1) OECD MC have been fulfilled.

2) Vice versa, if the other preconditions of Article 5(1) OECD MC were **not fulfilled** for a period exceeding **183 days** at the time when one or more of these preconditions have dropped, the taxpayer shall be treated (again, retroactively) as if a PE had never existed – even if there was compelling evidence that the taxpayer had originally planned and designed the facility and activity for a period exceeding the 183-day limit.

74 It should be noted, however, that with regard to case (2), our view deviates from the OECD MC Comm. The OECD MC Comm. suggests that a POB can constitute a PE from its inception even though it existed, in practice, for a very **short period of time**, if as a consequence of special circumstances, it was **prematurely liquidated** (no. 6.3 OECD MC Comm. on Article 5). Moreover, the OECD MC Comm. provides two typical examples for such special circumstances: the death of the taxpayer and investment failure.

75 The inclusion of a premature liquidation into the OECD MC Comm. creates significant and unnecessary risks for the taxpayer In our view, **liquidation** (even if due to insolvency) is part of **regular market developments**; and it does not differ categorically from other reasons for the cessation of a facility or activity. In contrast, a sudden cessation of the activity as a consequence of the **death of an individual** (either the taxpayer or one of the crucial employees who work in or for the POB) may indeed leave the characterization of the POB unaffected – but this should remain the only exception.

76 Admittedly, the rather strict adherence to the facts rather than the intention of the taxpayer may create an **unfair burden** or an **unfair relief**, as the case may be, if the tax level in the Contracting States differs significantly. Moreover, it amounts to a substantial risk for tax planning which every tax consultant should disclose to his clients.

77 However, a **strict interpretation** of the term 'permanent' in favour of the ex post perspective is the only way to achieve two of the paramount objects and purposes of the PE provisions, that is, to overcome difficulties which the tax authorities would otherwise have in identifying **non-resident taxpayers**, and the lack of legal certainty in the application of the all-or-nothing rules behind Article 5 OECD MC

c. Beginning and End of a PE

78 As a rule, a PE begins to exist as soon as the **last indispensable element** contained in the PE definition of Article 5(1) OECD and UN MC (or any of the subsequent deemed PE requirements under Article 5(5) OECD and UN MC) has been met (no. 11 OECD MC Comm. on Article 5). If all of the conditions have been met but a **negative element** (e.g., one of the barriers contained in Article 5(4) or (6) OECD and UN MC) applies, the PE does not begin to exist until this negative element has ended. There is no need to modify this rule with regard to preparatory activities (see *infra* m.no. 82). In particular, the period of time during which

47. In the application of this view, a broad range of circumstances gains relevance. These circumstances are grouped in two main categories: facts which prove or indicate that the taxpayer had originally planned to maintain and use the POB for a longer period of time (e.g., long-term leasing contracts, long-term loans, or long-term employment contracts); and facts which prove or indicate that the abandonment of the POB (or the activities) are a result of external influence (e.g., illness, a fire or an earthquake, armed conflicts, the withdrawal of a permission by public authorities in the source State etc.).

the fixed POB itself is being set up by the enterprise should not be counted (no. 11 OECD MC Comm. on Article 5).

The PE ceases to exist as soon as the first of the indispensable elements of Article 5(1) OECD and UN MC (or of Article 5(5) OECD and UN MC, respectively) has dropped out. **Insignificant interruption** of the business activity are not taken into account. Apart from such short-term interruptions, the leasing out of an enterprise or a PE by the taxpayer will usually bring the PE of the lessor taxpayer to an end (no. 11 OECD MC Comm. on Article 5) (see, however, *supra* m.no. 32 et seq.; and *infra* m.no. 118 et seq.). **79**

Likewise, a PE ceases to exist as soon as one of the negative elements contained in Article 5(4) or (6) OECD and UN MC occurs. **80**

It is important to note, however, that the determination of the beginning and end of a PE is relevant for **capital taxation only** (Article 22(2) OECD and UN MC). By contrast, it need not be considered for **income tax** purposes. This is particularly true with regard to Article 7(1) and (2) OECD and UN MC, as the rules on the attribution of profits to a PE allow an attribution of earnings and expenses to the PE even if they have accrued at a time when the PE had not subsisted yet – or, vice versa, after the PE had ceased to exist. The same applies, mutatis mutandis, with regard to income qualifying under the other PE provisions (Articles 10(4), 11(4), 12(3) etc. OECD MC and Articles 10(4), 11(4) and 12(4) UN MC). **81**

Given, therefore, **that time shifts between the existence of the PE and the accrual of income** do not pose a problem for the application of DTCs anyway, there is relatively little need to say that even preparatory activities (performed during the process of setting up a PE in the source State) qualify as a carrying on of the business of the enterprise (Article 5(1) OECD and UN MC).[48] **82**

Still, this issue is relevant in two ways. First, with regard to capital taxation (i.e., if the PE State is entitled to levy any capital tax on assets of the POB at a time when this POB has not commenced its operational business activity but is still in the start-up period; see *supra* m.no. 82), and secondly with regard to cases of a 'failed PE' which, for whatever reason, is prevented from commencing its operational business activity. Here, a careful analysis is needed with regard to the particular circumstances of the case. **83**

d. Insignificant Interruptions

The requirement of permanence tolerates temporary interruptions in the activity. If the fixed POB continues to exist, and the taxpayer does **not lose or give up control** over the POB, periods of inactivity do not cause the PE to cease to exist (nos 6.1, 11 and 19 OECD MC Comm. on Article 5). Examples include holidays, illness of staff and inactivity due to technical defects, due to a lack of material, or due to insufficient demand. Likewise, where a seasonal business cannot, by its nature, be carried on during certain times of the year, the hibernation of the activities does not affect the permanence test (no. 11 OECD MC Comm. on Article 5). **84**

Much more intricate is the question if interruptions remain insignificant if they concern other elements of Article 5(1) OECD and UN MC. At first glance, this question does not become relevant with regard to the requirement of place, as a place cannot become a non-place. As indicated above, however, a 'place' is often the entirety of a point on (or within) the soil and certain facilities. If such facilities are **moved from one place** to another and shortly thereafter moved back to their initial (ordinary) place, one may well regard this as an interruption of the requirement of a 'place'. As shown *infra* m.no. 88 et seq. for recurrent activities, these interruptions can be disregarded under certain circumstances. **85**

48. This view has been held, however, by a broad number of authors. See, e.g., Andersen, P., 36 *ET* 419 et seq. (1996); Görl, M., in: V&L (5th edn), Art. 5 at m.no. 31.

86 Likewise, it is acceptable (and does not cause a PE to cease to exist) if the fixation is **removed from time to time**. For cases where the facilities are untied and then transferred to a new place, or where they roam through a certain area on a regular basis, see *supra* m.no. 59 et seq.

87 With **regard to control**, too, temporary interruptions (which may include the preliminary transfer of control to a third person) should be disregarded, and control be deemed to persist (see *infra* m.no. 121 et seq. for details).

e. Activities of a Recurrent Nature

88 Within the permanence test, a crucial problem arises wherever the taxpayer enterprise does not perform its activities continuously, but activities are performed with **significant interruptions** (as opposed to those described *supra* m.no. 84 et seq.) or in **multiple tranches**. Where none of these activities of a recurrent nature meets the requirement of 'permanence' in itself, a PE may still exist if the single activity forms part of one comprehensive project or one ongoing homogeneous business.

89 The standards are stricter than under Article 5(5) OECD and UN MC, however. While an agent qualifies as a PE as soon as he exercises his authority to conclude contracts 'habitually' ('habituellement'), a POB constitutes a 'permanent' establishment under Article 5(1) OECD and UN MC only under more rigorous conditions. It is required that, given its frequency and rhythm, the recurring activities are **equal to a non-transient business** from an economic viewpoint. Here, the **conceptual criterion** is the question: Could the taxpayer have reasonably set up a subsidiary (rather than a POB) for the same activities? If so, we can equate the activities of a recurrent nature with a corresponding permanent uninterrupted activity.

90 The OECD MC Comm. suggests that each **period of time** during which the place is used should be considered in combination with the **number of times** during which that place is used, even if these periods extend over a number of years (no. 6 OECD MC Comm. on Article 5).[49] Where each period is of the same numbers of days, a multiplication of the duration of the single periods with the number of periods is plausible. In contrast, where the single periods vary in length, all periods should be added on the basis of full days (see *supra* m.no. 73 et seq.). Typically, the shorter each single period is, the more regular and the more often the activity should recur (cf. no. 6.1 OECD MC Comm. on Article 5). This hypothesis cannot be used in a strictly mathematical sense, however.

91 Whether or not such comprehensive project or ongoing homogeneous business can be acknowledged should be decided under the same criteria as the concept of one single project or venture (*supra* m.no. 599 et seq.).

92 Based on the above-mentioned standards, a PE has convincingly been acknowledged in the case of a **market pitch**, which a taxpayer used on a regular basis year in, year out. Likewise, a PE has been acknowledged in the case of a US resident salesman who sold wares at an exhibition in Canada from a **trailer and portable sales booth** two weeks each year for fifteen years. However, twice he left the trailer and stand in Canada between exhibitions, allegedly for repairs.[50] It seems to your author that this decision is not beyond doubt, however.

93 Not every recurring activity qualifies as a permanent activity. The longer it takes for the enterprise to **fulfil the 183-day requirement**, the less convincing is the acknowledgment of such recurring activities as 'permanent'.

49. A different view has been held by the German *Bundesfinanzhof* in its judgment of 17 September 2003, case I R 12/02, 203 *BFHE*, pp. 400 et seq. = *BStBl II* 396 et seq. (2004).
50. Decided by the Tax Court of Canada in *Fowler v. M.N.R.*, *Dominion Tax Cases* 1834 (1990), regarding Canada's DTC with the US; for a discussion, see Boidman, N. 20 *TMIJ* 38 (1991).

94 Examples where a PE has correctly been **denied** include:

- a Norwegian case concerning **fifty stays** within **600 days** divided in different offices and in two different cities;[51]
- **travelling circuses, ice skating shows** and similar enterprises which carry on their business on an itinerant basis do not create a PE at the places where they perform for no more than a short period;[52]
- **dancing and music groups** who come to the source State only once a year;[53]
- a repeated entry of a **horse in races** within the source State, provided that each race takes place at a different race course.[54]

f. Relative Standards

95 As indicated above, there are strong arguments in favour of the **absolute (183 days) standard** rather than a flexible adaptation of the requirement of permanence to each individual case. It should be noted, however, that this tendency to achieve legal certainty should itself not be set absolute.[55]

96 Apart from cases of recurring activities (which, in our view, can meet the ordinary permanence test anyway; see *supra* m.no. 788 et seq.), the OECD MC Comm. suggests that an exception from the usual standards of permanence should be made where activities constituted a **business** that was **carried on exclusively in that country**. In this case, the business may have short duration by nature, but since it is wholly carried on in one country, its connection with that country is stronger than the connection with the State of which the taxpayer is a resident (no. 6 OECD MC Comm. on Article 5).[56]

97 The tax authorities of the source State might have difficulties in identifying and taxing the taxpayer. But this holds equally true for all other States, including the State of residence. The first **reason for the strict 183-day interpretation** of the permanence requirement is, therefore, **obsolete**. The same holds true for the second reason – the need for legal certainty. Where both States agree on the abstract rule that a relative standard should be applied in the above-mentioned group of cases, legal certainty is not in danger. On the contrary, the application of the DTC becomes easier and will create less arguments. Both aspects support the view of the OECD MC Comm. which, therefore, deserves full approval on this point.

98 It is also necessary to consider similar cases. There is no reason to assign taxation back to the State of residence if the taxpayer carries on a **business in two or more source states** (but again, not in the State of residence). Rather, a PE should be assumed (provided the further preconditions set forth in the respective PE definition of the bilateral DTC concerned have been fulfilled) in each of the source States. It is true that this might give rise to new asymmetries if one compares the situation in the different source States. However, the generous assumption of a DTC in each source State is not to the detriment of any other source State. It is therefore justified to stick to the purely bilateral (DTC-related) view.

51. Norwegian Høyesterett, Rt. 752, 761 (1994): DTC Norway/UK; Vogel (3rd edn), Art. 5 at m.no. 28.
52. Similarly, Vogel, 3rd edn, Art. 5 at m.no. 28a.
53. *Internal Revenue Service* (US) Letter Rulings 77–31–013, 79–24–025; see also various other Letter Rulings in 25 *Tax Notes* 40 (1984); for the vacillating older practices of the *Internal Revenue Service* (US), see further Huston, J. & Williams, L., *Permanent Establishments* (1993), at 13.
54. *Internal Revenue Service* (US) Letter Rulings 77–31–013, 79–24–025; a divergent view had previously been held by the *Internal Revenue Service* in Revenue Ruling 60–249, 1960–2 *Cumulative Bulletin* (US) 264.
55. Similarly, Vogel, 3rd edn, Art. 5 at m.nos 28 and 40.
56. With a new no. 6.1 OECD MC Comm. on Art. 5 in its 2014 update, this point will be made even clearer. For the envisaged text, see OECD, *Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention. Revised Public Discussion Draft* (19 October 2012).

99 Moreover, a taxpayer may carry on his business in all countries involved, including the state of residence, but maintain **substantial facilities only** in a **State of which he is not a resident**. The activities in the State of residence may consist only, for example, in the furnishing of personal services or the delivery of goods on an occasional basis. In particular, the taxpayer does not use its personal dwelling for any business activities. For the reasons mentioned above, relief from the strict 183-day requirement should be granted here, too. Consequently, a PE in (each of) the source State(s) should be acknowledged. It would be recommendable to modify the OECD MC Comm. accordingly.[57]

100 With regard to the last-mentioned case, it should be noted that there is another question involved, that is, the question of whether or not the **entire tax base** should be assigned **to the PE State**(s). If the case is a pure Article 7 case (business profits, with no other distributive rule applicable), the answer is being given by Article 7(2) OECD MC. Under OECD's functionally separate entity approach to Article 7(2) OECD MC, all transactions need to be assigned to a PE (see *infra* Article 7 at m.no. 80 et seq. for details). In the absence of a PE in the State of residence, all profits shall be allocated to a PE in the source State – even if they stem from activities carried on outside this PE State (here, from activities carried on in the State of residence).

101 As indicated earlier however, the mere fact that it is not sound from an economic perspective, or maybe **not even possible, to continue** the same activities at **the same POB** any longer does not in itself trigger the application of relative standards instead of the 183-day rule (*supra* m.no. 73 et seq.). Where, for example, a mine has been exploited after five months already, neither Article 5(1) nor Article 5(2)(f) OECD and UN MC permit the characterization of the POB as a PE (see also *infra* m.no. 164). It is irrelevant whether the early abandonment of the POB was foreseen or unforeseen (*supra* m.no. 75 et seq.).

6. 'Through': Control by the Taxpayer

a. Purpose of the Term

102 According to the traditional interpretation of Article 5(1) OECD and UN MC as set forth in the OECD MC Comm., the place of business qualifies only if the taxpayer and/or his staff have the place **at their disposal** (no. 4.1 OECD MC Comm. on Art. 5). This requirement follows, as a minus, from the term 'through' in Article 5(1) OECD and UN MC: The taxpayer will not be able to use the POB as an instrument for the carrying-on of his business unless he controls the POB to a considerable extent. There are no absolute standards for the modalities and intensity of control. Rather, the standards depend on the type of business activity at issue (see *supra* m.no. 84 et seq. for details).

b. Definition

103 The taxpayer or his staff (*infra* m.no. 104) control a POB if they have it at their disposal. In this context, 'disposal' is **the power** (or a certain fraction thereof) **to use the POB directly**. A person uses the POB if he employs it as an operating asset (or a bundle of operating assets) for the purposes of his business (for details, see the **functional integration** test *infra* m.no. 124 et seq.).

104 In addition to the taxpayer in person, **his employees, his relatives** and any **other person** who is closely affiliated to the taxpayer entrepreneur also qualify as the subject of control.

57. The words 'was carried on exclusively in that country' in no. 6 OECD MC Comm. on Art. 5 should be replaced by 'was carried on exclusively through one or more fixed places of business outside the State of residence'.

Even if the taxpayer himself is forbidden to enter the State in question, the POB may constitute a PE in that State if the taxpayer can send his staff to the POB.[58]

105 The mentioning of mines and related places in Article 5(2)(f) OECD and UN MC shows that a **place for the extraction of natural resources** can meet the requirement of control as well.[59] By contrast, the rights and/or the actual powers to alienate, abandon or demolish the POB will not in themselves meet the requirements of the control test, given that these activities alone will usually not constitute a sufficient basis for the taxpayer carrying on his business through the POB. However, this issue is dealt with in the context of the functional integration requirement in more detail (see *infra* m.no. 124 et seq.).

c. Legal or Factual Basis

106 For all types of business activities, control can be based on legal titles or factual circumstances. **Legal control** might be derived from ownership or any other right, including equitable rights under common law if the respective right conveys factual mastery of a POB to the taxpayer enterprise. Such rights are perfect where the taxpayer enterprise is the legal proprietor of the POB. Likewise, the position of the taxpayer as a tenant, a lessee (leaseholder, even in cases of short-term lease) or even a co-tenant will usually qualify as a controlling interest under Article 5(1) OECD and UN MC (no. 11 OECD MC Comm. on Article 5).[60]

107 But even in the absence of a legal right to use that place, the control test can be met if the taxpayer enterprise has **sufficient command** of the POB as a **matter of fact** (no. 4.1 OECD MC Comm. on Article 5).[61] Thus, for instance, a PE could exist where an enterprise illegally occupied a certain location where it carried on its business (as mentioned explicitly in no. 4.1 OECD MC Comm. on Article 5). Likewise, a company may create a PE on the premises of an associated company if this associated company grants accommodation to, or tolerates the lasting presence of employees of the first-mentioned company (see *infra* m.no. 370 et seq.).

d. Relative Standards

108 The **degree of control** depends on the type of business activity that the taxpayer carries on. It is therefore not necessary that the taxpayer is able to exclude others from entering or using the POB (for details, see *supra* m.no. 121 et seq.).

109 The painter example in the OECD MC Comm. (no. 4.5 OECD MC Comm. on Article 5) (however questionable it might be with regard to the functional integration test; see *infra* m.no. 124) suggests that **the type and extent of control** need not exceed the level of what is **required for the specific type of activity** which is determined by the concrete business.

110 By contrast, in the case of a self-employed engineer who had free access to his customer's premises to perform the services required by his contract, the Canadian Federal Court of Appeal ruled that the engineer had no control because he had access only during the

58. German *Bundesgerichtshof*, 40 *RIW* 1068 (1994), *HFR* 476 et seq. (1995).

59. It should be noted, however, that the qualifying POB is not identical to the extracted natural resources. The resources (oil, gas, metal, diamonds) will be removed in the course of the activity. Therefore, they are not themselves 'used' by the taxpayer – they form the object rather than the instrument of his activities (see *infra* m.no. 423). It is rather the persisting facilities and the point or area of work which constitute the POB.

60. See also the Luxembourg *Esch* case of 1999: Junius, M., Mischo, P. & Prussen, Y., 'National Report Luxembourg', *CDFI* vol. 94a (2009) at 439 (442 et seq.).

61. See also the decisions issued by the Finanzgericht Münster, 14 *EFG* 501, 502 (1966); the former Reichsfinanzhof, *RStBl.* 127 (1928); *RStBl.* 1095 (1939); and *RStBl.* 469 (1942); and the Bundesfinanzhof *BStBl.* II 97 (1991).

customer's regular office hours and was not entitled to carry on businesses of his own on the premises.[62]

111 Similarly, a Special Bench of Delhi's Income Tax Appellate Tribunal denied the existence of a PE in the case of *Ericsson*. The Tribunal held that it was not sufficient that Ericsson's employees had **access to the premises** of Indian mobile phone providers **to deliver the hardware, software and know-how** required for operating a network. By contrast, in the case of a competing enterprise, the Bench did assume an Indian PE because the employees of that enterprise (unlike Ericsson's) had exercised other businesses of their employer.[63]

112 The OECD view can hardly be reconciled with the two court cases. All three examples do indeed shed some light onto the method how the relative standards for the control threshold should be designed. While the OECD MC Comm. suggests that it is sufficient to require not more than the type and extent of control necessary for the specific business activity which the taxpayer wants to exercise in the source State, the Canadian and Indian decisions advocate for **stricter standards** for the control threshold.

113 The OECD MC shows a paramount tendency (though no strict rule) that PEs should be **treated like subsidiaries** (cf. Article 24(3) OECD and UN MC), and that facilities of a subsidiary would rarely been unusable outside the office hours of one of its customers (i.e., a third person), the view of the two courts is still more convincing.

114 Along these lines, a POB will usually exist only where the taxpayer **is free to use the POB**:

- at any time of his own choice (see, however, *infra* m.no. 121 et seq.);
- for work relating to more than one customer; and
- for his internal administrative and bureaucratic work.

115 In all, the taxpayer will usually be regarded as controlling the POB only where he can **employ it at his discretion**. This does not imply that the standards of the control test should not be flexible and adaptive. Generally, the less invasive the activities are, and the more they allow a parallel use of the same POB by other persons, the lower are the requirements under the control test. There are, however, a number of traditional PEs which by their nature require an exclusive use of the POB by only one taxpayer and/or his personnel. A small workshop (cf. Article 5(2)(e) OECD and UN MC) of 10 or 12 square meters can hardly be used by more than one person. The same holds true for a room where the taxpayer runs a noisy machine.

e. Joint Control

116 There are cases in which the taxpayer uses, and needs to use, only a relatively **small part or a particular function of the POB**. In these cases, a joint use by two or more enterprises stands to reason which, however, requires some careful distinguishing. However, where two or more unrelated persons use the same place only subsequently (but never simultaneously), but each of them has full control over the place during the period of use, problems may arise with regard to the permanence test (*supra* m.no. 65 et seq., and m.no. 88 et seq. for recurring activities).

117 Where a particular POB is used by **a number of similar businesses carried on by the same or related persons**, but each person uses the POB for very short periods of time only, an aggregation is admissible and required, that is, all of these periods shall be added up. This applies particularly (but in our view, not exclusively) where the fragmentation of control has been made in an attempt to avoid that the place being considered to have been used for more

62. Canadian Federal Court of Appeal, *The Queen v. Dudney*, [2000] 3 FC D-23.
63. Delhi ITAT (Special Bench), *Motorola Inc., Ericsson Radio Systems AB and Nokia Corporation v. DCIT* [2005] 96 TTJ Delhi 1 of 22 June 2005.

than purely temporary purposes by each particular business (no. 6.2 OECD MC Comm. on Article 5).

Where the taxpayer makes **direct use** while someone else uses the same place indirectly[64] at the same time (e.g., a landlord or lessor), there is no doubt that the taxpayer (being a tenant, a lessee etc.) has sufficient control. This has been clarified by the replacement of 'the enterprise' in Article 5(1) OECD MC 1963 by 'an enterprise' in 1977. The landlord (lessor), in turn, will usually use the POB as a passive investment, and in that case not carry on his own business at and through the same POB simultaneously (no. 11 OECD MC Comm. on Article 5) (see *supra* m.no. 31 et seq. and m.no. 79). In these cases, one need not test his control anyway. 118

This is by no means compulsory, however. Rather, control of the POB can be shared between two or more persons both in a vertical and a horizontal sense. **Control** is **shared vertically** if there is a principal-agent relationship between the taxpayer and someone else. Where an entrepreneur carries on business, for example, in a rented hotel room or a rented holiday cottage on a permanent basis (*supra* m.no. 38 et seq.), and the owner of the respective place provides full service (cleaning, renewing towels or providing meals), both the entrepreneur and the owner carry on their respective businesses at the same place. Likewise, both of them have, and exercise, the type and degree of control necessary for the provision of their respective active services. It follows that **both** the owner and his guest can **maintain a PE** in the room or cottage simultaneously. 119

Vice versa, where the taxpayer enterprise interposes a subcontractor in order to fulfil external contractual obligations, the activities of this subcontractor might be attributed to the principal, thus constituting a PE of this principal, if the subcontractor is subject to full supervision and control by the taxpayer.[65] 120

A **horizontal share of control** can occur where two or more enterprises of the same level form a joint venture, such as an entrepreneurial condominium or even a partnership. If they use the place simultaneously, or if they rotate use cooperatively (i.e., on the basis of coherent interests and close coordination), there is a mutual attribution of control to all participant of the joint venture. Each of them should, therefore, be deemed to have control of the place at any given time. 121

Examples. Four intercontinental **airlines** jointly rented a fully-equipped **aircraft hangar** on a long-term basis (but with no joint repair staff). Two aircrafts could be checked simultaneously. Each of the four airlines has a sufficient degree of control and, therefore, maintains a PE there – even though none of the airlines exercises exclusive control. The result would not change even if there were space for only one aircraft at a given time. 122

Likewise, where a team of self-employed **medical doctors** share their **office/surgery rooms** and their employees and/or their patients, all rooms are constantly attributable to each of them, even if every single doctor is present for one day per week (in contrast, where only rooms are shared but patients and employees are not shared, the standards for activities of a recurrent nature apply: see *supra* m.no. 88 et seq.). 123

7. 'Through': Functional Integration

Article 5(1) OECD MC (since 1977; see *supra* m.no. 40) requires that the business of an enterprise (for these terms, see *supra* m.no. 22 et seq.) is carried on through the fixed POB. The preposition 'through' specifies the **functional relation** between the **POB** and the 124

64. For the distinction between 'direct' and 'indirect' use in the tax treaty terminology, cf. Art. 6(3) OECD MC. See, e.g., Wassermeyer, F., in: Wassermeyer, Art. 6 OECD MC at m.no. 91 et seq.; and Reimer, E., in: V&L, 5th edn (2008), Art. 6 at m.no. 154 et seq.
65. For a future adoption of this view in a new no. 10.1 OECD MC Comm. on Art. 5, see OECD, *Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention. Revised Public Discussion Draft* (19 October 2012).

activities of the **taxpayer**. This relation can be described best by the notion of a functional integration of the POB in the enterprise of the taxpayer. Such functional integration contains several aspects which need to be carefully distinguished from one another. Their common denominator, however, is the type and degree of proximity of the POB to, or even identification with, the taxpayer's paramount economic activity.

125 The first function of the term 'through' is to make it clear that the taxpayer has to **control** the PE (see *supra* m.no. 102 et seq. for details).

126 Secondly, functional integration presupposes that the taxpayer 'wholly or partly **carrie[s] on' his business** (Article 5(1) OECD MC; the OECD MC Comm. uses the verb 'carried out' synonymously (no. 7 OECD MC Comm. on Article 5)). However, like 'business' and 'enterprise' (cf. *supra* m.no. 22 et seq.), these words do not function as a substantive filter either. While early draft Model Conventions[66] contained the condition that the fixed POB should have 'a productive character', this requirement was never adopted by the OECD Model (see no. 7 OECD MC Comm. on Article 5). None of the current MCs provide a specific productivity test. It follows that POBs may constitute a PE even if they perform activities which have mainly or exclusively expenditures to show for.[67]

127 Likewise, the 'carrying-on' requirement does not imply an activity in the sense of an **active and visible work**. It includes even **stand-by services and omissions**. This gains significant relevance where the omission is profitable (e.g., in the case of a POB earning money in the source State simply by fulfilling, for whichever period of time, a non-competition agreement relating to the territory of that State).[68]

128 However, a **diffuse passivity** which equals a (temporal or lasting) suspension of the activities which the POB has been designed for may indicate that the POB is not 'permanent'.[69] For details, see *supra* m.no. 84 et seq.

129 Thirdly, the phrase 'through which' indicates that the taxpayer makes use of the POB in that he employs it as an **instrument** (equalling or resembling an operating asset) **for his entrepreneurial activities**. This third aspect of the functional integration is by far the most disputed one.

130 Historically, the instrumental character of the POB for the carrying-on of the enterprise could not be taken for granted. Between 1963 and 1977, the OEEC/OECD MC did not employ this term. Rather, it was sufficient that the taxpayer carried on his business **'in' the POB** (see *supra* m.no. 40). Based on the old Model, some older DTCs use the words 'in which' still today. While some authors have denied that the replacement of 'in' by 'through' amounts to any deviation in substance,[70] we do see a **substantial difference** between both terms.

131 On the one hand, the activities need no longer be carried on in or at the POB. In this respect, the **1977 change** of Article 5(1) OECD MC has **enlarged the scope** of the PE definition. Especially if one thinks of an activity as a human behaviour, one can now (unlike before 1977) easily subsume unmanned facilities under the PE definition (see *supra* m.no. 240 and see, e.g., no. 42.6 OECD MC Comm. on Article 5).

132 On the other hand, the requirement of an **instrumental character of the POB** has become irrefutable. Even stronger than the English amendment ('through which' instead of 'in which'), the corresponding modification of the French text ('par l'intermédiaire de laquelle' instead of 'où') has stressed the functional integration of the POB in the business.

133 The **OECD MC Comm.** has weakened the meaning of 'through' since 2003.[71] The Commentary holds the view that the requirement of a functional integration is met as soon as the taxpayer exercises the business **in a fixed POB** which is at his disposal (no. 4.6 OECD

66. For example, the 1943 and 1946 Mexico and London Drafts.
67. German *Reichsfinanzhof RStBl.* 1516 et seq. (1935); and Vogel, 3rd edn, Art. 5 at m.no. 33.
68. See for details: Reimer, E., 60 *BIFD* 110 et seq. (2006).
69. Cf. the language of no. 7 OECD MC Comm. on Art. 5: '*must be* carried out on a regular basis'.
70. Most prominently, Görl, M., in: V&L, 5th edn (2008), Art. 5 at m.no. 30.
71. Caridi, A., 43 *ET*, 13 (2003).

MC Comm. on Article 5 (added on 28 January 2003)). This is the reason for the characterization of the famous painter example (i.e., the fictitious case of a painter who, for two years, spends three days a week in the large office building of its main client) as a service PE.[72] In substance, the view of the OECD MC Comm. limits the meaning of 'through' to the first two instead of all three semantic aspects required by Article 5(1) OECD MC (*supra* m.nos 125 et seq. and 129 et seq.).

This abridging interpretation of Article 5(1) OECD and UN MC is not convincing, though.[73] It sets the term 'through' as a synonym of 'in' or 'at'. It is certainly not harmful, under Article 5(1) OECD and UN MC, if the taxpayer carries on his business also 'in' the POB. However, it is not sufficient. Given that the terms 'in' or 'at' have been used in a considerable number of bilateral DTCs and, above all, that the OECD Model has intentionally **replaced the word 'in' by 'through' in 1977** (*supra* m.no. 40), the deviation in the text of the OECD MC is to be **regarded as meaningful**. The ordinary meaning of 'through' and 'par l'intermédiaire de' is different from, and goes beyond, the ordinary meaning of 'in' or 'at' (cf. Article 31(1) VCLT). Before the background of the 1963 OECD MC, it is least among OECD Member States that 'through' has been given a special meaning as opposed to 'in' (cf. Article 31(4) VCLT). A reconsideration might be reasonable and recommendable from a policy viewpoint. It can only be realized, however, by a modification of the text of Article 5(1) OECD and UN MC itself. 134

Given that the POB may be a complex and heterogeneous object, the issue arises whether every single element or component part needs to be used. This is not required. It is sufficient that **the POB as a whole** is **functionally integrated**, in the aforementioned sense, into the business of the taxpayer. It should be noted, however, that a too narrow use might trigger the application of Article 5(4) OECD and UN MC even if the POB as a whole would not have fallen under Article 5(4) OECD and UN MC by virtue of its outward appearance. 135

8. Aggregation

A cross-sectional issue which concerns several requirements of the PE definition is the question if two (or more) **factual elements** (places, periods, types of activity) might be summed up and regarded **as a unit** where each of them, in itself, is not sufficient to meet the PE threshold, but where the agglomerate does qualify as a PE. 136

This question arises in different scenarios: may **two or more POBs** be **counted as one**, even if they are situated at different locations (*infra* m.no. 139 et seq.)? May two or more short-term POBs at the same location be regarded as one, even if there is a time gap between them (*infra* m.no. 146)? Can locations and times be combined, so that two or more POBs at different locations and during different time periods can be counted as one (*infra* m.no. 147 et seq.)? 137

In any case, the conceptual starting point is that **each element** in itself (i.e., when looked at separately and in isolation) meets at least the **requirements of a place of business** (*supra* m.no. 13 et seq.). Likewise, the control test needs to be fulfilled by each POB separately (*supra* m.no. 102 et seq.). By contrast, the requirements of fixation (*supra* m.no. 45 et seq.) as well as permanence (*supra* m.no. 65 et seq.) may be analysed on the level of the entirety of two or more single POBs, and need therefore not be tested separately for each single POB. Similarly, it is not indispensable that each POB in itself has an instrumental character under the functional integration test (*supra* m.no. 126 et seq. and m.no. 132 in particular). 138

On the side of the legal consequences of aggregation, where the prerequisites set out below have been met, the **different POBs** shall be summed up and **regarded as a unit** for tax treaty 139

72. Literally, the OECD MC Comm. (*supra* n. 403) declares that it is 'the presence of the painter' (as opposed to his activities) which constitutes a PE.
73. Lüdicke, J., 'Recent Commentary Changes Concerning the Definition of Permanent Establishment', 58 *BIFD* 190 (2004).

purposes, that is, as one place and thus one establishment which qualifies as a PE under the OECD MC.

140 Such aggregation, from the viewpoint of terminological consistency, represents an **unclenched interpretation of 'place'** (i.e., that two or more places are one 'place of business'). This, however, is neither logically illegitimate nor does it conflict with the ordinary meaning of the term 'place' (cf. Article 31(1) VCLT), given that a 'place' is not one single point on the surface of the earth but designates an area (*supra* m.no. 416), and that this area may well consist of two or more (sub) places.

a. Contraction of Two or More Synchronous POBs

141 Unless a DTC explicitly provides for the contrary, each place of business which meets the preconditions of Article 5 OECD and UN MC is to be regarded as **a PE on its own**. As a rule, the fact that a taxpayer maintains more than one qualifying POB at different locations within the source State will neither require nor permit a contraction or consolidation of the several POBs into one PE under tax treaty law (for the consequences under Article 7, see *infra* Article 7 at m.no. 141 et seq.).

142 It should be noted, however, that this might be different under the **domestic law of the source State**. Each State is autonomous to consider facilities which constitute two (or more) PEs under tax treaty law as just one PE under its domestic law. If the source State follows this approach of contraction or consolidation, the taxpayer will usually be relieved from a considerable part of his procedural duties, for example, be entitled to file just one aggregated tax return.[74]

143 Under tax treaty law, there is some leeway for an aggregation of two or more single points or small areas to one **paramount place**, too. This is easy to legitimate where the constituent POBs or areas are part of one and the same real estate, or they form a coherent whole already from a cadastral point of view. However, a substance-over-form approach should be taken, and the necessary (no. 5.1 et seq. OECD MC Comm. on Article 5) geographical coherence in substance does not depend on formal cadastral coincidence. Rather, two (or more) POBs may be regarded as one if they are located on two different, though adjacent premises. In contrast, a contraction of synchronously run POBs is not possible where two (or more) POBs are separated from one another through unaffiliated (someone else's) real estate.

144 In addition, the OECD MC Comm. has convincingly established a **requirement for commercial coherence** (no. 5.1 et seq. OECD MC Comm. on Article 5). Unlike geographical coherence, commercial coherence is multi-dimensional and therefore particularly problematic. It should be assessed on the basis of a broad range of indicators which, as a whole, allow a conclusion as to whether the activities exercised at the different single POBs should be considered as one.

145 These indicators include:

- identity of **customers**;[75]
- identity of **staff and equipment** on the side of the taxpayer; and
- identity or coincidence of negotiations resulting in **homogeneous or similar terms of trade** (see no. 5.3 OECD MC Comm. on Article 5).

Like in similar contexts, further criteria may be added (see, for example, *supra* m.no. 61 et seq.).

74. For the US example, cf. Fed. Cl., Docket No. 95-758-T of 16 Dec. 2005 – NatWest III.
75. This aspect has been particularly stressed by no. 5.3 OECD MC Comm. on Art. 5.

b. Contraction of Two or More Short-Term Activities at the Same POB

The second issue is the question of whether or not a minimum duration should be required with regard to the existence and/or activity of the POB, and if two or more activities which take place at the same location might be summed up when **each one of them alone does not meet the minimum duration requirements**. On all of these issues, see *supra* m.no. 90 et seq. for details. 146

c. Diagonal Contractions

Thirdly, **locations and times can be combined** so that two or more POBs at different locations and during different time periods can be counted as one. This diagonal contraction (i.e., the contraction of different locations and different dates/periods) has been acknowledged by the OECD MC Comm., which explicitly mentions that 'activities are moved' (no. 5.1 OECD MC Comm. on Article 5) and provides corresponding examples (nos 5.2 to 5.4 OECD MC Comm. on Article 5). Like the aforementioned types of contractions, diagonal contraction requires that the activities constitute a coherent whole commercially and geographically (no. 5.1 OECD MC Comm. on Article 5). 147

Common examples of a diagonal contraction are **relocated or roaming facilities** (see *supra* m.no. 59 et seq. for details). But even where the taxpayer does not use particular equipment, but only transfers his activities from one location to another, diagonal contraction might be required. 148

An example is a non-resident taxpayer who **owns a piece of land with two buildings** on it. If the taxpayer, after exercising his entrepreneurial activities in the smaller building for three months, transfers his business activities to the bigger building and tears down the first one, there is little dispute that both buildings together form one single PE, simply because they are located on the same premises. 149

On the one hand, diagonal contractions (like synchronous contractions; *supra* m.no. 141 et seq.) do not necessarily require that both POBs are located on the same piece of land as defined under cadastral law. On the other hand, they must not be separated from one another through unaffiliated real estate. The OECD MC Comm. has correctly held that **geographical coherence** is indispensable. Where it is lacking, one cannot speak of one 'place' (Article 5(1) OECD and UN MC) any longer without leaving the ambit of the ordinary meaning of this word (cf. Article 31(1) VCLT and discussion of the transfer of facilities *supra* m.no. 61 et seq.). 150

With regard to **commercial coherence**, the decisive criterion is that the function of both POBs is identical, and that the use of both POBs by the taxpayer is based on the same homogeneous and coherent business concept. Again, recourse may be had to corresponding criteria on the transfer of facilities (*supra* m.no. 59 et seq.). 151

Examples where the OECD MC Comm. has convincingly confirmed both geographical and commercial coherence include: 152

- **a large mine** (even if business activities move from one location to another) (no. 5.2 OECD MC Comm. on Article 5);
- **an office hotel** in which a consulting firm regularly rents different offices (no. 5.2 OECD MC Comm. on Article 5);
- **a consultant** moves from one office to another within the same branch of the customer enterprise and within the same location (no. 5.4 OECD MC Comm. on Article 5);
- **a pedestrian street, outdoor market or fair** in different parts of which a trader regularly sets up his stand (no. 5.2 OECD MC Comm. on Article 5).

d. Intertemporal Force of Attraction

153 It should be noted that there is a fourth set of questions. It concerns **the beginning and the end of the attribution of activities to a fixed POB**. This issue has dual relevance. On the one hand, it is crucial for the existence of a PE (for details on this aspect, see *supra* m.no. 78 et seq.; and m.no. 84 for insignificant interruptions of the activities). On the other hand, this issue gains relevance for the assignment of inflows and expenses to a PE in a situation where these inflows/expenses occur before the PE is constituted or after the PE has ceased to exist. This issue is regulated by the 2nd sentence of Article 7(1) OECD and UN MC (see *infra* Article 7 at m.no. 55 et seq.).

II. Divergent Country Practice

154 Unlike the subsequent paragraphs, Article 5(1) OECD and UN MC shows a **high degree of convergence** in the Models and almost all bilateral DTCs. In conformity with the pre-1977 OECD MC, many old DTCs have still employed the preposition 'in which' (the business of an enterprise is carried on) which makes a difference with regard to the control on the POB by the taxpayer (*supra* m.no. 102 et seq.) and, most notably, with regard to the functional integration of the POB into the enterprise of the taxpayer (*supra* m.no. 124 et seq.).

C. Article 5(2) OECD and UN MC

I. The Models

155 While Article 5(2) of the 1963 OECD MC contained one comprehensive catalogue, the 1977 version (and all the 1980 first-time UN Model and all OECD updates ever since) introduced a two-tier approach. First, the basic PE definition in Article 5(1) OECD and UN MC is supplemented by a **broad range of places of business** which, at least in typical cases, constitute a PE. This list is closely connected to Article 5(1), as the OECD and UN MC employ the words 'The term ... includes especially'. Article 5(2) OECD and UN MC has been disconnected from Article 5(3) OECD and UN MC that adds a rule on building sites and construction or installation projects. Compared to Article 5(2), the rule laid down in Article 5(3) OECD and UN MC ('... constitutes a [PE] only if it lasts more than twelve months') is much more restrictive in that it contains an indispensable, but not a sufficient condition (see *infra* m.no. 176 et seq. for details).

1. Rule

156 Under Article 5(2) of both the OECD and the UN MC which are almost literally identical, the term 'permanent establishment' includes especially places of management branches, offices factories, workshops as well as mines, oil or gas wells, quarries or any other places of extraction of natural resources.

2. Relation to Article 5(1) OECD and UN MC

157 A key issue in the context of Article 5(2) is its relation to Article 5(1) OECD and UN MC. From a theoretical viewpoint, there are three different ways that Article 5(1) and Article 5(2) OECD and UN MC can relate to each other: Article 5(2) OECD and UN MC could **extend** the scope of Article 5(1) OECD and UN MC (*infra* m.no. 158 et seq.), their scope could

exactly coincide, or Article 5(2) OECD and UN MC could **exemplify** some, but not all cases covered by Article 5(1) OECD and UN MC. The third alternative is most convincing (*infra* m.no. 160). The OECD MC Comm. States that the 'examples' in Article 5(2) OECD and UN MC 'are to be seen against the background of the general definition given in paragraph 1' and that 'it is assumed that the Contracting States interpret the terms listed ... in such a way that such places of business constitute PEs only if they meet the **requirements of paragraph 1'** (no. 12 OECD MC Comm. on Article 5). This is in line with overwhelming country practice.[76] Similarly, scholarly literature has stressed that a place of business of the kind envisaged by Article 5(2) OECD and UN MC could not constitute a PE unless it met the requirements of the general PE definition in Article 5(1) OECD and UN MC.[77]

158 It should be admitted, however, that there are a number of reasons to support an understanding of Article 5(2) OECD and UN MC as '**deeming provision**' (i.e., a substantive broadening of the general definition contained in Article 5(1) OECD and UN MC).[78] Even the OECD MC Comm. claims a somewhat reduced authority on this point. The OECD MC Comm. mitigates and diminishes a clear order ('are to be seen') by the subsequent use of weak and vague words ('against the background of', 'it is assumed'). Article 5(2) OECD and UN MC would indeed not make much sense if one had to start from zero with regard to Article 5(1) OECD and UN MC in cases where there is no doubt that a certain facility matches the requirements of one of the examples listed in Article 5(2) OECD and UN MC. Essentially, Article 5(2) OECD and UN MC functions as a reduction for the burden of analysis with regard to the requirements of Article 5(1) OECD and UN MC.

159 However, it is only in very clear-cut cases of Article 5(2) OECD and UN MC that a distinct test against the general requirements of Article 5(1) OECD or UN MC is redundant, and that the prima facie evidence, based on Article 5(2) OECD or UN MC, for the compliance of facilities listed there with the **general requirements** in Article 5(1) OECD or UN MC is **sufficient in itself** (no. 12 OECD MC Comm. on Art. 5(2); para. 2 UN Comm. on Article 5).

160 For all other cases, the position indicated in the OECD MC Comm. is convincing that Article 5(2) OECD and UN MC does **not extend the scope** of the PE concept beyond the definition in Article 5(1) OECD and UN MC. This might be taken as a first indicator for Article 5(2) OECD and UN MC as a mere exemplification, rather than derogation, of the definition in Article 5(1) OECD and UN MC. It is true that this understanding would have been much more striking if Article 5(2) OECD and UN MC had referred to 'The definition in paragraph 1' rather than 'The term "permanent establishment"'. However, historical interpretation supports this view. While Article 5(2) of the 1963 OECD Model had used the words 'shall include especially' (French: 'comprend notamment'), the 1977 version simply reads 'includes especially'. The French text remained unchanged. This modification in the English version aimed at abolishing any attempts to interpret Article 5(2) OECD MC as a substantial extension of Article 5(1) OECD MC, and stressed the character of the list as an example of typical cases.

161 Moreover, unlike Article 5(4) and (5), Article 5(2) OECD and UN MC does not use the words 'notwithstanding the preceding provisions of this Article' or 'notwithstanding the provisions of paragraphs 1 and 2', respectively. This difference between Article 5(2) on the one hand and Article 5(4) and (5) OECD and UN MC on the other is a further argument in favour of Article 5(2) OECD and UN MC being a **mere clarification**, but not an extension of Article 5(1) OECD and UN MC. It follows from all of these arguments that Article 5(2) OECD and UN MC does not do away with the general necessity to apply each element of the

76. Sasseville, J. & Skaar, A., General Report, *CDFI* vol. 94a (2009), at 31 et seq.
77. Vogel, 3rd edn, Art. 5 at m.no. 47.
78. For early discussion, see German Reichsfinanzhof *RStBl.* 840, 841(1935): Germany's DTC with Switzerland; Häck, in: Flick/Wassermeyer/Kempermann, Art. 5, Anm. 28; Debatin/Walter, re Art. II, para. 28; van Raad, K., 19 *Intertax* 501 (1991); for Germany's DTC with Austria, confer Lang, M., 2 *SWI* 363 (1992).

definition in Article 5(1) OECD and UN MC. This is particularly true for the requirement of a fixed place (see *infra* m.no. 165 et seq.).

162 The list of examples contained in Article 5(2) OECD and UN MC does **not cover all places or facilities** which fall under the general definition in Article 5(1) OECD and UN MC.[79] For example, both the wording and continuous and undisputed treaty practice support the view that hotels or restaurants of a hotel chain constitute PEs under Article 5(1) OECD and UN MC, even if they do not fall under any of the six cases covered by Article 5(2) OECD and UN MC.[80] The OECD MC Comm. has therefore correctly labeled Article 5(2) OECD MC as a non-exhaustive list of examples (no. 12 OECD MC Comm. on Article 5). It follows that Article 5(2) OECD and UN MC describes a sub-set of the general PE definition contained in Article 5(1) OECD and UN MC.

163 This link between Article 5(2) and Article 5(1) OECD and UN MC is not unidirectional, however. While Article 5(2) OECD and UN MC needs to be interpreted in the light of Article 5(1) OECD and UN MC, the examples presented in Article 5(2) OECD and UN MC, in turn, shed some light to the general definition in Article 5(1) OECD and UN MC and its application to situations other than the ones listed in Article 5(2) OECD and UN MC. More precisely, Article 5(2) OECD and UN MC functions as a **clarification of some of the general PE requirements** under Article 5(1) OECD and UN MC, as Article 5(2) OECD and UN MC gives substance to these requirements, and makes them more concrete.

164 An **example** is Article 5(2)(f) OECD and UN MC which makes perfectly clear that '**permanent**' should not be interpreted as '**everlasting**' but that this requirement can also be met, under relative standards, where the extraction facilities should be maintained, and have actually been maintained, only until all mineral resources at this site have been entirely exploited.

a. Article 5(2) OECD and UN MC and the Requirement of a Fixed Place

165 As indicated *supra* m.no. 157 et seq., facilities mentioned in Article 5(2) OECD and UN MC constitute a PE only if they fulfil the preconditions of Article 5(1) OECD and UN MC. They are therefore subject to the fixed place of business test, as outlined *supra* m.no. 13 et seq. Indeed, the common feature of all examples listed in Article 5(2) OECD and UN MC is their **close attachment to land**, that is, to the territory of the source State.

166 For this reason, there is usually little dispute that Article 5(2) OECD and UN MC facilities meet the requirement of a fixed place. In some cases, however, Article 5(1) OECD and UN MC does **function as a filter**. For example, the seat of a self-employed bus driver is not an office (Article 5(2)(b) OECD and UN MC), even if the driver organizes his business mainly or exclusively from this seat, and does not maintain an office somewhere else.

b. Article 5(2) OECD and UN MC and the Requirement of Permanence

167 Likewise, Article 5(2) OECD and UN MC does not make the requirement of permanence obsolete. Again, the standards of Article 5(1) OECD and UN MC (*supra* m.no. 65 et seq.) apply. They gain relevance where, for example, an office has been set up for a short period during, for example, a fair or an exhibition. Such office does not constitute a PE.

79. As correctly held by the French Conseil d'Etat on 29 Jun. 1981, n°16.095, RJF 10/81, 470.
80. It is true that each hotel will usually maintain an office. The hotel, however, is much more than this office. With regard to the distributive rules (most notably, Arts 7(2) and 22(2) OECD MC), it is necessary to characterize not just the office but the whole hotel as a PE.

3. Connections between the Examples in Article 5(2) OECD and UN MC

Between the six examples contained in Article 5(2)(a) through (f) OECD and UN MC, there is **no complementarity**. Overlaps as well as combinations are frequent. One POB may constitute a place of management (Article 5(2)(a) OECD and UN MC) and an office (Article 5(2)(b) OECD and UN MC) at the same time.[81] 168

II. Divergent Country Practice

1. Offshore Activities

A number of bilateral DTCs have **added further elements** to their positive lists. In many instances, however, these amendments have little impact on the effective allocation of taxing rights. Typical examples include facilities for the use and exploitation of natural resources in the context of agriculture, forestry, exploitation of oil or gas dwells, mining activities etc. Income from these activities would have been assigned to the State of situs anyway under Article 6 OECD and UN MC. 169

Almost all DTCs concluded by the Netherlands have included a provision according to which a PE is deemed to exist when offshore activities – that is, activities in connection with the **exploration or exploitation of the sea bed** and sub-soil areas and their natural resources situated in one of the Contracting States – are performed by an enterprise for more than thirty days within a taxable year, sometimes a calendar year.[82] Similar clauses have been used by Norway, the UK and the United States.[83] 170

While rules of this type clarify and sometimes modify requirements of stability, and they make efforts to alleviate problems arising in the context of **relocated or roaming POBs** (*supra* m.no. 59 et seq.), these amendments to Article 5(2) OECD and UN MC do not alter the general balance between the source State and State of residence in substance. 171

2. Pipelines

In some instances, pipelines are explicitly integrated into Art. 5 (2) OECD or UN MC. An example can be found in the 2011DTC between the Netherlands and Georgia. 172

D. Article 5(3) OECD and UN MC

I. The Models

1. Rule

Article 5 (3) OECD and UN MC is the rule on '**project PEs**' (i.e., **building sites, construction and installation projects**). They are considered to constitute a PE only if they last more than twelve months. While the 1963 OECD MC listed building sites, construction or assembly projects in Article 5(2)(g), the 1977 version separated this category of PEs into a new example under Article 5(3). At the same time, the misleading term 'assembly project' was replaced by 'installation project', while the French version uses the shorter phrase 173

81. Sasseville, J. & Skaar, A., General Report, *CDFI* vol. 94a (2009) at 34.
82. For details, see Pijl, H., 57 *BIFD 208* (2003).
83. See, e.g., Skaar, A., *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991) at 425 et seq.

'chantier de construction ou de montage' for its description of the substantive scope of Article 5(3) OECD MC.

174 The crucial element of Article 5(3) OECD MC, and the main reason for its existence, is the **twelve-month period**. In spite of distinct criticism from capital-importing countries, this period has remained unchanged in the OECD MC since 1963. However, many other Model Conventions have introduced shorter periods (most notably, Article 5(3) of the UN MC which contains a threshold of six months). This more source-related approach has been adopted by a broad number of DTCs between developed and developing countries.

175 In all MCs, the paragraph on building sites, construction, or assembly projects has given rise to a surprisingly **high number of disputes** over interpretation. This might be due to the fact that foreign enterprises are usually well aware of the existence, and the tax consequences, of rules like Article 5(1) and (2) OECD and UN MC, whereas source-State taxation of income from building sites, construction projects etc. has not always been foreseen by inexperienced enterprises.

2. Relation to Article 5(1) and (2) OECD and UN MC

176 While there was little dispute before 1977 that building sites, construction and installation projects constituted PEs only if they met the general requirements of Article 5(1) OECD and UN MC, the separation of Article 5(3) from the catalogue of Article 5(2) OECD and UN MC might have untied Article 5(3) OECD and UN MC from the general requirements. Article 5(2) OECD and UN MC is introduced by the words 'includes especially' while Article 5(3) OECD and UN MC has not adopted this language. Likewise, the OECD MC Comm. does not repeat the clear statement which it makes regarding Article 5(2) OECD MC (no. 12 OECD MC Comm. on Article 5(2)) in the context of Article 5(3) OECD MC. This is why there has indeed been some speculation on whether building sites, construction and installation projects form a **third category of PEs** (in addition to POBs as the first category, and dependent agents as the second one).[84]

177 It should be noted that the historical (genetic) argument which refers to the origins of Article 5(3) in the pre-1977 Article 5(2)(g) OECD MC is at least ambiguous.[85] It is true that the separation was primarily motivated by the **desire to exclude**, more clearly than before, any building sites, construction and installation projects if they last twelve months or less. This has clearly been expressed by the use of the word 'only' in Article 5(3) OECD MC.

178 However, this merely negative impact might not be the only element of the 1977 amendment. There are rather good arguments to assume that the 1977 amendment also aims at **widening the spectrum** of **building, construction and installation PEs** in a fourfold manner.

179 First, the OECD MC Comm. States that (unlike for fixed POBs under Article 5(1) and (2) OECD MC), a building site as well as a construction or installation project can be a **moving object** (see *infra* m.no. 198 et seq. for details). The term 'project' eases the stricter preconditions with regard to local stability which would have applied under the general rule of Article 5(1) OECD and UN MC ('fixed place'; see *supra* m.no. 45 et seq.). This OECD MC Comm. view has been legitimized by its adoption in widespread State practice.

180 Secondly, the qualifying activities of the taxpayer enterprise deviate significantly from the activity-related requirements in Article 5(1) OECD and UN MC. While Article 5(1) OECD and UN MC is applicable if, and only if, the taxpayer uses the POB (functional integration test; *supra* m.no. 112 et seq.), Article 5(3) OECD and UN MC does **not require any usage** of the sites or projects by the taxpayer. It is rather the taxpayer's work as a constructor or

84. Cf. Skaar, A., *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991) at 344 et seq.; Baker, P., Art. 5 at m.no. 5B.15.

85. Less critical on this point is Baker, P., Art. 5 at m.no. 5B.15 who assumes continuity, after 1977, in the applicability of the general requirements of Art. 5(1) OECD MC.

creator of certain objects which is required for the characterization of this object as a PE under Article 5(3) OECD and UN MC.

It follows that, as a third extension of Article 5(1) OECD and UN MC, the site or 181
construction PE under Article 5(3) OECD and UN MC does **not require the same type of control** by the taxpayer. While a POB qualifies as a PE under Article 5(1) and (2) OECD and UN MC only if the taxpayer has, and habitually exercises, owner-like powers with regard to the facilities, there is no reason to assume that a site or project PE under Article 5(3) OECD and UN MC is a PE only if the taxpayer is entitled to exclude others from entering or even using the facilities during the time of construction. On the contrary, it is typical in huge building projects and in infrastructure construction (roads, railways, power plants, etc.) that enterprises of different branches and sectors work simultaneously at the same site and on the same project.

Fourthly, fixed places on which building, construction, and installation activities are 182
carried out are **not instruments 'through' which a business occurs**; rather they are objects of these activities. This aspect supports the view that the 1977 separation of Article 5(3) OECD MC has excluded that certain or all building sites or construction and installation projects be sorted out, just because they did not match the instrumental aspect of the functional integration test (*supra* m.no. 124 et seq.) under Article 5(1) OECD MC.

It is particularly the fourth aspect which makes it clear that (at least today) Article 5(3) 183
OECD and UN MC is a **substantial extension** rather than a clarification or exemplification of Article 5(1) OECD and UN MC.[86] Even where a building site or a construction or installation project does (exceptionally) meet the requirements of the functional integration test as required under Article 5(1) OECD and UN MC, the twelve-month or, respectively, six-month requirement continues to apply.

For similar reasons, Article 5(3) OECD and UN MC will usually **not be regarded as a lex** 184
specialis vis-à-vis Article 5(2) OECD and UN MC either. However, there are some (though rare) phenomena where the catalogue of Article 5(2) OECD and UN MC provides more detailed and more specific descriptions and thus takes precedence over Article 5(3) OECD and UN MC. The most relevant example is the exploitation of natural resources. The practical consequence is that here, the twelve-month requirement does not apply.

3. Relation to the Other Paragraphs of Article 5 OECD and UN MC

If a fixed POB qualifies under Article 5(1), (2) and (4) OECD and UN MC but the 185
acknowledgement as a PE is prohibited by the twelve/six-month rule of Article 5(3) OECD and UN MC, conflicts with Article 5(5) OECD and UN MC may occur. This is of particular relevance for **turn-key building enterprises** which function as main contractors of the owner and conclude agreements with subcontractors. Where the main contractor (the taxpayer) acts through a dependent agent who is swift enough to make sure that the building is completed after ten months, the wording of Article 5(5) OECD and UN MC seems to be fulfilled, especially as neither Article 5(5) nor Article 5(6) OECD and UN MC contain any reference to the requirement of a minimum period as laid down in Article 5(3) OECD and UN MC – which could have been expected, given that Article 5(5) does explicitly refer to Article 5(4) OECD and UN MC.

Indeed, this result is hardly legitimate – the weaker presence in the source State (only 186
through a short-term agent) would allow source-based taxation while an identical presence of the taxpayer (in person) would trigger the ban under Article 5(3) OECD and UN MC. It is therefore more convincing to assume the prolongation of both negative rules (Article 5(3) and (4) OECD and UN MC) onto the **notion of agent PEs** under Article 5(5) OECD and UN MC.

86. Vogel, 3rd edn, Art. 5 at m.no. 72.

187 If an analysis of Article 5(3) or (4) OECD and UN MC reveals that no PE exists, a dependent agency relationship within the ambit of Article 5(5) OECD and UN MC should be ruled out too. Therefore, a **PE cannot be constituted** in these cases at all. It is only where Article 5(1) and (2) OECD and UN MC reveals the non-existence of a PE due to the absence of a fixed POB that the case should be tested against Articles 5(5) and (6) OECD and UN MC.[87]

4. Relation to Service PE Clauses

188 As a rule, activities on a construction site or in course of an installation project consist of a combination of services, delivery of goods and share of know-how. Still, while the main focus is on services, Article 5(3) OECD and UN MC shows a close connection to, and constitutes a **lex specialis** vis-à-vis**, general service PE** clauses like the ones drafted in no. 42.23 MC Comm. on Article5 or in Article 5(3)(b) UN MC.[88]

5. Mixed Activities or Facilities

189 Given that Article 5(3) OECD and UN MC, as compared to Article 5(1) and (2) OECD and UN MC, functions both as **a restriction and an extension** (*supra* m.no. 176 et seq.), any heterogeneous activity of the taxpayer on the site or project gives rise to a bifurcation. The taxpayer is only subject to the requirements of Article 5(3) OECD and UN MC including, most notably, the twelve-month period, with regard to building activities, construction, installation, assembly etc.

190 The instrumental use of the site or project as operating assets in the course of any other business activities will constitute a PE only if the prerequisites of Article 5(1) and (2) OECD and UN MC are met, and the POB does not disqualify under Article 5(4) OECD and UN MC.

191 Where the taxpayer meets the prerequisites of both Article 5(3) and Article 5(1) and (2) OECD and UN MC with regard to one and the same site or project, **two PEs exist**. All other DTC rules (most notably, Article 7(2) OECD and UN MC) shall then apply separately to both PEs.

6. Persons Covered

192 Article 5(3) OECD and UN MC applies to **taxpayers who perform**, fully or in part, one of the building, construction or installation **activities** covered by the provision (see *infra* m.no. 201 et seq. for details). This includes building companies, self-employed entrepreneurs and all similar enterprises irrespective of their legal form (Article 7(1), read in connection with Articles 1, 3(1)(a) to (c), and 4(1) OECD and UN MC).

193 The OECD MC Comm. requires the application of the twelve-month test at the level of a **fiscally transparent partnership** wherever the activities concern the activities of that partnership. As a rule, it is sufficient if either the partners or the employees of the partnership are on the site. If these stays, in the aggregate, exceed the twelve-month period, the enterprise carried on by the partnership will therefore be considered to have a PE. For the consequences of transparency concepts, see *infra* m.no. 325.

194 It is immaterial if the taxpayer enterprise is a direct contractor of the owner of the premises or a mere sub-contractor who does not have any direct contractual relationship with the

87. Id. Art. 5 at m.no. 7; with further references.
88. See *infra* m.no. 405 et seq. for details. A different view has been held by Bayer, A., in *ÖStZ 507 et seq.* (2013).

owner. The main contractor of a turn-key project may qualify under Article 5(3), even if he has **sourced out all work** to one or more sub-contractors (see *infra* m.no. 205).

By contrast, Article 5(3) OECD and UN MC does not apply to the owner or occupier of 195
the object if he is **not more than the client of the construction company**, that is, if he is not the builder but the person or entity for whom the object is being built.[89] Likewise, taxpayers who are only users, brokers, or sellers of the respective object do not qualify under Article 5(3) OECD and UN MC (*infra* m.no. 201 et seq.). Consequently, they are not bound by the twelve-month period and might therefore constitute a PE under Article 5(1) or (2) OECD and UN MC even if they use the place for their business for a period not exceeding twelve months (see *supra* m.no. 68 et seq. for details).

7. Objects Covered

As the French wording ('chantier de construction ou de montage') suggests, the internal 196
relationship between the three English terms contained in Article 5(3) OECD and UN MC (building site, construction project, installation project) has an **exemplificatory character** in that the **connection between the two elements** of each term (building, construction, installation on the one hand; and site and project on the other hand) is **interchangeable** – Article 5(3) OECD and UN MC equally covers building projects as well as construction sites and installation sites. It is therefore plausible that the OECD MC Comm. addresses the expressions 'building site or construction or installation project' as one term (cf. no. 17 OECD MC Comm. on Article 5).

While the terms 'building', 'construction' and 'installation' designate the object of the 197
work, the terms 'site' and 'project' reflect the requirements of Article 5(1) OECD and UN MC. 'Site' connects Article 5(3) OECD and UN MCto the requirement of strict local stability ('fixed place'). As an alternative, the term 'project' allows a replacement of such local stability (fixation) by the size and coherence of the works.

To define the term '**project**', **territorial aspects** do matter. A lack of territorial identity 198
may be compensated, however, by a particularly high degree of temporal and/or material identity of works which take place at different sites, even if they are geographically unconnected (for details, see *supra* m.no. 189 et seq.).

Typical objects covered by Article 5(3) OECD MC have been listed by the OECD MC 199
Comm. With regard to **primary stand-alone objects**, the rule applies to buildings, roads, bridges or canals and pipe-lines (no. 17 OECD MC Comm. on Article 5). Likewise, Article 5(3) OECD and UN MC covers railways, dams and water reservoirs, artificial lakes, power plants (including windmills, solar panel fields etc.), walls, fences and any other structures fixed on the ground.

Moreover, Article 5(3) OECD and UN MC applies to **secondary equipment** which does 200
not constitute a building in itself but major interieur thereof or outdoor equipment with technical functions – like complex machines, indoors or outdoors (no. 17 OECD MC Comm. on Article 5).

8. Activities Covered

The term '**construction**' in Article 5(3) OECD and UN MC includes the erection as well as 201
other work on the aforementioned objects (*supra* m.no. 180). It is immaterial whether the objects have been produced at the building/construction site or whether the site is only the place where pre-fabricated products are being put together or regrouped.[90]

89. See Baker, P., Art. 5 at m.no. 5B.16.
90. Holmes, K., *International Tax Policy and Double Tax Treaties* (2007) at 153.

202 With regard to sub-soil objects, 'construction' comprises **excavating** and **dredging activities**. In this respect, however, Article 5(3) OECD and UN MC applies only where it is ordinary soil (earth, sand, stone, turf) which is either removed or accumulated in order to reshape the surface of a place or a landscape, or in order to prepare the subsequent construction of a road, a building etc. Where natural resources of some value are exploited (usually for the purpose of distant use), the twelve/six-month period is inapplicable. This follows from Article 5(1), read in connection with Article 5(2)(d) OECD and UN MC which should be regarded as leges speciales to Article 5(3) OECD and UN MC in this particular respect.

203 A dispute has arisen on whether a PE can be constituted by the **on-site planning** and **on-site supervision** of the erection of a building. While there is no doubt that situations in which the enterprise carries on both supervisory and proper building activities qualify, the mere supervision or planning has been regarded as insufficient under Article 5(3) OECD and UN MC by some authors (which makes the twelve-month period inapplicable so that Article 5(1) and (2) OECD and UN MC apply).[91] Where the taxpayer is involved in planning and/or supervision, and the contractor functions as the main contractor but has transferred the entire 'real' work to subcontractors, prominent scholars have held that the taxpayer did not meet the requirements of Article 5(3) OECD and UN MC.[92] By contrast, the OECD MC Comm. subsumes all (i.e., also isolated) supervisory and planning activities under Article 5(3) OECD MC wherever they refer to one of the objects covered by this rule (*supra* m.no. 196 et seq. and see no. 17 OECD MC Comm. on Article 5).[93]

204 While all of these above-mentioned activities are part of the primary (first) mounting of the respective object, other activities commence only **after the object has been completed**. Considering these secondary activities, the OECD MC Comm. suggests that works on the substance may encompass the renovation of the aforementioned facilities (no. 17 OECD MC Comm. on Article 5). This is true if, and to the extent that, these secondary activities require skills, use methods, or have reached a volume which are similar to the first-time establishment of the object. The same applies for repairs. In contrast, if the activities do not go beyond the mere maintenance and/or redecoration of the object, Article 5(3) OECD and UN MC does not apply (no. 17 OECD MC Comm. on Article 5).

205 As indicated earlier (*supra* m.no. 194), it is immaterial whether the taxpayer performs the **work personally** (either as the main contractor or a sub-contractor), or if he simply functions as the **main contractor** of a turn-key project, but sources out all factual work to one or more sub-contractors. As long as the taxpayer supervises and retains control of, the sub-contractors during their work (or their supervision and control of sub-sub contractors, etc.), he qualifies under Article 5(3) OECD and UN MC.[94]

206 In any case, the range of qualifying activities does not include the **mere ordering** or the **mere off-site planning** of the respective object (*supra* m.no. 203).

207 Eventually, the activities covered by Article 5(3) OECD and UN MC require a delimitation to persons who **simply use** the object (as covered by provisions like Article 6(3) OECD and

91. For example, Holmes, K., *International Tax Policy and Double Tax Treaties* (2007) at 154.
92. Most notably, Baker, P., Art. 5 at m.no. 5B.16, referring to a judgment of the French *Court Administratif d'Appel de Nancy* of 9 May 1996, Case no. 94-914, RJF 6/97, no. 604.
93. For an analysis of the pending OECD update, see Ditz, X. & Quilitzsch, C. 84 *FR 496* (2012).
94. See the judgment of the Dutch *Hoge Raad* of 9 Dec. 1998, Case no. 32, 709, 1 ITLR (1998) at 839; van Raad, K., 53 *BIFD* 321 et seq (1999).; and Baker, Art. 5 at m.no. 5B.15 with n. 4. Much more broadly (i.e., on the level of Art. 5(1) OECD MC), this view will be adopted officially by no. 10.1 of the 2014 Update to the OECD MC Commentary. See OECD, *Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention. Revised Public Discussion Draft* (19 October 2012).

UN MC[95]) as well as to persons who exploit the object or who alienate it (as covered by Article 13 OECD and UN MC[96]).

9. Aggregation

Like all other types of PEs including, most notably, ordinary POB PEs (*supra* m.no. 124 et seq.), each construction site and each qualifying project needs to be **looked at separately** for the purpose of Article 5(3) OECD and UN MC. In determining how long the site or project has existed, no account should be taken of the time previously spent by the taxpayer enterprise on other sites or projects. 208

While this need to distinguish between two (or more) separate sites or projects is undisputed at the outset (cf. no. 18 OECD MC Comm. on Article 5), the intricate question arises under which circumstances **a series of lots, facilities or activities** should be **characterized as one site or project**, and when they should be assigned to two or **more sites or projects** under Article 5(3) OECD and UN MC. The OECD MC Comm. is not fully consistent in this respect. While it has mostly made clear that each site or project is subject to its own twelve-month period,[97] one sentence in the OECD MC Comm. seems to allow a connection of heterogeneous places provided that there is at least some connecting factor, while a separation (with a double and unconnected test of Article 5(3) OECD MC) should be made only (?) if 'other sites or projects … are totally unconnected' with each other (2nd sentence of no. 18 OECD MC Comm. on Article 5). This language, however, is misleading in that it seems to allow a comprehensive twelve/six-month test for two or more sites/projects. A more precise (literal) interpretation of Article 5(3) OECD and UN MC should, in our view, stick to the basic phrase of the OECD MC Comm.[98] which requires a strictly separated twelve/six-month test for each single site/project. 209

According to a convincing proposal made in the OECD MC Comm., however, the characterization of two (or more) places as one single site or project is admissible and required with regard to all places which '**form a coherent whole commercially and geographically**' (no. 18 OECD MC Comm. on Article 5).Like the interpretation of most other DTC provisions (Cf. *infra* m.no. 217, 331 and 392), the interpretation of Article 5(3) OECD and UN MC follows a substance-over-form approach in this respect. In particular, any merely formal split of contracts will not, in itself, require or justify that a heterogeneous but connected bundle of lots, facilities or activities be separated into several sites or projects for the purposes of Article 5(3) OECD and UN MC. 210

The **range of decisive economic criteria** to determine the coherence of two or more lots, facilities or activities is broad. The acknowledgment of only one (rather than two or more) site or project can only be determined by way of a comprehensive judgment which considers each of the following criteria without attributing absolute relevance to any single criterion. The criteria include, but may not be limited to, the persons or entrepreneurial units involved (*infra* m.no. 212 et seq.), the geographical places where the qualifying activities are performed (*infra* m.no. 224), the homogeneity or heterogeneity of the objects created (*infra* m.no. 225 et seq.), and the type(s) of activities performed (*infra* m.no. 227). 211

Personal diversification may have an impact on the determination of the twelve-month period. The typical building site or a construction or installation project involves a relationship between **two** (or more) **steady partners** over the entire period. However, changes of persons may, under certain circumstances, leave the computation of the 212

95. For details, see Reimer, E., in: V&L, 5th edn (2008), Art. 6 at m.no. 131 et seq.
96. For details, see Reimer, E., in: V&L, 5th edn (2008), Art. 13 at m.no. 2 et seq.
97. 1st sentence of no. 18 OECD MC Comm. on Art. 5; similarly, the 3rd and the following sentences which use the singular, too.
98. *Id.*

twelve-month period unaffected. This is true for changes in both the clients (*infra* m.no. 213) and the supplying enterprises (*infra* m.no. 214 et seq.).

213 With regard to activities of one supplier (taxpayer enterprise) on behalf of **two or more clients**, the OECD MC Comm. has convincingly held that an aggregation of the activities is required where the site or project forms a **single unit** (no. 18 OECD MC Comm. on Article 5). Specific criteria is applied to determine if the site or project forms a single unit (*infra* m.no. 224 et seq.).

214 On the side of the **supplier** (the taxpayer), the aggregation of lots and facilities run by different persons, and the aggregation of activities performed by different persons poses fundamental questions which go far beyond Article 5(3) OECD and UN MC. Aggregation may impact the permanence test under Article 5(1) and (2) OECD and UN MC as well as in all other treaty Articles with complexly structured legal prerequisites:[99] Is it admissible to interpret DTC provisions in a way that certain legal prerequisites (or elements thereof) are **fulfilled jointly by two or more persons** (Article 1, 3(1)(a) OECD and UN MC) in that each person contributes different elements in a complementary manner?

215 Some DTCs have explicitly answered this question in the affirmative. A prominent example is Article 5(4) of the **1997 Nordic Convention** concluded between Denmark, the Faroe Islands, Finland, Iceland, Norway and Sweden. This DTC provides that for the calculation of the period referred to in Article 5(3), an activity carried on by an enterprise which is associated with another enterprise shall be deemed to be carried on by the enterprise with which it is associated if the activity is **substantially similar in character to the activity** carried on by the enterprise, and the activities of both enterprises are concerned with the same project.

216 By contrast, the **OECD and UN MC lack such explicit provisions**. Therefore, a more cautious approach to interpretation is required. It should be noted that a far-reaching aggregation of short-time periods which two or more different taxpayers have spent on the same construction site would, to some extent, resemble an **implied transparent partnership**. However, this approach is certainly limited to the interpretation of clauses like Article 5(3) OECD and UN MC, and thus does not conflict with issues of the DTC treatment of partnerships in general. Most notably, this approach does neither require nor imply that the 'team' as such qualifies as a person under Article 3(1)(a) OECD and UN MC or even as a resident under Article 4(1) OECD and UN MC.

217 Rather, the acknowledgment of a joint and complementary fulfilment of distributive rules is not more than a **mutual imputation of activities** between two or more persons. It does justice to the fact that a division of labour cannot modify or distort the characterization of income, as compared to a situation where the same taxpayer would meet all legal requirements in person. Like under the beneficial ownership concept laid down in Articles 10-12 OECD and UN MC (see *infra* m.no. 272), the assignment of activities to a person for the purposes of DTC law follows a substance-over-form approach.[100]

218 Above all, the interpretation based on the ordinary meaning of the terms used by Article 5(3) OECD and UN MC suggests that the **twelve/six-month period should** be computed with reference to the **duration of the building site** (or the construction or installation project), not the single person's activity. In requiring that 'it' needs to last more than twelve/six months, Article 5(3) OECD and UN MC refers to the object/place rather than a person and their activities.

99. A prominent example is the question of whether activities of two persons may be aggregated in a situation where each single person, if looked at in isolation, does not exceed the threshold of an 'enterprise' under the first sentence of Art. 7(1), read in connection with Art. 3(1)(c) & (h) OECD MC, e.g., due to a lack of frequency in the number of transactions, whereas the threshold would be exceeded if their activities were to be regarded as a coherent whole by reason of the coordination between both taxpayers.

100. For the concept of beneficial ownership, see the references *infra* fn. 180.

It is only through the implied connection between Article 5(3) and Article 5(1) OECD and UN MC that the acting persons and their activities on the building/construction site come into consideration. This indirect reference to the person-and-activity-related approach taken under Article 5(1) OECD and UN MC may well **restrict a purely object-related approach**. It does not, however, allow a formal approach in the sense that each person or enterprise should be looked at separately and for the purposes of Article 5(3) OECD and UN MC. 219

In our view, a **more economic approach** suggests a compromise between the two extremes. Two or more legally different persons or entities may be viewed as a single unit for the purposes of the twelve-month period if, from an economic viewpoint, these persons/entities act under common control, or they act jointly and in coordination. This implies that it is immaterial whether the employees of the taxpayer who work on-site remain identical during the entire works, or if they are replaced by other employees within the twelve-month period. 220

Acting under **common control** occurs where one or more persons (or enterprises) **participate directly or indirectly in the management**, control or capital of one or more other persons or enterprises (cf. Article 9(1)(a) OECD and UN MC). Common control also exists where one or more persons or enterprises participate directly or indirectly in the management, control or capital of two or more other persons or enterprises. 221

For two or more persons to act jointly and in coordination, they do not necessarily need a high degree of communication. It is sufficient that they make use, in full or in part, of the **same resources, equipment or customers**. Common examples are syndicates or informal networks of subcontractors. They do not qualify, however, if the type of work exercised by the different taxpayers is unequal and the coordination between the different and independent building enterprises does not exceed the ordinary and reasonable level of communication which is required in the course of an efficient turn-key project. By contrast, where two unrelated enterprises have only communicated with one another in order to coordinate their respective work for the sake of a professional and efficient fulfilment of their respective contractual duties, their activities must not be regarded as one site or project. 222

In all, the rules for aggregation of activities performed by two or more persons for the purposes of Article 5(3) OECD and UN MC appear to be even **broader than the above-mentioned rule** contained explicitly in Article 5(4) of the Nordic Convention (*supra* m.no. 215). From a treaty policy perspective, however, clarifying rules of this (or a similar) wording is highly advisable. 223

Geographical diversification does not necessarily create two (or more) sites or projects. As long as two or more building lots in one country form a coherent whole, that is, are operated at one place or for one and the same ordering party, for related parties, or for parties who act jointly and in coordination, these places should be aggregated and treated as one single unit for the determination of the minimum period.[101] The OECD MC Comm. acknowledges one building site for a row of houses, even if the orders have been placed by several persons (no. 18 OECD MC Comm. on Article 5).[102] Similarly, a mutual agreement between Belgium, Germany and the Netherlands endorses that principle with regard to works accomplished at entirely different places, provided that they belong to a comprehensive overall project.[103] 224

Similarly, an **objective** (qualitative) **diversification** alone is not sufficient to avoid aggregation. Where the same taxpayer enterprise has contracted for, and performs different types of work on one construction site (e.g., masonry, plastering and painting), all these types of work will usually be added together for the purposes of the twelve-month period. 225

In certain circumstances, work is not aggregated. For example, the **Spanish Audiencia Nacioñal** rejected aggregation in a case where two contracts had been concluded for more 226

101. A slightly more restrictive view has been held by Vogel, 3rd edn, Art. 5 at m.no. 79 who indicates that both requirements (identity of places and parties) shall be met cumulatively.

102. See also id. at m.no. 67.

103. Id. at m.no. 79.

than two construction or assembly projects at the same place, though with a time gap of about two and one half weeks between the end of the first project and the start of the second one. Likewise, work for different ordering parties will usually mark the beginning of new minimum periods, even if it is performed at the same place (see *infra* m.no. 239).

227 Likewise, if activities performed are heterogeneous, it is less likely that **different lots or facilities** will be regarded as one site or project. It should be noted, however, that this criterion **cannot** be set on **equal footing with the three identity-determining criteria** mentioned above (*supra* m.no. 211). Rather, the mere diversification of activities performed remains fully immaterial if the same taxpayer enterprise performs these activities on behalf of the same client at the same place or object. It is only in case of a diversity with regard to any of the aforementioned criteria that a diversity of activities may function as a tie-breaker. For example, where two or more clients demand different activities from the taxpayer, these activities are usually not regarded as belonging to one site or project.

228 As a rule, activities are different if they stem from, or are usually assigned to different crafts, or if they require fully heterogeneous techniques and instruction. There is no abstract and general standard since the **taxpayer enterprise itself sets the standards**. If the taxpayer has shown that he typically functions as a general contractor who realizes turn-key projects, a diversity of activities performed on the lot does not allow a splitting-up of the different activities, and an application of the twelve-month period to each single activity separately.

229 In contrast, if a taxpayer who is usually only **engaged in masonry** (and works as a mason for the left half of a semi-detached house on behalf of client 1) is requested by client 2 to paint the walls of the right half of the same building, the painting activity might be regarded as an unconnected and incidental activity which is not part of the taxpayer's main (masonry) business. In this case, no aggregation is required for the purposes of Article 5(3) OECD and UN MC, and the work in each half should be looked at separately.

10. Minimum Period

230 **Beginning and end.** The minimum period requirement is an application and (where it exceeds the six-month 'rule of thumb' applicable in the context of Article 5(1) OECD and UN MC; see *supra* m.no. 68) an extension of the requirement of permanence. The site or project under Article 5(3) is deemed to exist from the beginning of the twelve/six-month period, not only from the first day after this period has expired (cf. *supra* m.no. 72 et seq.).

231 By contrast, **subjective elements** including the taxpayer's original intention to maintain a site or project for a period longer than the twelve/six-month period are irrelevant. Unlike Article 5(1) OECD and UN MC, where prospective permanence is sufficient (*supra* m.no. 69), the indicative mode of Article 5(3) OECD and UN MC ('if it lasts') makes clear that the actual duration of the site or project is crucial here. It is therefore an ex post rather than an ex ante perspective which is decisive for the twelve-month test (like under the permanence test under Article 5(1) OECD and UN MC; see *supra* m.no. 73). It is irrelevant whether the prolongation was unexpected and was caused by geological or other difficulties.[104]

232 The minimum period begins on the calendar day when the enterprise **starts to perform business activities** on the spot in connection with a building site or construction or assembly project. This first day is included in the computation of the twelve-month period (see *infra* m.no. 241 for details). There are good arguments in favour of the assumption that the start of on-site preparatory or ancillary work is sufficient to trigger the twelve-month period, even if these preparatory or ancillary works would have been disqualified under Article 5(4) OECD and UN MC had they remained isolated (no. 19 OECD MC Comm. on Article 5).[105] The only precondition is that the preparatory or ancillary work should directly serve the operation of the building site or project, and it should have economic substance – the mere signing of a

104. Vogel, 3rd edn, Art. 5 at m.no. 76.
105. Concurring, id. at at m.no. 77.

contract or the registration with public authorities (including tax authorities) is not sufficient.[106]

In contrast, **planning or ancillary activities** which relate mainly or exclusively to other 233
activities shall not be taken into account. The same holds true for planning or ancillary activities which are performed in the State of residence or a third State, even if they relate to the site or project at issue.

The inclusion of preparatory work in the minimum period avoids practical difficulties 234
which would otherwise occur if one had to **draw the line** between such **ancillary activities** and '**building works proper**'. The inclusion of preparatory and ancillary activities is also justified because it takes the technical and economic nature of building works into account.

The period does not end on the date when the last building, construction or installation 235
activities have been completed. Rather, **wrapping-up activities** during the post-processing phase are included in the computation of the twelve-month period if they follow the main activities without interruption. These activities might include:

- **a trial run for testing** the assembled or installed device;[107]
- **potential rectifications** if a defect has appeared, or has been claimed, before or immediately after the first usage; and
- **the removal of all equipment and facilities** by the taxpayer which are no longer needed on the (former) construction site.

By contrast, the realization of later **warranty claims**, **maintenance works**, or **after-sales** 236
service operations do not qualify for the computation of the twelve-month period. Likewise, off-site activities (especially activities which the taxpayer enterprise performs in the State of residence or in a third State) are not considered. The same is true for activities which do not primarily concern the site or project at issue; and for legal or contractual activities (including tax compliance) without economic substance. In all, the post-construction period follows the same line of interpretation with regard to the computation of the twelve-month period as the pre-construction period (*supra* m.no. 233 et seq.).

Interruptions. Time gaps between preparatory or ancillary works and the main activities 237
(cf. *supra* m.no. 233 et seq.), interruptions during the main operational works or time gaps between the completion of the main works and the beginning of post-processing wrap-up activities (cf. *supra* m.no. 236 et seq.) do **not toll the calculation** of the twelve-month period.

Minor inactivity of workers who are engaged in the site or project will leave the 238
computation of the minimum period unaffected. This case should be decided along the standards which have been developed under Article 5(1) OECD and UN MC (see *supra* m.no. 84 et seq.), as well as under the 183-day rule in Article 15(2)(a) OECD and UN MC (see no. 5 OECD MC Comm. on Article 15).[108]

By contrast, **a major** (even temporary) **abandonment**, as well as a **disassembly** of the 239
facilities, barracks, machines or tools which the taxpayer uses at the building site or the construction or installation project will set the stopwatch back to zero. An example is the shutdown of a construction site after the client has filed for bankruptcy if it is uncertain whether the works will be resumed at all, and/or if new investors need to be found, new procurement procedures might take place, and there is a considerable danger that a new contractor might replace the taxpayer enterprise on this construction site.

Months as computational units. It follows from Article 5(3) OECD and UN MC which 240
mentions months rather than a year or 365 days that the calculation of the twelve/six-month period is not tied to the calendar year. Where a site or project lasts from 1 July until 2 August,

106. Id.
107. Id. at m.no. 78.
108. Cf. Prokisch, R., in: V&L, 5th edn (2008), at m.no. 83 et seq.

the requirements of Article 5(3) OECD and UN MC are met. The same holds true if the works exceed the end of an assessment period (a 'tax year').[109]

241 On the other hand, Article 5(3) OECD and UN MC does not refer to single days. Taking the use of a month as the decisive unit (which, in our view, follows convincingly from a comparison to the 183-day rule contained in Article 15(2)(a) OECD and UN MC) would require further clarification with regard to how **calendar months** should be **counted**:

- only if the taxpayer has **maintained the site or project during each day** of this month;
- if it is sufficient that the site or project **was maintained during at least one day** within this calendar month; or
- if any intermediate solution (e.g., **the majority of days** within the calendar month) deserves approval.

242 However, it is again Article 15(2)(a) OECD and UN MC which can eventually be used as an argument in favour of **a day-related computation** rather than the calculation in full calendar months. On this aspect, not all has been said and done yet.

243 As indicated above (*supra* m.no. 233), the day in course of which the prerequisites of Article 5(3) OECD and UN MC have been met for the first time shall be included in the computation of the twelve/six-month period (similarly, no. 67 OECD MC Comm. on Art. 5).

II. Divergent Country Practice

244 Many bilateral DTCs have deviated from Article 5(3) OECD and UN MC. Most of these deviations concern the **minimum period**, which has often been fixed at a much **lower level** than OECD's twelve-month threshold. The lowering of this period is a key concern of many developing countries as well as other countries who import more building or construction services than they export. Among developed countries, however, the minimum periods have sometimes been extended to up to twenty-four months.[110] As indicated earlier, such deviations may create significant difficulties and inconsistencies in triangular cases, ranging from double non-taxation to the non-consideration of losses.

245 Other deviations concern **supervisory activities**, which have been **explicitly included** in the substantive scope of the clauses governing construction sites in a significant number of bilateral DTCs.[111] Following the proposal submitted in Article 5(3)(a) UN MC, such clarifications (cf., however, *infra* m.no. 423 et seq.) can be found in Article 5(3) of the Nordic Convention (*supra* m.no. 215), but also in the treaty network of Australia, China, Egypt, India, Korea, Norway, Turkey, as well as many Eastern European countries and many developing countries.

246 Moreover, the clauses corresponding to Article 5(3) OECD MC have sometimes been supplemented by a catch-all clause for service PEs along the lines of Article 5(3)(b) UN MC (see *infra* m.nos 399 et seq., 420 et seq.).

109. Vogel, 3rd edn, Art. 5 at m.no. 76.
110. See, e.g., Art. 5(2) of the 1973 DTC between Denmark and Switzerland; or Art. 5(3) of the 1996 DTC between Romania and Serbia and Montenegro.
111. Cf. the concluding remark in no. 17 OECD MC Comm. on Art. 5.

E. Article 5(4) OECD and UN MC

I. The Models

1. Rule

247 Article 5(4) OECD and UN MC excludes (partly in a purely declaratory manner; see *infra* m.no. 253) a number of POBs from the status as a PE if the facility is **merely of a preparatory or auxiliary character** (this subordinate character being the common denominator for all POBs listed therein; see *infra* m.no. 284 et seq.). Above all, the rules contained in Article 5(4) OECD and UN MC reflect a high degree of practical wisdom rather than notional boundaries or concepts of international equity.

248 Tax treaty law is designed for application in a variety of cases. Under the teleological (or more precisely, praxeological[112]) interpretation, a guiding principle and a good benchmark for the interpretation of treaty terms is **practicability**. The list of exceptions in Article 5(4) OECD and UN MC is largely based on difficulties in the allocation of an adequate portion of profits to the facilities enumerated in this list (no. 23 OECD MC Comm. on Article 5).[113] From a typological viewpoint, these difficulties do not outweigh the potential outcome in tax revenue of the source State.

249 Some elements of Article 5(4) OECD and UN MC (in particular, the rules contained in letters a, b and d) are intended to **avoid disincentives for cross-border commerce**. The most prominent examples are the carve-outs of purchasing offices, distributing warehouses and other auxiliary facilities which are designed to facilitate international trade.

250 **Similar negative catalogues** have been inserted in Article 5(4) UN MC, as well as many national Models and bilateral DTCs (on bilateral treaty practice, see *infra* m.no. 302 et seq.). Compared to Article 5(4) OECD MC, the UN MC fails to carve out facilities (Article 5(4)(a) OECD MC) and stocks (Article 5(4)(b) OECD MC) if they are maintained for the purpose of the delivery of goods or merchandise.

251 **Other deviations** which had existed in the past have meanwhile **disappeared**. This is particularly true for the clause on the combination of activities (*supra* m.no. 298 et seq.): unlike the 2001 UN MC and the OECD MC, the 1980 UN MC did not contain any corresponding rule at all.

252 *[vacant]*

2. Systematic Relevance within the Article

a. Relationship vis-à-vis Article 5(1) OECD and UN MC

253 Most facilities listed in Article 5(4) OECD and UN MC **meet the positive requirements of the general definition** in Article 5(1) OECD and UN MC. Thus, Article 5(4) OECD and UN MC functions as a true carve-out provision. To some extent, however, it is doubtful whether a facility would have met the preconditions of Article 5(1) OECD and UN MC at all. Where it does not, Article 5(4) OECD and UN MC has a merely declaratory meaning.

112. Vogel, 3rd edn, Art. 5 at m.no. 9.
113. Id. at m.no. 9, 99 and 108.

b. Relationship vis-à-vis Article 7 OECD and UN MC

254 Article 5(4) OECD and UN MC establishes true **binary thresholds**. As long as a POB (or an agent under Article 5(5) OECD and UN MC) falls under Article 5(4) OECD and UN MC, and therefore disqualifies as a PE, no portion of the profits will be assigned to this entity under the 2nd sentence of Article 7(1) OECD and UN MC. The State of residence which remains [is] entitled to tax the pertinent portion of the profits of the enterprise.

255 By contrast, as soon as the taxpayer **exceeds the thresholds** designated by Article 5(4) OECD and UN MC, the pertinent facilities/POBs/agents will be subject to full taxation in the source State – and taxation by the source State is not limited to (the share of the profits which is attributable to) the exceeding factors.

256 Particular advantage to the proper interpretation of Article 5(4) OECD MC can be derived from the existence of Article 7(5) OECD MC in its pre-2010 version. According to this latter clause, no profits shall be attributed to a PE by reason of the **mere purchase of goods or merchandise for the enterprise** (see no. 56 et seq. of the 2008 OECD MC Comm. on Article 7). Where Article 5(4)(d) OECD and UN MCor one of the other letter indents of Article 5(4) OECD and UN MC apply, there is no PE and therefore exclusive taxation by the State of residence anyway (1st sentence of Article 7(1) OECD and UN MC) so that one did not arrive at Article 7(5) of the 1977 OECD MC anyway (see *infra* m.no. 299; and Article 7 at m.nos 55 et seq., 140 et seq.).

257 Consequently, Article 7(5) OECD MC 1977 targeted cases where a PE has been constituted under Article 5 OECD MC, that is, where a POB or a **dependent agent have not, or not exclusively, purchased goods or merchandise** but performed other activities which (separately or in the aggregate) did not fall under Article 5(4)(f) or any other alternative of Article 5(4) OECD MC.[114]

c. Impact on the Issue of 'Service Permanent Establishments'

258 As the explicit reference to Article 5(4) in Article 5(5) OECD and UN MC shows, **agents do not constitute a PE** even if they meet the positive preconditions of Article 5(5) OECD and UN MC where their activities do not go beyond those listed in Article 5(4) OECD and UN MC. Considering the close relationship between service PEs and agency PEs, the same observation should be made for agency PEs too.

3. The Internal Structure of Article 5(4) OECD and UN MC

259 The internal structure of Article 5(4) OECD and UN MC requires some thoughtful unbundling. It is obvious that subparagraphs (a) to (d) describe **four different, though similar alternatives,** whereas subparagraphs (e) and (f) reflect a broader and more **abstract concept.** It is particularly these last-mentioned subparagraphs which suggest a synthetic rather than an analytical interpretation of the preceding subparagraphs (a) to (d). The differences in wording between these first four subparagraphs can be regarded as exemplifications of a homogeneous concept of subordinate POBs, as described in Article 5(4)(e) and confirmed and amalgamated in Article 5(4)(f) OECD and UN MC.

260 This **synthetic approach** is supported by the view expressed by the OECD MC Comm. that the common feature of all activities listed in Article 5(4) OECD and UN MC is that they are, in general, preparatory or auxiliary activities (no. 21 OECD MC Comm. on Article 5). It is particularly Article 5(4)(e) OECD and UN MC that ties the single elements in

114. As correctly stated by *Ditz, X.*, in: Wassermeyer *et al.* (eds), *Betriebsstätten-Handbuch* (2006) at m.no. 4.60.

subparagraphs (a) to (d) together. In other words, Article 5(4)(a) to (d) OECD and UN MC do not constitute specific carve-outs of Article 5(1) OECD and UN MC, but designate examples of one comprehensive carve-out.[115]

Nevertheless, the following subchapters aim at analyzing the single elements of Article 261
5(4) OECD and UN MC. Where one of these specific descriptions of a subordinate POB in Article 5(4)(a) to (d) OECD and UN MC applies, the existence of **a PE can be excluded** with a considerably **high degree of legal certainty**. The catch-all clause in Article 5(4)(e) OECD and UN MC seems to leave more leeway for interpretation and, therefore, to reduce legal certainty significantly, so an attentive analysis of the terms 'preparatory' and 'auxiliary' is required (*infra* m.no. 263 et seq.).

Four types of requirements are distinguished: elements related to the primary (visible) 262
activity (use and maintenance), location-related elements (facilities, stocks and fixed POBs), object-related elements (goods, merchandise and information), and elements related to the intended activity (storage, display and delivery).

a. Use and Maintenance as Visible Activities

As visible activities, Article 5(4)(a) OECD and UN MC requires a use of the facility. Like in 263
Article 6(3) OECD and UN MC, the term '**use**' does not cover the legal disposition (e.g., alienation) or substantial factual changes of the respective POB (see *supra* m.no. 207 for details). Likewise, Article 5(4)(a) OECD and UN MC applies equally to direct and indirect use.

By contrast, subparagraphs (b) to (f) of Article 5(4) OECD and UN MC refer to 264
maintenance, which is less than use. Maintaining the POB means keeping it ready for use in the not too far future. It will usually include checking the stock or the POB, and protecting, repairing or removing it as appropriate. The maintenance ends when the taxpayer neglects the stock or POB in a way that proves that it is more probable than not that he will give up the stock or POB without using it any more in an operative manner.

b. Facilities, Stocks and Fixed Places of Business as Visible Locations

As the French version of Article 5(1) and (4)(a) OECD MC proves, the term 'facilities' 265
(French: *installations*) is almost synonymous to 'fixed place of business' (French: *installation fixe d'affaires*). While 'fixed place of business', as used in Article 5(4)(d) to (f) OECD and UN MC, has exactly the same meaning as in Article 5(1) OECD and UN MC (see *supra* m.no. 12 et seq.), the term 'facilities' does **not necessarily require geographical stability**. To the extent that 'facilities' is broader than 'fixed place of business', however, a PE would not be constituted anyway under Article 5(1) and (2) OECD and UN MC. Therefore, the omission of 'fixed'/'fixe' and 'business'/'affaires') is of relevance only in the context of Article 5(3) and (5) OECD and UN MC. The filtering function of 'facilities' should in any case not be overestimated.

Stocks are **agglomerations of goods or merchandise** (*infra* m.no. 269 et seq.) stored on 266
the premises of another enterprise for processing by the latter.[116] The inclusion of a rule on stocks in Article 5(4)(b) and (c) OECD and UN MC is declaratory rather than necessary in a twofold manner.

115. See, again, no. 21 OECD MC Comm. on Art. 5: 'subparagraph e) … actually amounts to a general restriction of the scope of the definition contained in paragraph 1'.
116. Vogel, 3rd edn, Art. 5 at m.no. 112.

267 First, stocks are **assets**. The use of the term 'stock' includes goods or merchandise, even if the goods or merchandise are not stored in a POB and they do not form part of a fixed POB. Thus, stocks do not qualify as fixed POBs under Article 5(1) or (2) OECD and UN MC.

268 Secondly, stocks fail to satisfy the **requirements of the general PE definition** in Article 5(1) OECD and UN MC also with regard to the requirement of functional integration ('through'; see *supra* m.no. 124 et seq.). Stock is not used by the enterprise for its activities. Instead, it is the object in which the enterprise trades or which it processes.[117] Article 5(4)(b) and (c) OECD and UN MC makes this clear.[118]

c. Goods, Merchandise and Information as Imaginary Objects

269 Each of the four examples (Article 5(4)(a) to (d) OECD and UN MC) as well as the catch-all clause in subparagraph (e) specify the function of the visible activity (use or maintenance of the POB) in that they describe a **certain purpose of the POB**. This specification refers to certain activities (for these 'intended activities', see *infra* m.no. 275 et seq.) exercised at or through certain objects.

270 **Goods** are all items of tangible property, solid, liquid or gaseous. Unlike 'merchandise', the term 'goods' includes movable operating assets of the enterprise, for example, the drills of a mining enterprise or petrol tanks of a haulage company.

271 **Merchandise** are goods (*supra* m.no. 270) with which the enterprise of the taxpayer carries on a trade, that is, goods that are sold or distributed by the taxpayer. Goods consumed by the taxpayer are excluded. It is immaterial, however, whether these goods have been produced by the enterprise or a third person.

272 As a rule, the owner as well as the destinee of the goods and merchandise is **immaterial**. However, subparagraphs (a) to (c) of Article 5(4) OECD and UN MC apply only where the items 'belong to the enterprise'. This specific ownership requirement does not establish a strict link to private law. Similar to the concept of beneficial ownership, a more economic view prevails. Where a taxpayer wishes to establish a PE, he cannot escape the application of Article 5(4)(a) to (c) OECD and UN MCby transferring title of the goods or merchandise to a related party or a trustee. Therefore, it is sufficient if the enterprise using the facilities is the beneficial owner of the goods or merchandise stored, or if it has a status similar to that of an owner.[119]

273 **Examples** include a commission agent,[120] a trustor or a lessor, at least under ordinary short-term leasing contracts. By contrast, beneficial ownership might be attributed to the lessee rather than lessor in cases of a long-term lease if the lessee has a right to dispose of the asset, or if he has acquired a call option by virtue of which he can obtain legal title at his sole discretion.

274 **Information** is all data in which aggregate state so ever (written, oral, electronic, bionic). Where information is printed or stored in solid state, a delimitation between information (Article 5(4)(d) OECD and UN MC) and goods or merchandise (Article 5(4)(a) to (d) OECD and UN MC) is required. This delimitation resembles parallel problems in the context of the royalty definition under Article 12 OECD and UN MC (see no. 8 et seq. OECD MC Comm. on Article 12).[121]

117. Kolck, J. D., *Der Betriebstättenbegriff im nationalen und internationalen Steuerrecht* (1974) at 190.
118. See also Vogel, 3rd edn, Art. 5 at m.no. 111.
119. For details on the concept of beneficial ownership, see Vogel, K., in: *V&L*, 5th edn (2008), Pre Art. 10-12 at m.no. 10 et seq.
120. Kolck, J.D., *Der Betriebstättenbegriff im nationalen und internationalen Steuerrecht* (1974) at 190.
121. For an analysis of the impact which the deletion of 'industrial, commercial, or scientific equipment' in 1992 has had for the royalty definition contained in Art. 12(2) OECD MC, see Pöllath, R. & Lohbeck, A., in: V&L, 5th edn (2008), Art. 12 at m.no. 54 et seq.

d. Intended Activities

275 The verbs **storing**, displaying or delivering (Article 5(4)(a) and (b) OECD and UN MC) should be interpreted broadly. They include all activities which are typically connected to the storage, display or delivery of goods or merchandise, for example, adding tags, adding or reading bar code labels, packaging or dispatching. For the exclusion of delivery activities in many bilateral DTCs, see *infra* m.no. 302.

276 Article 5(4)(c) OECD and UN MC 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 (no. 22 OECD MC Comm. on Article 5). The term 'processing' means the working of articles or products to change some of their essential features, or if they are raw materials or intermediate products, to turn them into something different.[122]

277 The requirement that the goods or merchandise need to be processed by another enterprise (Article 5(4)(c) OECD and UN MC), as well as the lack of the term 'processing' in Article 5(4)(d) OECD and UN MC allows for a conclusion that a **fixed POB** designed or used for the processing of goods, merchandise (Article 5(4)(c) OECD and UN MC) or information (Article 5(4)(d) OECD and UN MC) by the taxpayer enterprise himself does not qualify under Article 5(4) OECD and UN MC, and therefore constitutes a PE (for an example, see *infra* m.no. 291 et seq.).

278 The **purchasing of goods or merchandise** (1st case of Article 5(4)(d) OECD and UN MC) is every activity which consists of, or prepares or supports, the acquisition of these objects. A transfer of property rights is not required. A maiore ad minus, also a temporary acquisition by way of rental or leasing, qualifies. From a systematic viewpoint, the term 'purchase' designates transactions complementary to the activities listed in Article 5(4)(a) and (b) OECD and UN MC (*supra* m.no. 275). As indicated above (*supra* m.no. 256), the 1st case of Article 5(4)(d) OECD and UN MC is connected to Article 7(5) OECD MC in its pre-2010 version, according to which no profits shall be attributed to a PE by reason of the mere purchase of goods or merchandise for the enterprise. If the activities of a fixed POB are restricted to purchasing, this POB does not constitute a PE.

279 Similar to the verbs used on the storage and output side (*supra* m.no. 275 et seq.), 'purchasing' includes **activities which are subordinate**, but typically connected, to the purchasing activity. Examples include controlling the quality of the goods and merchandise offered.[123]

280 The **collecting of information** (2nd case of Article 5(4)(d) OECD and UN MC) is the gathering of data of whatever type and form (see *supra* m.no. 274). Collecting is not necessarily a passive endeavour. It may also cover active 'information hunting' including industrial espionage. Moreover, the term 'collecting' includes corresponding storage, processing and further transfer (communication) of the relevant objects collected in the source State (for a delimitation, see *infra* m.no. 280 et seq.).

281 Collecting information does not cover **any data processing** which goes **beyond a systematic arrangements and filtering** of the information received in the source State. Therefore, remote data processing centres which use mainly or exclusively data which have been sent from the State of the head office and/or from third States do not qualify under Article 5(4)(d) OECD and UN MC. Consequently, they do constitute PEs under the ordinary standards of Article 5(1) and (2) OECD and UN MC.

282 **Example.** The collection of information pursuant to the 2nd case of Article 5(4)(d) OECD and UN MC covers bureaus of a journalist or a newspaper correspondent. At the outset, such

122. Wassermeyer, F. & Schönfeld, J, in: Flick/Wassermeyer/Becker, §8, at notes 23 & 24.
123. Concerning an establishment in Antwerp of a Swiss enterprise purchasing diamonds, see Arrêt G 04/9 Court of Appeal of Ghent dd. 30 Nov. 2004.

bureau has no purpose other than to act as one of the many 'tentacles' of the enterprise.[124] To exempt such a bureau is fully consistent with the concept of exempting mere purchase activities from taxation in the source State (1st case of Article 5(4)(d) OECD and UN MC; and see no. 22 OECD MC Comm. on Article 5) as long as the journalist working in the bureau is strictly confined to the collection of material and, at the utmost, limited to re-writing the facts.

283 By contrast, any evaluation, editing work or other active transfiguration of facts and quotations goes beyond the mere collection of information. It would be a processing of information which is not covered by Article 5(1)(c) or (d) OECD and UN MC. For the application of Article 5(4)(e) OECD and UN MC, see *infra* m.no. 295 et seq.

4. Preparatory or Auxiliary Character

284 All of the activities listed in Article 5(4)(a) to (f) OECD and UN MC have to be preparatory or auxiliary (*infra* m.no. 284 et seq.). This follows from the use of the word **'other'** in Article 5(4)(e) OECD and UN MC. This word relates not only to the subsequent word 'activity' (otherwise, one should expect an if-clause or a 'provided that'-clause like after 'activity', like in Article 5(4)(f) OECD and UN MC) but to the entire phrase 'activity of a preparatory or auxiliary character'. By contrast, other requirements in Article 5(4)(e) OECD and UN MC have no paramount relevance but apply within the ambit of this subparagraph only (*infra* m.no. 295 et seq.).

a. As a General Requirement for Article 5(4)(a) to (f) OECD and UN MC

285 The activities listed in Article 5(4) OECD and UN MC can be characterized as preparatory or auxiliary based on an **absolute standard** or based on a **relative standard**. For example, consider a comparison of two enterprises: 1) an integrated enterprise which covers many steps in the creation of value (e.g., all steps from agricultural production through the processing of raw materials, further refinement up to marketing, sale and delivery of the goods to final consumers) and 2) a specialized enterprise which focuses on one of these steps only (e.g., on the delivery of goods). Suppose that each enterprise maintains a POB in a foreign State just for the sake of the delivery of goods. The same activity (the delivery of goods) is ancillary and subordinate for enterprise (1) while it constitutes the core business of enterprise (2).

286 The **amount of** value added by either enterprise is the same, and so is the potential tax revenue in the source State. An absolute standard suggests equal treatment of case (1) and (2).

287 However, the ordinary meaning of both 'preparatory' and 'auxiliary' requires the identification of a **point of reference**. One may say that the absolute standards are based on an analysis of the function of the core activity in relation to the entire chain of economic value added. It is more convincing, however, to apply relative standards in the sense that the value added is considered on a micro rather than a macro level, that is, that the core activity should be compared to the entirety of all activities exercised by the enterprise. This relative view would prohibit a PE in case (1), and allow a PE in case (2). This view is shared by most authors.[125]

288 It seems to your author, however, that the strict and exclusive application of relative standards would not do justice to cases where an enterprise of type (1) above (*supra* m.no. 264) is so large that POBs which, from an absolute perspective, are respectable entities with valuable assets, a considerable number of employees and fully-fledged bureaucratic and

124. Vogel, 3rd edn, Art. 5 at m.no. 98.
125. Cf. Skaar, A., *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991) at 280, 288, 290, 325; Baker, Art. 5 at m.no. 5-33, no. 24.

administrative facilities of their own, just seem to be small, preparatory or auxiliary from the perspective of the company's headquarters. If they are still the **biggest employer in a given municipality**, it is hardly justified from the viewpoint of fiscal equivalence to exempt such POBs under Article 5(4) OECD and UN MC.

It follows that a combined approach is most appropriate. While relative standards apply at 289
the outset (*supra* m.no. 285), absolute standards require a second filter:

- The activities of a POB qualify as being 'of a preparatory or auxiliary character', as compared to the overall activities of the enterprise if they have **not more than a marginal relevance** within the enterprise's overall business plan. It should be noted that it is not the share in actual profits or losses on which the comparison should be based. Rather, the characterization of an activity as preparatory and/or auxiliary depends on the type, sector and intensity of the activity, as compared to the core business of the enterprise as a whole.
- If the activities of a POB qualify as preparatory and/or auxiliary under these relative standards, they still do not fall under Article 5(4) OECD MC if the POB (and the activities exercised through it) alone, when looked at separately from the rest of the enterprise, **exceeds a certain size and degree of professional entrepreneurship**.

This absolute threshold would be met if the **POB** would be **economically viable** when untied 290
from the rest of the enterprise. Where similar independent POBs exist, a strong presumption advocates against the application of Article 5(4) OECD and UN MC. By contrast, a business representation with six employees but which lacked the authority to conclude contracts has not been regarded as a PE.[126] Similar standards apply where Article 5(4) OECD and UN MC is being tested in the context of Article 5(5) OECD and UN MC.

Examples of activities of a preparatory character include, but are not restricted to, **market** 291
research (both on the supply and on the demand site), the **acquisition of operating assets**, interviews with potential future employees, the collecting of capital for the start-up of an industrial or commercial enterprise, and the application for administrative permissions or documents before the enterprise starts its business, before a new facility is built, or before a new product is launched.

Activities of an auxiliary character may include **advertising** or the **supply of marketing** 292
information or of **scientific research**, all for the enterprise.[127] While such POBs may well contribute to the profit of an enterprise, the services which they perform are so remote from the actual realization of a profit that it would be difficult to allocate any profit to the fixed POB concerned (see no. 23 OECD MC Comm. on Article 5).

A further group of examples covers rooms and facilities which an employer makes 293
available in order to accommodate his employees or help them to recreate or spend their idle time. This includes hotels, bedrooms, lounges or restrooms maintained outside the ordinary premises which the employer uses for the purpose of his core business. Similarly, locker rooms and coaches' rooms occupied by a baseball team while playing in venues outside the headquarters of the team do not constitute PEs of the baseball clubs.[128]

126. According to a ruling by the Danish Landsskatteret LSR 1991–4–122, 61 *Revision & Regnskabsvæsen* (Denmark) SM 201 (1991). For a detailed discussion on representative offices, see Baranowski, K.H., *IWB* Fach 3, Deutschland Gruppe 2 at 619.
127. Thus with respect to a representation of a Spanish bank in Switzerland se Swiss Federal Court, 102 Ib *BGE* 264 (1964).
128. As the Court of Appeal for Ontario has convincingly ruled, '[f]undamental to any professional sports business are the contracts entered into with its players, the selling of tickets, the licensing of concessions, the negotiations of sponsorships and advertising, television and radio broadcasting rights' and 'that these business activities were conducted in the home venue of the teams'. It

294 In contrast, **sales activities of a manufacturing company** are not of an auxiliary character. If they occur in a fixed POB, they create a PE even if the sales contracts are subject to approval by the head office or another PE.[129]

b. Confinement to Internal and Administrative Activities

295 Under Article 5(4)(e) OECD and UN MC, preparatory or auxiliary activities do not constitute a PE only if they are **exercised 'for the enterprise'**, that is, for the taxpayer himself. By contrast, where services are rendered **for a third party**, they will constitute part of the enterprise's main object, and corresponding facilities may well be PEs.[130] A specific activity exercised for an enterprise may be auxiliary, even if it is the sole business activity of some other enterprise, such as in the case of advertising or scientific research (*supra* m.no. 284 et seq.).

296 Where a **laboratory** that generally provides **preparatory services** only for the enterprise to which it belongs, or the advertising division of an enterprise, in certain cases also **performs services directly for third parties**, their activities will, to that extent, no longer be of an auxiliary character. The laboratory, or the advertising division, as a whole will then be characterized as a PE.

297 However, a **non-recurring service for a third** party will not lead to the above consequences. To do so, the activity needs to show some degree of permanence. Maintenance by independent enterprises, whether members of a group or not, of a common facility of the kind dealt with here would also constitute a case of services being rendered to third parties.[131]

5. Combinations of Non-qualifying POBs: Article 5(4)(f) OECD and UN MC

298 According to Article 5(4)(f) OECD and UN MC, the maintenance of a fixed POB solely for any combination of activities mentioned in Article 5(4)(a) to (e) OECD and UN MC is **carved out from being a PE**. This applies only, however, if the overall activity of the POB resulting from this combination is of a preparatory or auxiliary character.

299 This clause was inserted into the OECD MC in 1977, and it was later adopted by the 2001 UN MC. It aims at solving the previous dispute as to whether the 'consolidation of business' resulting from combinations of the exceptions enumerated in Article 5(3) OECD and UN MC leads to a PE.

300 For the single requirements listed by Article 5(4)(f) OECD and UN MC see *supra* m.no. 259 et seq. and 284 et seq. Unlike in subparagraphs (a) to (e), the single activities of the enterprise at the specific POB (or through the specific dependent agent) **shall be added up** before the auxiliary and preparatory test is made, given that a combination of zero-rated items need not necessarily result in another zero-rated item.

301 Klaus Vogel has convincingly stressed that **combinations of two or more auxiliary activities** must not be judged on rigid lines, but **rather individually** with due regard to the economic situation that arose from the integrating measures. A reason that militates for including such cases of combinations in Article 5(4) OECD and UN MC is that the entrepreneur might just as well have had the various activities performed by organizationally

inferred that from the point of view of the business conducted by the clubs the baseball games were not core activities and did not constitute PEs for this reason: *Toronto Blue Jays et al. v. Minister of Finance, TNI* 749 (2005).

129. As convincingly ruled by the Danish Ligningsråd, *Skat Udland* 52 (1991).
130. See the Austrian Bundesministerium der Finanzen, 4 *SWI* 147 (1994).
131. Vogel, 3rd edn, Art. 5 at m.no. 116a, referring to a decision of the French Conseil d'État, req. n. 37.410, 36 *Droit Fiscal commentaire* 145 (1984).

separate units at different places.[132] However, the significance attached to this latter point when assessing an actual case of such combination should not be too great.[133]

II. Divergent Country Practice

Many bilateral DTCs have **shortened the catalogue** of Article 5(4) OECD and UN MC exclusions. In particular, facilities used solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise (Article 5(4)(a) OECD and UN MC) have often been accepted as PEs.[134] 302

Less far reaching, though similar in substance, is a deviation of the 2001 UN MC, as compared to the OECD MC and most DTCs between, and national Model DTCs of, OECD Member States. In its list of exceptions to the PE concept, Article 5(4) UN MC covers neither the facilities used solely for the delivery of goods or merchandise nor the stocks of goods or merchandise maintained solely for the purpose of delivery. Consequently, such facilities or stocks should be characterized as constituting, or not constituting, a PE only on the basis of the general rules (Article 5(1) to (3) and (5) to (7) OECD MC). These general rules will usually support the characterization of delivery facilities as PEs,[135] while stocks will not qualify as a PE (see *supra* m.no. 265 et seq.). 303

The **1996 US MC** as well as bilateral treaties of some other countries did not adopt the words 'provided that' from Article 5(4)(f) OECD and UN MC and, consequently, went as far as to exclude all combinations of facilities listed in Article 5(4)(a) to (e) OECD and UN MC from being a PE. However, the 2006 US MC has accepted the OECD proviso. 304

F. Article 5(5) OECD and UN MC

I. The Models

1. Rule

Under Article 5(5) OECD MC and Article 5(5)(a) UN MC, a PE shall be deemed to exist where a person (other than an agent of an independent status to whom Article 5(6) OECD MC or Article 5(7) UN MC applies; see *infra* m.no. 349 et seq.) **acts** in one Contracting State **on behalf of an enterprise** of the other Contracting State (*infra* m.no. 327 et seq.), has **authority to conclude contracts** which bind the represented enterprise (*infra* m.no. 329 et seq.), and **habitually exercises such authority** (*infra* m.no. 333 et seq.). If these positive preconditions are met, the enterprise shall be deemed to have a PE in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in Article 5(4) OECD and UN MC, which if exercised through a fixed POB, would not make the fixed place of business a PE (*supra* m.no. 258).[136] 305

The origins of the relevance of agents for the existence of a PE date back to Article 2(1) and (2) of the **1899 DTC between Austria and Prussia**. In this treaty, however, the agent was placed on equal footing with the entrepreneur himself, his co-partner or his proxy. Moreover, 306

132. Vogel, 3rd edn, Art. 5 at m.no. 117a, referring to Häck, in: Flick/Wassermeyer/Kempermann, Art. 5, Anm. 54.
133. Cf. Ludwig, M.B., 'General Report', *CDFI* vol. 58a (1973): at 55 et seq. For a different view, see the decision of the Dutch Hoge Raad, Rolno. 17 812, *BNB* 1976/121.
134. For examples, see Lehner, M. & Reimer, E., CDFI vol. 90a (2005), at 326.
135. See UN Comm. on Art. 5(4), 67.
136. For the notion and the difficulties of agency PEs, see Williams, L. & Huston, J., *TPIR* 19 (1992); Bendlinger, S., *ÖStZ* 140 et seq. (2010); and Niehaves, D., *Die Vertreterbetriebsstätte. Konzeption und Einkünftezuordnung* (2010).

they did not constitute a PE merely on the basis of an activity in the source State, but only if there was a POB.[137]

307 Since 1903 at the latest, DTCs have provided that even in the absence of a fixed place of business (*supra* m.no. 12 et seq., 45 et seq.), a PE shall be deemed to exist where an **employee of the taxpayer remains** in the source State on a **permanent basis**.[138] Important textual elements were taken from, or at least inspired by, UK legislation.[139]

308 A considerable number of source-oriented DTCs have replaced a facility-oriented approach by an **activity-related approach**. They have acknowledged the concept of deemed PEs constituted by human activities (for service PEs, see *infra* m.no. 398 et seq.) including, most notably, activities of a permanent agent or representative.

309 **Further variations** exist with regard to the **degree of proximity** of this agent to the taxpayer. As a rule, dependent agents meet the requirements of the deemed PE definitions (Article 5(5) OECD MC, Article 5(5)(a) UN MC) while independent agents will usually not constitute a PE of the principal (Article 5(6) OECD MC, Article 5(7) UN MC; see *infra* m.nos 349 et seq.). Particular rules should be observed with regard to companies (Article 5(7) OECD MC, Article 5(8) UM MC; see *infra* m.no. 370 et seq.) or partnerships and hybrid entities as agents (*infra* m.no. 320 et seq.). Where an agent qualifies as a dependent agent, the taxpayer (i.e., he who runs the enterprise for which the agent acts) is treated as if he had a PE in the State(s) where the agent acts in that State in respect of any activities which that person undertakes for the enterprise (*infra* m.no. 326 et seq.).

310 It is due to their deviation from, and their character as a supplement to, the requirement of a fixed POB (Article 5(1) OECD and UN MC) that the agent provisions in Article 5(5) OECD and UN MC can **only result in 'deemed' PEs**. Like building sites, construction and installation projects (Article 5(3) OECD and UN MC and *supra* m.no. 201 et seq.), agents are mainly characterized by the activities which they perform. Unlike the PEs under Article 5(3) OECD and UN MC which are still attached to certain piece of land (*supra* m.no. 196 et seq.), however, an agent may be fully mobile within the entire territory of the source State (see *infra* m.no. 333 et seq. for details). In the context of Article 5(5), the OECD MC gives up the fixed geographical link to a certain situs as a necessary feature for PEs.

311 It should be noted that the **legal consequences** between **'real' PEs** under Article 5(1) to (3) OECD and UN MC and **'deemed' PEs** under Article 5(5) OECD and UN MC do **not differ at all**. Both types of PEs qualify as PEs for the purpose of all Articles in the OECD and UN MC which refer to the existence of a PE (for details, see *infra* m.no. 340 et seq.).

312 Nevertheless, the linguistic divergence between POBs and deemed PEs indicates a considerable degree of distance or even **mismatch** between the dependent agent requirements under Article 5(5) OECD and UN MC and the preconditions of Article 5(1) and (4) OECD and UN MC: given that the requirement of a POB is obviously obsolete, one may doubt whether the requirement of permanence under Article 5(1) OECD and UN MC (*supra* m.no. 65 et seq.) as well as the twelve-month threshold under Article 5(3) OECD and UN MC (*supra* m.no. 230 et seq.) should be applied to agent PEs (see *infra* m.no. 336 et seq.).

2. Person (Articles 5(5), 3(1)(a) and (b) OECD and UN MC)

313 Although it is often an individual who functions as an agent (*infra* m.no. 314), the OECD and UN MC provides for a broad concept in which **every 'person'** (Article 3(1)(a) OECD and UN

137. Cf. Art. 2(1) & (2) of the DTC between Austria and Prussia of 21 June 1899 ('Als Betriebstätten gelten Zweigniederlassungen, Fabricationsstätten, Niederlagen, Comptoire, Ein- oder Verkaufsstellen und sonstige Geschäftseinrichtungen zur Ausübung des stehenden Gewerbes durch den Unternehmer selbst, Geschäftstheilhaber, Procuristen oder andere ständige Vertreter').
138. See Art. 1(1) cl. 2 of the Austrian Regulation of 11 Nov. 1903 on the Agreement between Austria and Bavaria, Austrian *Reichsgesetzblatt* of 29 Dec. 1903 at 849.
139. See Avery Jones, J. F., 56 *BTR* 664 et seq. (2011); and Vann, R., 56 *BTR 551 et seq.* (2011).

MC) **qualifies as an agent**. At the outset, this includes companies in the traditional (non-tax) sense as well as any other entity that is treated as a body corporate for tax purposes (Article 3(1)(b) OECD and UN MC; see *infra* m.no. 315 et seq. and see no. 32 OECD MC Comm. on Article 5). Moreover, non-corporate entities like partnerships, associations, foundations and trusts qualify under Article 3(1)(a) OECD and UN MC, even though these entities have not been mentioned by the OECD MC Comm. (for details, see *infra* m.no. 265 et seq.).

a. Individuals (Article 3(1)(a) OECD and UN MC)

Individuals qualify as agents **irrespective** of whether and how they are **subject to tax** in any of the Contracting States. In particular, the individual does not have to be a resident under Article 4(1), read in connection with Article 1 OECD and UN MC, in either Contracting State. The individual may be a resident of a third State (no. 32 OECD MC Comm. on Article 5). Likewise, the status of the individual as a person (but possibly her authority to conclude contracts; see *infra* m.no. 329) does not depend on her age or mental abilities. 314

b. Companies and Other Bodies Corporate (Article 3(1)(b) OECD and UN MC)

According to Article 3(1)(a) OECD and UN MC, a company is a 'person', too. Under Article 3(1)(b) OECD and UN MC, the term 'company' includes **all bodies corporate**.[140] Among them are commercial and non-profit entities with members (like joint-stock companies, public or private limited liability companies, proprietary companies on the commercial side, and associations, societies, membership corporations on the non-profit side). Company also includes corporate entities without members (like foundations or trusts). 315

With regard to the continental European distinction between private and public law, it is fully **irrelevant** whether the entity has been **founded or incorporated** under **private law**, under **public law** or even under **international law**.[141] Therefore, entities like public radio stations, churches and other religious communities, public trusts, traditional communities or international organizations are a 'person' as well, and therefore can function as an agent. The same holds true for States, their political subdivisions, or local authorities like districts, municipalities, or communities. All of these public bodies qualify only if, and to the extent that, they are actively engaged on behalf of the enterprise, and they meet all other requirements of Article 5(5) OECD and UN MC (see *infra* m.no. 326 et seq. for details). 316

For companies which are **fully independent from the taxpayer** (except with regard to the principal-agent relationship which constitutes the PE under Article 5(5) OECD and UN MC), no further observations need to be made with regard to the test of whether or not they form a PE. 317

It should be noted that such independent companies, in addition to their contribution to the economic success of the taxpayer to whom they serve as an agent, will regularly make their **own taxable profits** (e.g., under Article 7 OECD and UN MC). The fact that the taxable profits of the agent company include a remuneration which the principal (the 'enterprise' under Article 5(5) OECD and UN MC) pays in consideration of the company's activities as an agent does not preclude this agent company from being a deemed PE. 318

For the impact of **group taxation schemes** on the concept of agent PEs, see *infra* m.no. 376 et seq. 319

140. For details, see Vogel, K., in: V&L, 5th edn (2008), Art. 3 at m.no. 13 et seq.
141. For details on the notion of 'person' under Art. 3(1)(a) OECD MC, see Vogel, K., in: V&L, 5th edn (2008), Art. 3 at m.no. 7 et seq.; Tumpel, M. & Aigner, G., 'Die Personeneigenschaft nach Art 3 Abs 1 lit a OECD-MA als Voraussetzung der Ansässigkeit', in Lang, Schuch & Staringer (eds.), *Die Ansässigkeit im Recht der Doppelbesteuerungsabkommen* (2008), at 33 et seq., 46 et seq.

c. Partnerships and Hybrid Entities as Agents

320 Even though partnerships and a wide range of other (often hybrid) entities may not be taxable, and thus they do not qualify as residents under Articles 4 and 1 OECD and UN MC, they are usually '**persons**' under Article 3(1)(a) OECD and UN MC, and may therefore **constitute a (deemed) PE** under Article 5(5) OECD and UN MC. In most instances, this follows from their characterization as 'other bodies of persons' (Article 3(1)(a) OECD and UN MC).

321 In some instances, they even **qualify as residents** if the State where they have their seat, POEM or any similar facility, under its domestic tax law, treats them as bodies corporate for tax purposes (and therefore as 'companies' under Article 3(1)(a) and (b) OECD and UN MC).[142]

322 The situation might be different, however, for DTCs which deviate from Article 3(1)(a) OECD and UN MC in that they do not include the words '**any other body of persons**'. If the State where the entity has its seat and/or maintains its POEM does not treat this entity as intransparent under Article 4(1) OECD and UN MC, the entity does not qualify as a (deemed) PE under Article 5(5) OECD and UN MC. In these instances, the partners, managers or employees of the entity may be seen as the agents referred to in Article 5(5) OECD and UN MC.[143]

d. Non-identity with the Taxpayer

323 It follows from the requirement that the agent act 'on behalf of an enterprise' (French: 'pour le compte d'un enterprise') that the 'person' mentioned in Article 5(5) OECD and UN MC cannot be the entrepreneur himself.[144] **Employees** of the enterprise may qualify as dependent agents under Article 5(5) OECD and UN MC (they form the most relevant group of agent PEs). The same hold true for **directors** and **organs** of a company.[145]

324 Difficult delimitations are required where the enterprise (not the agent) is a **partnership**. No distinctions should be made between **intransparent partnerships**[146] and (other) companies. Therefore, all employees of the partnership as well as its managing partners may qualify as agents under Article 5(5) OECD and UN MC.

325 The situation is different, however, if the partnership is treated as **transparent** for the purposes of the applicable DTC. The concept of 'agency' under common law may be applicable to the partner of this partnership.[147] Given the transparency of the partnership, however, the managing partner himself is the taxpayer. Consequently, his contract-concluding activities in the source State do not in themselves constitute a PE there – Article 5(5) OECD and UN MC remains inapplicable. Rather, a fixed POB available to him for this work, as well

142. The prerogative of the state of residence for the characterization of an entity as corporate or non-corporate (transparent) can be derived from Art. 4(1) OECD MC. See OECD, *The Application of the OECD Model Tax Convention to Partnerships* (1999), nos 29 et seq.; OECD MC Comm. on Art. 1, no. 5 et seq.; for further analysis cf. Lang, M., *SWI* 60 et seq. (2000); van Raad, K. & De Broe, L. et al., 56 *BIFD* 285 (2002); Kosters, B., 12 *APTB* 19 (2006); Prokisch, R., in: V&L, 5th edn (2008), Art. 1 at m.no. 17 et seq.
143. Vogel, 3rd edn, Art. 5 at m.no. 137.
144. See Bundesfinanzhof, 37 *RIW* 356 (1991); Huston, J. & Williams, L., *Permanent Establishments* (1993), at 81.
145. Austrian Ministry of Finance, EAS 1666 of 30 May 2000; and EAS 2111 of 2 Sep. 2009; concurring, Puls, M., 50 *RIW* 172 et seq. (2004). A different view has been held by the Finanzgericht Düsseldorf of 16 Jan. 2003, *EFG* 1125 et seq. (2003) (with further references); and Bendlinger, S., *ÖStZ* 141 (2010.
146. On this notion and the prerequisites for the treatment of a partnership as transparent or intransparent under a DTC, see OECD *Partnership Report* (1999).
147. Williams, R.L., Huston, J.C., 19 *TPIR* 25 (1992).

as the necessary degree of permanence are required to establish a PE (Article 5(1) OECD and UN MC).

3. Activity (Article 5(5) OECD and UN MC)

The person needs to act in one Contracting State on behalf of an enterprise of the other Contracting State. 326

The fact that the agent acts **on behalf of the enterprise** will usually be unveiled and communicated to the other contracting partner. It is not indispensable, however.[148] Especially where the contracting partner has no specific interest in getting to know details about the identity of the entrepreneur with whom he is negotiating and/or contracting (e.g., because the services have been provided, or goods been delivered, in advance to the satisfaction of both sides; or because there is no significant commercial or legal risk at issue), the characterization of the local representative as an 'agent' under Article 5(5) OECD and UN MC rather than an independent entrepreneur does not depend on any publicity of him acting on behalf of a non-resident principal. 327

Where the person exercises only activities of **a subordinate or auxiliary character**, he does not qualify as an agent under Article 5(5), read in connection with Article 5(4) OECD and UN MC (for details, see *supra* m.no. 284 et seq., and *infra* m.no. 338 et seq.). 328

4. Authority to Conclude Contracts (Article 5(5) OECD and UN MC)

Under Article 5(5) OECD and UN MC, an agent qualifies only if he has the authority to conclude contracts on behalf of the enterprise. Whether or not the agent has such authority is to be **determined under the decisive conflict of laws rules**, read in connection with the private law (contract law) of the State which has authority to apply its contract law. 329

The authority to conclude contracts is **more than the mere arrangement** or **brokerage** of a contract (cf. Article 5(6) OECD MC, Article 5(7) UN MC). However, it is not required that the agent himself is entitled to make the decisive legal statement of offer or acceptance, and/or that he is entitled to receive, with binding legal effect for the principal, any statements made by the third party. 330

As a rule, it is sufficient that the **principal accepts and acknowledges the results** of the actions taken, and contracts negotiated by the agent. Considering a high degree of arbitrariness if the merely formal act of finally signing a contract were decisive, we propose a substance-over-form approach with regard to the authority to conclude contracts test: if it belongs to the typical activities of the agent to communicate with the third party and to discuss and arrange (spontaneously or after the agent has sought the consent of the principal) the main features of the contract, it is immaterial if the final signature is made by the agent on behalf of the principal, or by the principal himself. It is required, however, that the principal will follow the arrangements of the agent in the overwhelming majority of cases. According to this yardstick, a recent decision of the Dutch Court of Appeal of The Hague deserves full approval.[149] 331

Not all DTCs contain the requirement of a contract-concluding authority for every sector of business. It is particularly with regard to **insurance enterprises** that many DTCs (especially those which have adopted a clause corresponding to Article 5(6) UN MC) assume an agent PE as soon as the agent performs any customer-related activities in the source State. 332

148. As convincingly stated by no. 32.1 OECD MC Comm. on Art. 5.
149. Gerechtshof 's-Gravenhage, case BK-07/00604 of 15 Jul. 2008.

5. Habitual Exercise of Contracting Authority (Article 5(5) OECD and UN MC)

333 Given that agents need not show any personal link to the territory of the source State in terms of residence or citizenship (*supra* m.no. 314), they constitute a deemed PE only if other **connecting factors** justify them being assigned to the territory of the source State. For this reason, Article 5(5) OECD and UN MC refers to the habitual exercise of the contracting authority in the territory of the source State.

334 The contracting authority is exercised in the territory of the source State if the agent (or the individuals who act as his representatives) is **physically present** in this State at the time when the decisive decisions are being made. It is immaterial that the contracts have been concluded under the law of this State, or if later arguments are subject to this State's jurisdiction.

335 The exercise of the contractual authority is 'habitual' if the **agent acts for the same principal** (*infra* m.no. 336 et seq.) **repeatedly**, that is, more than occasionally and not merely in isolated cases (no. 32 OECD MC Comm. on Article 5). From a methodological viewpoint, the relatively high requirements can be derived from an interpretation in the light of the permanence test in Article 5(1) OECD and UN MC (see *supra* m.no. 53 et seq. and see no. 32 OECD MC Comm. on Article 5).

6. Exclusion of Short-Term Agents

336 As indicated above, a crucial problem in the interpretation of Article 5(5) OECD and UN MC is the applicability of **minimum time requirements**. While they have been provided for explicitly in Article 5(3) OECD and UN MC for construction sites, building and installation projects (see *supra* m.no. 230 et seq. and 211 et seq. for details) and are contained, though less clear-cut, in the notion of permanence (see *supra* m.no. 65 et seq.), Article 5(5) OECD and UN MC does not seem to include any minimum period. In particular, neither Article 5(5) OECD and UN MC nor Article 5(6) OECD MC and Article 5(7) UN MC contain any reference to the requirement of a minimum period.

337 The requirement that the agent needs to exercise his contracting authority in the territory of the source State habitually, however, makes it clear that agents **acting only in the context of one or several, though isolated**, transactions do not meet the requirements of Article 5(5) OECD and UN MC. In the view of your author, one should move even further.[150] The understanding of 'habitual' should not be tied only to the mere frequency of transactions in the past. The strong needs for legal certainty would be met by a transfer of the six-month threshold contained implicitly in Article 5(1) OECD and UN MC to the meaning of 'habitual'. An adequate and consistent interpretation, however, needs to consider that even long-term agents do not qualify under Article 5(6) OECD MC and Article 5(7) UN MC if they have never, or almost never, concluded contracts. For this reason, a combination of time and frequency criteria is most appropriate: The agent needs to function as an agent for more than six months, as judged from an ex post perspective (*supra* m.no. 73 et seq.), and he has to exercise his authority to conclude contracts in several (not necessarily numerous) instances or transactions.

150. More reluctant is no. 33.1 of the OECD MC Comm. on Art. 5.

7. Exclusion of Subordinate and Auxiliary Activities

Where the person exercises only activities of a subordinate or auxiliary character, he does not qualify as an agent under Article 5(5), **read in connection with Article 5(4) OECD and UN MC** (for details, see *supra* m.no. **284** et seq.).[151] 338

In some instances, this result has been regarded as unfair given the intensity of activities which an agent carries on in the source State. This is particularly true for agents who are **engaged in large-scale distribution** of standardized products like goods, services, insurance policies etc. While they would disqualify under Article 5(5), read in connection with Article 5(4) OECD and UN MC, a number of States have decided to deviate from the OECD MC in this respect and to extend the scope of (deemed) PEs to these categories of agents by adding specific clauses to their PE Article. Corresponding attempts have been made in DTCs, for example, in the DTC between Belgium and Switzerland (inclusion of all activities of insurance agents in the scope of agency PEs). 339

8. Legal Consequences

a. Scope of Profits Assigned to the Agent Permanent Establishment

Where an agent constitutes a (deemed) PE, the profits assigned to this agent PE **follow the transactions in which the agent was involved**. The range of such transactions includes all transactions which have been initiated, performed, supported or accompanied, and all contracts which have been concluded, by the agent on the territory of the PE State – even if the actual performance of such contracts has fully or partly remained an activity of another PE of the taxpayer enterprise (usually in a different State, in many cases in the State of residence). By contrast, activities of the agent outside the PE State shall not be assigned to an agent PE, even if the transaction or contract concerned shall later on be performed within the territory of the PE State. 340

Moreover, it should be noted that even if the transaction is assigned to the PE accordingly, a profit-split will usually be required under Article 7(2) OECD MC (see *infra* Article 7 at m.no. 190 et seq. for details). 341

b. Remuneration of the Agent and Deduction of Expenses

Irrespective of whether an agent qualifies as a PE or not, and irrespective of which elements the agent's remuneration is composed (cf. *supra* m.no. 318 et seq.), this remuneration forms **part of his taxable income**. For the enterprise of the principal, it will usually constitute a **deductible expense**. 342

In many cases, both of these two consequences will coincide in one and **the same State** (i.e., the source State) if an agent PE exists (Article 5(5) OECD and UN MC). This coincidence is by no means necessary, however, and the DTCs do not prohibit taxation of the agent's income in one State and deduction of the principal's expenses in another State. Such **divergence** may occur as a result of a DTC, where: 343

- the agent is a resident of, and exercises his activity in the **source State**, but does **not constitute a (deemed) PE of the principal** in this source State, for example, because Article 5(6) OECD MC or Article 5(7) UN MC applies; or

151. As an example in recent case law, see the decision of the Administrative Court of Appeal of Gothenburg, 23 Jan. 2009.

– a self-employed, but dependent agent (*supra* m.no. 323) is not a resident of the source State but **constitutes a PE of the principal** there which, is **not at the same time a PE of the agent** as well.

344 In the first case, the **source State taxes the agent's income** but is **not** (or at least, not under a DTC) **responsible for the deduction** of any expenses incurred by the principal's enterprise for the agent. This is because most States (when in the role of the source State) will deny the deduction of any expenses which pertain to, or are effectively connected with, accruals which are taxable only in another State (i.e., the State of residence of the entrepreneur) under the 1st sentence of Article 7(1) OECD and UN MC. Rather, the principal may claim a deduction of his expenses primarily in this other State (his State of residence). In some cases, deduction of expenses might be available only in a third State. For example, if the principal maintains a PE in this third State and the agent's activity is effectively connected to this third-State PE under the conditions set forth in Article 7(2) OECD MC. (See *supra* m.no. 191 for details).

345 In the second case, the **PE State will tax the principal's income** under the conditions in Article 7(2) to (4) OECD MC or Article 7(2) to (6) UN MC, and will be entitled to **deduct expenses** attributed to the activity of the agent (Article 7(2) OECD MC). The agent's income, however, is not taxable in the PE State but only in his State of residence (1st sentence of Article 7(1) OECD and UN MC; the 2nd sentence of Article 15(1) OECD and UN MC does not apply since the agent is self-employed).

II. Divergent Country Practice

346 The following country list is compulsory but not necessarily exhaustive. Feel free to add further countries, and/or to merge two or more of the following into one paragraph.

347 The DTC between Brazil and India does not contain any rule that assigns the character of a PE to construction sites or other projects. In this case, the existence of a PE depends solely on the general requirements of clauses like Article 5(1)&(2) OECD and UN MC (e.g., the existence of a 'workshop'), on the requirements of clauses following Article 5(5)&(6) OECD and UN MC, and/or on the existence of a general service PE following Article 5(3)(b) UN MC.

G. Article 5(6) OECD and Article 5(7) UN MC

I. The Models

1. Rule

348 According to Article 5(6) OECD MC and Article 5(7) UN MC, an enterprise shall not be deemed to have a PE in a Contracting State merely because it **carries on business** in that State through a **broker**, **general commission agent** or any **other agent of an independent status**, provided that such persons are acting in the ordinary course of their business.[152]

349 This exclusion of independent agents serves to distinguish agent PEs from the wide range of business contacts among enterprises which meet on equal footing.

350 Article 5(6) OECD MC and Article 5(7) UN MC makes it clear that if an entrepreneur acts in the **ordinary course of his own business**, he cannot by so doing create a PE of any third party, even if his activity involves looking after a third party's interests[153] (for rare exceptions to this rule, see *infra* m.no. 362 et seq.).

152. See Skaar, A., *Permanent Establishment: Erosion of a Tax Treaty Principle* (1991), at 515 et seq.
153. Vogel, 3rd edn, Art. 5 at m.no. 168.

Where such business contacts include **fiduciary relationships** and, in particular, a proxy of one party to act on behalf or on account of the other party, a literal interpretation of Article 5(5) OECD and UN MC would result in the existence of an agent PE. Under the OECD MC Comm., however, this classification would not acknowledge the fact that an independent agent pursues his own business rather than the business of the principal (no. 36 OECD MC Comm. on Article 5). If this assumption (or, more precisely, the concept of a strict exclusivity which this antagonistic language implies) were correct, Article 5(6) OECD MC and Article 5(7) UN MC would indeed be of a merely declaratory manner. 351

This view, however, does not deserve our approval. **Every agent** (irrespective of whether he is an employee, a high-ranking manager, a commercial representative, an independent broker or a general commission agent) **pursues both the well-being of the principal and his own good.** Both independent and dependent agents receive part, but not all, of the surplus which the principal derives from the use of their activity in the source State (at the most, it is the composition of the agent's remuneration that sheds some light on his status as a dependent or independent agent; see *infra* m.no. 359 et seq. for details). Likewise, the dual pursuit is also visible to the third party. Contractual relationships between this third party and the agent are not required. All of these aspects support the view that there is no categorical difference between a dependent and an independent agent, and that the carve-out laid down in Article 5(6) OECD MC and Article 5(7) UN MC is more than a mere clarification. It marks just another PE threshold on a quantitative scale. 352

2. Persons Covered

The distinction between an ordinary agent (Article 5(5) OECD and UN MC) and an independent agent (Article 5(6) OECD MC and Article 5(7) UN MC) relies upon a **broad and indefinite variety of criteria**. None of these criteria constitutes an indispensable precondition for the classification of the agent's status. From a methodological viewpoint, however, the classification is relatively easy within the ambit of the two typical examples mentioned in Article 5(6) OECD MC and Article 5(7) UN MC (*infra* m.no. 354 et seq.). By contrast, where the two examples don't apply, the entire spectrum of criteria becomes relevant. 353

A broker is a person, corporate or non-corporate, who negotiates, arranges or concludes contracts in the name and on account of the enterprise. It is irrelevant which types of contracts are concerned. It is characteristic for a broker that he receives consideration for his activities and that his consideration is not fixed, but it depends on the number and volume of contracts arranged. 354

A **general commission agent** is a person, corporate or non-corporate, who negotiates or arranges contracts. By contrast, the commission agent will usually not have the legal power to conclude a contract on behalf of, and with binding effect to, his principal. 355

From a continental European law viewpoint, the explicit inclusion of brokers and general commission agents is redundant. Both types of (potential) agents **lack the authority to conclude contracts** and therefore do not fall under Article 5(5) OECD and UN MC.[154] For common law countries, or at least for the UK, the clarification might have been necessary, however.[155] 356

Where the agent is neither a broker nor a general commission agent, his status should be tested against the general attribute 'independent'. The decisive sub-criteria cover legal as well as economic aspects, and both aspects are indispensable (no. 37 OECD MC Comm. on Article 5). 357

154. Vogel, 3rd edn, Art. 5 at m.no. 168.
155. See for discussion Avery Jones, J.F. & Ward, D.A., et al., 38 *BTR* 341 (1993), and in 33 *ET* (Netherlands) 154 (1993).

358 The sub-criteria include, but are not limited to, the **autonomy** of the agent in:

- deciding on his **working time** (beginning, duration, end);
- deciding on the **place of work**;
- **negotiating the contractual details** with third persons, including most notably the purchase price.

Where the agent's commercial activities for the enterprise are subject to detailed instructions or to comprehensive control by the enterprise, such agent cannot be regarded as independent of the enterprise (no. 38 OECD MC Comm. on Article 5).

359 Further indicators in favour of an **independent** status include:

- a prevalence of **profit-based** or turnover-based elements determining the **remuneration** of the agent;[156]
- activities, simultaneously or consecutively, for **more than one principal**.

The 2nd sentence of Article 5(7) UN MC explicitly states that if an agent's activities are devoted wholly or almost wholly to one enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status. However, both elements of this rule reflect ideas common to all DTCs: the more principals an agent has, the more he is independent from one principal, and his independence is reflected by an arm's-length remuneration which reconciles the efforts made by the agent and the benefits to the principal (*supra* m.no. 352). For these reasons, both elements may function as indicators for the distinction between dependent and independent agents (though less categorical than under an explicit rule modelled after the 2nd sentence of Article 5(7) UN MC) and under all DTCs which follow the OECD MC.

360 By contrast, a strong presumption arises that an agent is **dependent** if the agent:

- forms an **integral part of the principal's staff** as an employee, or even functions as an owner, director, member of the board, or manager of the principal;
- is given a clear-cut **holiday entitlement**;
- is being paid by the principal on the basis of a **fixed salary** (with or without profit-related bonuses); and/or
- is being **paid pro rata temporis** (maybe even during periods of illness, maternity/parental leave or holiday).

361 As a rule, any consideration paid by the enterprise to the agent constitutes **deductible expenses** of the enterprise and, correspondingly, **taxable income of the agent**. As indicated above (*supra* m.no. 351), this applies irrespective of whether the agent is dependent or independent. In the absence of a PE (most notably in cases of independent agents under Article 5(6) OECD MC and Article 5(7) UN MC), the deduction of expenses might be available only in the State where the enterprise is resident (Article 4(1) to (3) OECD and UN MC), while any corresponding income of the independent agent is usually taxable in the State where he resides or where he maintains a PE or fixed base.

3. Acting in the Ordinary Course of One's Business

362 Where the agent qualifies as an independent agent (*supra* m.no. 353 et seq.), a PE is excluded only if the independent agent acts in the ordinary course of his business. The singular ('his business') does not imply that every person has one business only and/or that only one main activity out of two or more separate activities can qualify under Article 5(6) OECD MC and Article 5(7) UN MC. Rather, the term 'his business' refers to the aforementioned status of the

156. Notwithstanding the tax (or tax treaty) treatment of such remuneration. See *infra* m.no. 361.

person as a broker, general commissioner etc. It follows that a person can have **more than one status**; and that each activity should be assigned to the status that fits best. If this status does not qualify as the status of an independent agent under Article 5(6) OECD MC and Article 5(7) UN MC, the agent falls back to the 'ordinary' (i.e., dependent) agent under Article 5(5) OECD and UN MC.

Functionally, the **ordinary-course test** is therefore an important corrective for the status-related assignment of activities under the independent-agent test (*supra* m.no. 353 et seq.). 363

The identification of the ordinary course of business can be accomplished only by a scrutiny of the ordinary activities of the person concerned, not in an abstract manner on the basis of a **general vocational profile**.[157] This case-related view is reflected by a change in the OECD MC Comm. (no. 37 OECD MC Comm. on Art. 5 (previously, no. 36 of the 1977 OECD MC Comm.); emphasis added) from 'in the ordinary course of this business' to 'in the ordinary course of *his* business'. 364

If an independent agent exceeds the limits of the ordinary course of his business, the excess activities must be scrutinized against the background of Article 5(5) OECD and UN MC. They would, therefore, not constitute a PE of the principal unless the agent had **authority**, in law or in fact, **to conclude contracts** covering such **extraordinary transactions**, nor would they constitute a PE if they were merely activities of a preparatory or auxiliary character within the meaning of Article 5(4) OECD and UN MC.[158] 365

II. Divergent Country Practice

Given significant uncertainties in the characterization of an agent as dependent or independent, a number of States have decided to **abandon this distinction for certain sectors**. In doing so, they have added specific clauses to their PE Article. Corresponding attempts have been made in DTCs, for example, in the DTC between Belgium and Switzerland (inclusion of the activities of all insurance agents into the scope of agency PEs). 366

[vacant] 367-369

H. Article 5(7) OECD MC and Article 5(8) UN MC

I. The Models

1. Rule

Given that companies may qualify as agent PEs under Article 5(5) and (6) OECD MC or Article 5(5) and (7) UN MC (*supra* m.no. 305 et seq.), facilities of a subsidiary might function as a **PE of its parent company**. Vice versa, facilities of the parent company might, at least in some instances, constitute an agent **PE of the subsidiary**. Where a principal-agent relationship exists between affiliated companies, Article 5(7) OECD MC or Article 5(8) UN MC needs to be observed. In spite of the formal prominence which this proviso has gained when it was adopted in early Model Conventions,[159] it has a merely declaratory meaning and 370

157. See the German Bundesfinanzhof *BStBl.* II 626, 628 (1975); and Vogel, 3rd edn, Art. 5 at m.no. 172, with further case law.
158. See the concluding phrase of Art. 5(5) OECD MC as well as no. 38 OECD MC Comm. on Art. 5.
159. The proviso dates back to Art. 5(2) cl. 2 of the League of Nations Draft Convention No. 1a, Art. 2B(2) cl. 2 Draft Convention No. 1(b), and Art. 3(2) cl. 2 Draft Convention No. 1c, Double Taxation and Evasion. Report presented by the General Meeting of Government Experts, *Publications of the League of Nations II.* Economic and Financial (1928), II. 49 (October 1928) and was confirmed by

is legally superfluous. Its helps to avoid any specific misinterpretation of Article 5(1) to (6) OECD MC and Article 5(1) to (7) UN MC in cases where the potential PE is constituted by facilities or activities of a company affiliated with the taxpayer. With unimagined publicity, such misinterpretation was at dispute when the Italian *Corte Suprema di Cassazione* did acknowledge intra-group PEs in several *Philip Morris* cases.[160]

371 According to Article 5(7) OECD MC and Article 5(8) UN MC, the fact that a company which is a resident of a Contracting State **controls or is controlled** by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a PE or otherwise), shall **not** of itself **make either company a PE of the other**. But it remains possible that, by virtue of additional circumstances, the affiliated company meets the prerequisites of Article 5(1) to (6) OECD MC and Article 5(1) to (7) UN MC, and a PE can be created (see *infra* m.no. 394 et seq., for details).

2. The Textual Elements of Article 5(7) OECD MC and Article 5(8) UN MC

372 The term '**company**' has been defined in Article 3(1)(b) OECD and UN MC, and there is no doubt that Article 5(7) OECD MC and Article 5(8) UN MC covers all entities which meet this definition (see *supra* m.no. 315 et seq. for details and examples).

373 From the outset, Article 5(7) OECD MC and Article 5(8) UN MC has been phrased symmetrically into both directions in that it states that neither is the controlled company automatically a PE of the controlling company, nor is the controlling company automatically a (head office) PE of the controlled company. It has been held, however, that Article 5(7) OECD MC and Article 5(8) UN MC has an even broader scope, at least with regard to the controlling unit. In this regard, it has been assumed to apply also to **enterprises others than those covered by Article 3(1)(b) OECD and UN MC**[161] like, for example, an individual sole shareholder.

374 The term '**to control**' designates the right and/or a factual power of one company to make or to substantially influence all, or all major operational business decisions of the other company. This power does not have to be exercised. It is irrelevant whether one company is owned, directly or indirectly, by the other one, and/or by a common parent (or grandparent) company. Rather, Article 5(7) OECD MC and Article 5(8) UN MC covers all types of control, even if they have been established in the absence of a parent-subsidiary relationship, that is, simply by assuming an obligation to obey under private law (e.g., in a franchise relationship, in a landlord-tenant relationship or any fiduciary relationship).

3. Object and Purpose of Article 5(7) OECD MC and Article 5(8) UN MC

375 Eventually, however, due to the declaratory character of Article 5(7) OECD MC and Article 5(8) UN MC all of these textual elements are less essential than the textual elements of any other paragraph of Article 5 OECD and UN MC. It is rather the object and purpose

Art. V(8) of the Protocol to the Mexico (1943) and London (1946) Drafts of a League of Nations Model Tax Convention. It opposed the earlier League of Nations' view taken in 1927 that affiliated companies shall be regarded as PEs (see, e.g., Art. 5 of the Draft Model elaborated by the second experts' conference of 1927).

160. Corte Suprema di Cassazione of 7 March/25 May 2002, case no. 7682/02 – *Amministrazione Finanziaria vs. Philip Morris H BV*, 4 *ITLP* 903 (2002); of 7 March 2002, cases no. 3367 & 3368/02 – *Amministrazione Finanziaria vs. Philip Morris Germany GmbH et al.*, 4 *ITLP* 647 (2002); and of 25 January 2006, case no. 17206/06 – *UGE SA vs. Amministrazione Finanziaria di Arezzo*, 9 *ITLP* 345 (2006). See Trutalli, F., 42 *ET* 364 et seq. (2002); Ballancin, A., 2 *Diritto e Pratica Tributaria Internazionale* 953 et seq. (2002); Muizelaar, M., 18 *Emory International Tax Law Review* 211 and Wichmann, M., *StBJB* 100 (2004/05).

161. Vogel, 3rd edn, Art. 5 at m.no. 191; and id., in: V&L, 5th edn (2008), Art. 5 at m.no. 167.

of Article 5(7) OECD MC and Article 5(8) UN MC which should be taken into account in course of the interpretation of Article 5(1) to (6) OECD MC and Article 5(1) to (7) UN MC. The original intent of Article 5(7) OECD MC and Article 5(8) UN MC as an **'anti-single entity' clause**[162] was to safeguard the independence that each company has under tax law and tax treaty law (no. 40 OECD MC Comm. on Article 5). The position of each company as a separate and independent entity for the purposes of tax law as well as tax treaty law should neither be affected by its dependency under company law or under any other branch of law, nor by its actual economic dependency (cf. *supra* m.no. 3480. Neither is the controlling company a place of management PE (Article 5(2)(a) OECD and UN MC) of the controlled company.[163]

4. Consequences for Different Types of Group Taxation Schemes

376 When one tests the wide range of different systems of group taxation (including fully consolidated groups with a **deferral of capital gains/losses in intra-group transactions**, *Organschaft* concepts where no such deferral is granted, group contribution schemes, group relief systems with an internal transferability of losses etc.[164]) against the sophisticated rules of Article 5 OECD and UN MC, it becomes apparent that the issue of whether an enterprise maintains a PE follows quite different patterns.

a. Full Consolidation Schemes

377 In full consolidation cases, the distinction between the two companies has become merely formal, because under domestic tax law, both are regarded as a **fully consolidated unit** for each single business transaction. In these instances (unlike under systems which still require a separate determination of profits for each entity and then balance these separate results), it is the unit that constitutes the 'resident' under Articles 7(1) and (2), 4(1) and (3), 3(1)(a) and (b) OECD and UN MC. As a rule, this one single enterprise will usually have POB PEs in each State in which either the head office or one of the subsidiaries has its place of management, or any other facility which meets the prerequisites of Article 5(1) to (3) OECD and UN MC.

378 It should be noted, however, that for the tests required under **Article 5(4) OECD and UN MC** in general, and Article 5(4)(e) and (f) in particular, a relative perspective applies by which the characterization of an activity as 'auxiliary' depends on the main business of the respective enterprise. With regard to this test, it is the **group as a whole** (i.e., the fully consolidated tax unit, not the single company established under private law) which serves as the point of reference. It follows Article 5(4) OECD and UN MC is more likely to apply to a consolidated group than to a non-consolidated group, where the relevance of each POB is to be determined by way of comparison to the activity of the respective private-law company (subsidiary) only. This is particularly important if the group consists of functionally separated (not just geographically separated) subsidiaries.

379 Moreover, if the existence of the **subsidiaries is faded out for the purposes of tax law** (Article 1, read in connection with Articles 3(1)(a) and (b) and 4(1) and (3) OECD and UN MC) and it is only the fully consolidated group as such that constitutes a taxpayer, one may doubt whether any of the private-law companies involved can still constitute an agent of the enterprise under Article 5(5) OECD and UN MC. Both a literal interpretation of Article 5(5)

162. See Vogel, 3rd edn, Art. 5 at m.no. 189.

163. Id. at m.no. 190.

164. Typologies and overviews have been developed by Endres, D., 31 *Intertax* 349 et seq. (2003); Masui, Y., *CDFI* vol. 89b (2004), at 1 et seq. for an overview.

OECD and UN MC as well as the object and purpose of Article 5(5) support a positive answer, however.

380 The term **'person'** in Article 5(5) OECD and UN MC is connected to the definition of this term in Article 3(1)(a) OECD and UN MC and, indirectly, to the term 'company' in Article 3(1)(b) OECD and UN MC. Under this definition, all bodies corporate constitute a company, irrespective of whether or not they are taxable entities. It is true that Article 3(1)(b) OECD and UN MC does require a treatment 'as a body corporate for tax purposes'. This requirement, however, applies to other 'entities' only (Article 3(1)(b), 2nd case OECD and UN MC). Unlike the definition of the term 'resident' in Article 4(1) OECD and UN MC, the definition of 'company' in Article 3(1)(b) OECD and UN MC does not contain a general requirement that the respective entity be a separate taxable entity.

381 Article 5(5) and (6) OECD MC and Article 5(5) and (7) UN MC distinguish between a **dependent** and an **independent agent**. Within a consolidated group, the degree of dependence is usually even higher than under other (ordinary) cases covered by Article 5(5) OECD and UN MC. It would be highly inconsistent to exclude just intra-group subsidiaries of all agents.

382 Within a group of companies that constitutes a fully consolidated unit under tax law, **each single company** can qualify **as an agent** under Article 5(5) OECD and UN MC if it contracts on behalf, or on account, of at least one other intra-group company.

383 Irrespective of which of the intra-group companies constitutes the PE (either by maintaining a fixed POB or by functioning as an agent), and which company receives the services rendered by the PE, it is always the group (or the head company, depending on the domestic law) which functions as the principal from a tax treaty perspective. Therefore, the PE will be attributed to the taxpayer enterprise as a whole.

b. Other Group Taxation Schemes

384 With regard to all other systems of group taxation (full attribution of each company's profits, after having been determined separately, to the head company and/or the group as such; partial attribution of profits or losses to any company within the group; loss relief etc.), the application of Article 5 OECD and UN MC remains **within the ordinary patterns**.

385 **The facilities** (POBs) of each intra-group company may qualify under Article 5(1) to (4) OECD and UN MC **as a PE of any other intra-group company**. It is crucial, however, that the POB is at the disposal of this other company and that only those activities qualify which, from an economic viewpoint, constitute affairs of this other company. Under Article 5(4) OECD and UN MC, the auxiliary character tests refer to the single company (subsidiary) only, not to the group.

386 Under Article 5(5) and (6) OECD MC and Article 5(5) and (7) UN MC, there is no doubt that each company would be able to function as an agent PE of another intra-group company.

387 Where one intra-group company (or more precisely, its facilities) constitute an intra-group PE under these rules, the PE shall be regarded as a **PE of one** (or more) **specific other intra-group companies only**. Unlike in the case of full consolidation (*supra* m.no. 377), it will not constitute a PE of the entire group.

5. Constellations of Cases

388 With regard to the circumstances which might overcome the Article 5(7) OECD MC and Article 5(8) UN MC rule, **two main groups of cases** can be identified, each of them showing a variety of possible constellations.

a. Sharing Locations

389 With regard to a POB PE (Article 5(1) to (3) OECD and UN MC), **one of the companies involved** might maintain an **office** or any similar representation **on the premises of the other company** (nos 41-42 OECD MC Comm. on Article 5). In this regard, the most popular constellation is that the controlling company sends an envoy to the controlled company who remains, both formally and in substance, on the payroll of the controlling company but moves into an office within the boundaries of the controlled company. If this POB is at his disposal (irrespective of whether the controlling company makes rental payments; see *supra* m.no. 102 et seq.) for a sufficient period of time (usually more than six months; see *supra* m.no. 68 et seq.), it will constitute a PE of the controlling company under Article 5(1) and (2)(c) OECD and UN MC if the activities of the envoy are, and remain, part of the ordinary business of the controlling company (no. 4.3 OECD MC Comm. on Article 5).

390 Article 5(7) OECD MC and Article 5(8) UN MC suggests that no PE will be created if the envoy confines himself to **controlling and supervising the host company**. Rather, the envoy has to engage in the operational business of the controlling company. This does not necessarily imply any business contacts to third parties (suppliers or customers). However, the activities have to go beyond the thresholds marked by Article 5(4) OECD and UN MC.

391 In turn, where the controlling company **accommodates managers** or **employees** of the controlled company, and allows or requests them to use an office within the boundaries of the controlling company, such office will constitute a PE of the controlled company under Article 5(1), read in connection with Article 5(2)(a) and (c) OECD and UN MC.

392 No PE is created where employees of one company are **hired-out to the other company** and perform an activity that is **essentially the own business** of this other company. Like most other elements of Article 5 OECD and UN MC (*supra* m.nos 143, 210, 217 and 331), the crucial distinction between 'own' and 'external' businesses follows a substance-over-form analysis. Duties and rights created by contract are not controlling. The decisive criteria are of economic nature, that is, the functions and risks assigned to the respective companies. Even though such assignment of functions and risks needs to be made particularly and separately for the purposes of Article 5 OECD MC, it might follow the rules set forth in the context of intra-enterprise assignments in Article 7(2) OECD MC and the Commentaries thereon (see *infra* Article 7 at m.no. 76 et seq.) as well as parallel rules in the context of Article 9 OECD MC.

b. Principle-Agent Tandems

393 The second group of cases is characterized by **fiduciary relationships** by virtue of which one company functions as an agent of the other company. Here, the general prerequisites of agent PEs under Article 5(5) OECD and UN MC (*supra* m.no. 305 et seq.) apply. As long as the agent company does not disqualify under Article 5(6) OECD MC and Article 5(7) UN MC, it can constitute a deemed PE of its affiliates, even if this affiliate company does not use any facilities of the agent company.

6. Participation in Controlled Foreign Corporations (CFCs)

394 A further consequence of Article 5(7) OECD MC and Article 5(8) UN MC is that Article 5 OECD and UN MC does not usually cover passive participations which a resident of one Contracting State holds in a controlled foreign corporation (CFC) in the other Contracting

State.[165] This applies **irrespective** of how the **domestic tax law** of the State of residence has designed (if at all) its CFC regime.

395 This goes without saying if the State of residence follows a **deemed-dividend approach**. In that case, the imputed income derived by the taxpayer from its participation in the CFC will usually fall under the regime of Articles 10 and 23A(2) or 23B(1) OECD and UN MC, even if the taxpayer does not hold the shares as a private investment but has assigned them to the sphere of an enterprise maintained in the State of residence.

396 But even if the State of residence follows a different approach and **imputes income** (or certain types or items of income, for example, passive income) which has been **derived by the CFC directly to the taxpayer**,[166] the CFC and its facilities do not automatically constitute a PE of the taxpayer. Neither the domestic law of the State of residence nor the one of the source State override the PE definition contained in a DTC in this respect. In the absence of factual circumstances which might constitute a PE of the taxpayer in the State where the CFC is located, it is the CFC State which has exclusive taxing rights, under the 1st sentence of Article 7(1) OECD and UN MC, for the undistributed profits derived by the CFC as such. It is only where the DTC at issue contains particular CFC provisos or where a general anti-abuse proviso applies (explicit or implied) that the State of which the taxpayer is a resident may apply its domestic CFC regime.

II. Divergent Country Practice

397 For the multitude of national deviations from the OECD and UN MC, see R/S/O (3rd edn, 2014), Country Reports.

I. Service PEs and Similar Concepts

I. Fundaments

398 For many decades, there was a consensus among OECD Member States that the **provision of services** within the **territory of the source State** by a **non-resident taxpayer** should not in itself constitute a PE under Article 5(1) OECD MC.[167] Services are intangible and often invisible for the tax authorities of the source State. For these reasons, the OECD required the existence of a fixed place of business (Article 5(1) OECD MC) or a fixed base, respectively (Article 14(1) OECD MC until 2000).

399 In the traditional design and interpretation of Articles 5 and 14 OECD MC, clauses like Article 5(3) and Article 5(5) have been regarded as **exceptions to this general rule** (see *supra* m.nos 176 et seq., 305 et seq.).[168] This distinction became particularly clear in the light of **Article 5(3)(b) UN MC** which, since its first release in 1980, has stipulated that the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose shall constitute a PE if activities of that nature have continued (for the same or a connected project) within the country for a period

165. Cf. no. 14 of the 2010 OECD MC Commentary on Art. 7, as phrased by the 2010 Update to the OECD MC, published on 22 Jul. 2010.
166. For this concept of a 'piercing the veil approach', see Michael Lang et al., *CFC Legislation, Tax Treaties and EC Law* (2004); Alexander Rust, *Die Hinzurechnungsbesteuerung* (2007), at 55 et seq.
167. On the taxation of services, see the General and National Reports in IFA (ed.), 'Taxation of payments to non-residents for independent personal services', *CDFI* vol. 67b (1982); Joos, C., *Technische Dienstleistungen im internationalen Steuerrecht* (1995). For further overview on the issues of service PEs, see Bendlinger, S., 17 *SWI* 151 et seq. (2007); and Loose, F., *Die StbG* 127 et seq. (2007).
168. See, e.g., Ghijsen, J.C., *WFR* 925 et seq (2004).

or periods aggregating **more than six months within any twelve-month period** (see *infra* m.no. 420 et seq.).[169] In 1980, the authors of the UN MC hoped that this rule would be regarded as a clarification of, rather than a substantial deviation from, Article 5(1) OECD MC.[170] In the two decades after 1980, however, OECD's Committee on Fiscal Affairs refrained from amending the OECD MC accordingly. It follows, at least at first glance, that the literal deviation of the OECD MC from Article 5(3)(b) UN MC corresponds to a deviation in substance.

In the eyes of many scholars, however, the traditional rules contained in the OECD and UN **400** MC have appeared as a severe **asymmetry within the system of Article 5**. Article 5(5) OECD and UN MC explicitly provides that the activity of a dependent agent to conclude contracts in the name, and to the benefit, of a non-resident taxpayer constitute a (deemed) PE of this taxpayer, irrespective of the types of facilities they use in the source State (*supra* m.no. 305 et seq.). By contrast, other equally valuable activities do not constitute a deemed PE in the absence of a fixed place of business. Moreover, even within the sphere of the activity to conclude contracts, the rules lead to the paradoxal result that enterprises who derive only parts of their profits through a dependent agent in the source State (most notably, through an employee) pay taxes there, while a sole entrepreneur who may even earn his entire profits in that State will remain taxable exclusively in the State of residence. This difference has always been considered an unjustified inconsistency.[171]

The deletion of Article 14 OECD MC marked the beginning of a smooth development **401** towards a **recognition of pure service PEs** and, in so doing, a reconciliation:

- of Article 5(1) OECD MC with **Article 5(3)(b) UN MC**; as well as
- of Article 5(1) OECD MC with **Article 5(3) and Article 5(5) OECD MC**.

In 2003, new nos 4.1 to 4.6 were inserted in the OECD MC Comm. on Article 5. These **402** insertions give four different examples of when the provision of services will or will not constitute a PE. The solutions of the first three examples are commonly regarded as convincing, and along the lines of a generally agreed interpretation of Article 5(1) OECD MC:

- a **salesman** who regularly visits a major customer to take orders, and **meets the purchasing director in his office** to do so, does not constitute a PE (no. 4.2 OECD MC Comm. on Article 5);
- an **employee of a parent company** who is allowed to use an **office in the headquarters** of a subsidiary for a long period of time in order to ensure that the subsidiary company complies with its contractual obligations to the parent company constitutes a PE (no. 4.3 OECD MC Comm. on Article 5); and
- a **road transportation enterprise** which uses 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 does not constitute a PE (no. 4.4 OECD MC Comm. on Article 5).

In addition, the OECD MC Comm. gives the example of a **painter** who, for **two years,** **403** spends **three days a week** in the large **office building** of its main client. The OECD conclusion that a PE of the painter exists (no. 4.5 OECD MC Comm. on Article 5) has invoked long-lasting disputes. As indicated *supra* m.no. 124 et seq., OECD's interpretation reflects an abridged and somewhat unhistorical concept of the functional integration requirement and, above all, ignores the ordinary meaning of the term 'through' in Article 5(1)

169. Unchanged in the 2001 UN Model Convention.
170. Cf. the language in the official Commentary on Art. 5(3)(b) of the 1980 UN MC ('which are not covered *specifically* in the OECD Model Convention').
171. See, e.g., Piltz, D., 13 *IStR* (2004): 181 et seq.; Görl, M., 'Die Vertreterbetriebsstätte der Doppelbesteuerungsabkommen – ein Geburtsfehler des Art. 5 OECD-MA', in Strunk *et al.* (eds), *Unternehmenssteuerrecht und Internationales Steuerrecht. Gedächtnisschrift für Dirk Krüger* (2006), at 113 et seq.; and Reimer, E., 18 *IStR* 380 (2009).

OECD MC since 1977. For the reasons mentioned above, your author does not agree with OECD's solution of the painter example under the present wording of Article 5(1) or (3) OECD MC, given that the service provider does not make use of a fixed place of business.

404 It should be noted, however, that a much more positive result is achieved from a treaty policy viewpoint, given that a painter's work on, and to the benefit of, immovable property is attached to the territory of this property as closely as lease payments, **income from usufruct** or any other items of income covered by Article 6(1) and (3) OECD MC. Given that the latter are subject to taxation by the source State without any minimum time requirements, it is fair to assign income derived by the painter to the source State as well (for alternative clauses and a corresponding clause drafted by the OECD (nos 42.23 and 42.45 OECD MC Comm. on Article 5)). However, these treaty policy aspects leave the interpretation of the existing OECD MC as well as the existing bilateral DTCs completely unaffected.

II. Alternative OECD Proposal (No. 42.23 OECD MC Comm. on Article 5)

405 It is plausible and deserves approval that OECD, in its **2008 update of the OECD MC Comm.**, has reflected the concept of **service PEs** on the level of Article 5(1) OECD MC in more detail,[172] attaching great importance to practical issues of administrability as well as compliance on the side of the taxpayer. Acknowledging the limits of the wording of the Model itself, the Committee of Fiscal Affairs has offered an additional (optional) paragraph on service PEs (no. 42.23 OECD MC Comm. on Art. 5). States wishing to do so might insert the following wording after the existing Article 5(3):

> 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.

172. On 18 July 2008, new nos 42.11 to 42.48 have been inserted to the OECD MC Comm. on Art. 5. These amendments have been prepared by a public discussion draft by the OECD, *The Tax Treaty Treatment of Services* of 8 December 2006, Internet: <www.oecd.org/tax/treaties/37811491.pdf>. For details on the final release see Jirousek, H., *ÖStZ* 195 et seq. (2009), (issue 8).

1. Relation to the Other Paragraphs of Article 5 OECD MC

It is evident that this rule would be redundant if its substance were already contained in Article 5(1) OECD MC. The existence of the alternative rule is not only due to the **clear-cut quantitative thresholds** (183-day rules; 50 per cent gross revenue rule) but brings about a **substantial broadening of the PE notion**. This might suggest that no. 42.23 of the OECD Comm. can function as a rampart against a too broad interpretation of Article 5(1) OECD MC. Still, the OECD is more reluctant. The Commentary stresses that there should be no repercussions on the interpretation of Article 5(1) and (2) OECD MC.[173] 406

The same goes for the relation of the **service PE** rule to Article 5(3) OECD MC. However, the service PE rule in no. 42.23 OECD MC Comm. constitutes an umbrella for all types of service PEs including construction sites and installation projects. If a bilateral DTC provides different time thresholds in the service PE clause and in the Article 5(3)-like clause on construction sites, the shorter of the two periods will be decisive (no. 42.27 OECD MC Comm. on Article 5).[174] 407

Like Article 5(1) to (3) OECD MC and dependent agents (Article 5(5) OECD MC), the (deemed) service PE is subject to the de **minimis carve-out** in Article 5(4) OECD MC. In this respect, the concluding words of the 1st sentence of no. 42.23 OECD MC Comm. achieve full consistency (see also no. 42.48 OECD MC Comm. on Article 5). 408

2. 183-Day Rules

Both alternatives of the service PE provision in no. 42.23 OECD MC Comm. require that a period or periods exceeding in the aggregate **183 days in any twelve-month period** have elapsed. These two (literally identical) 183-day rules are modelled after Article 15(2)(a) OECD MC. Their computation is neither linked to the calendar year nor to calendar months but only to calendar days. The starting points are different, however, for the two alternatives of no. 42.23 OECD MC Comm. In letter (a), the entry of the individual to the source State is decisive, whereas letter (b) requires that the person(s) have started to perform the services in course of a specific project (*infra* m.no. 413). 409

Example.[175] If an employee of the taxpayer (a large consulting company) has travelled to State S on 5 January at 6 p.m., spends a two-week ski holiday there and starts working on 20 January at 9 a.m. without any further holidays or other interrupt (except weekends), the period under letter (a) will start on 5 January at 0 p.m. and elapse on the end of the 183rd day thereafter. Therefore, State S obtains taxing rights under the **2nd sentence of Article 7(1) OECD MC** for the entire period if the taxpayer remains present in that State on or after 7 July, irrespective of whether she works on one single projects or several unconnected projects. In contrast, if she leaves on or before 6 July, exclusive taxation remains with the State of residence (1st sentence of Article 7(1) OECD MC). However, if she has been replaced in April by two colleagues who work on the same project, or on one or more connected projects (*infra* m.no. 413), she will not constitute a deemed PE under (a) of the service PE clause. Rather, the decisive criterion is whether the new team (or its successors) will remain in State S on or after 22 July. If they leave on or before 21 July, the preconditions of (b) have not been met either. 410

Interrupts **do not require** that the 183-day period **starts anew**. Rather, the words 'in the aggregate' indicate that any interrupt will prolong the periods under both (a) and (b). Therefore, if the employee (*supra* m.no. 409) has returned to her State of residence for ten full calendar days, the preconditions of (a) will be met only after 16 July etc. 411

173. Nos 42.24-42.26 OECD MC Comm. on Art. 5 ('obviously cannot limit the scope of the definition in paragraph 1 and of the examples in paragraph 2').
174. A different view is held by Bayer, A., *ÖStZ* 507 (2013).
175. For further examples, see nos 42.38 and 42.44 OECD MC Comm. on Art. 5.

412 Weekends and bank holidays do not pose any problems under (a). If the taxpayer remains in State S, the period is not interrupted. The same goes even for a **lengthy private holiday** which she spends in State S itself, given that the timing requirement of (a) tie to physical presence (not the performing of services) in that State. With regard to (b), however, **any interrupt will prolong the minimum period** by those calendar days on which no services are performed. Given the focus on 'working days of [the] individuals' (cf. no. 42.42 OECD MC Comm. on Article 5), the existence of general non-working days (weekends, bank holidays) should be ignored. Like under Article 15,[176] a full calendar week should therefore count as seven (not only five or six) days. The same goes for idle stand-by time which, too, counts as working time (no. 42.42 OECD MC Comm. on Article 5).

3. Project

413 More difficulties are triggered by the reference, contained in (b) of the service PE clause, to one or more projects. The notion of project is not clear-cut.[177] The rule on 'connected projects' suggests that the term 'project' alone designates a **homogeneous, usually output-related activity**. From a methodological viewpoint, it is recommended to apply similar criteria to those for relocated or roaming facilities under Article 5(1) (For details, see *supra* m.no. 59 et seq.).

414 Two (or more) projects are connected if there is **commercial coherence** (no. 42.41 OECD MC Comm. on Article 5). This requirement is met where the taxpayer can realize synergy effects from the combination or accumulation of the single projects. Inter alia, the connecting factors can be human resources (same employees, same training units), working instruments (same tools or equipment), or customers (same recipient of different types of services). It is not required, however, that the projects are of the same or similar kind.

4. Significant People

415 While the physical presence rule in (a) of the (deemed) service PE provision in no. 42.23 OECD MC Comm. focuses on one single individual (though she need not necessary be the taxpayer entrepreneur to whom the deemed PE is assigned under Articles 5 and 7 OECD MC), (b) of this rule allows and requires a cumulative view **on one or more individuals** if they are **connected by project(s)**.

416 In both cases, however, individuals will qualify only if they are identical to, or part of a **special relationship** with, the **taxpayer enterprise**. Typically, this special relationship is an employment. Still, services performed by any other dependent individual will be equally sufficient. Unlike under Article 5(5) OECD MC, this person is not required to conclude contracts in the name of the taxpayer. However, the criteria used under Article 5(6) OECD MC for distinguishing qualifying (= dependent) agents from independent entities may be used here, too.[178] Subcontractors and their staff will therefore not constitute a service PE of the principal under the (deemed) service PE rule in no. 42.23 OECD MC Comm. unless they are economically integrated into the enterprise of the taxpayer with regard to supervision, direction and control (no. 42.43 OECD MC Comm. on Article 5) or unless both enterprises (employers) are under the joint control, directly or indirectly, of a third person. These standards apply irrespective of whether or not the subcontractor, or the company that has

176. Cf. no. 5 OECD MC Comm. on Art. 15 (though for a physical presence test).
177. See, e.g., Rosenberger, F. & Vitali, M. & Ziehr, U., 19 *IStR Beih.* 6 (2010); Ditz, X. & Quilitzsch, C., 84 *FR* 494 (2012).
178. For details, see no. 42.43 OECD MC Comm. on Art. 5.

employed the individuals, is an unrelated (third) party or forms part of the same group of associated enterprises (companies) as the taxpayer enterprise itself (no. 42.43 OECD MC Comm. on Article 5).

5. 50 Per Cent Rule

417 The project rule laid down in (a) of the (deemed) service PE clause in No. 42.23 OECD MC Comm. applies only where the services of the individual contribute **at least 50 per cent to the taxpayer's overall** (world-wide) **gross revenue** of the period during which the other requirements of this rule are met. The determination of this quota (and any pertaining computation) is primarily up to the source State.

418 Under Article 3(2) OECD MC, this State is entitled and obliged to interpret the terms '**gross revenue**' and '**active business activities**' which apply to the denominator consistent with its own domestic law. The same applies to the personal attribution of the single items of profit (to the taxpayer or to a third person) and to their temporal allocation. Subject to violations of the general good-faith principle (cf. Art. 31(1) VCLT), the State of residence is bound to this characterization, computation, attribution and allocation.

419 By contrast, the terms '**derived from the services performed**' which determine the numerator of the quota shall be interpreted along the lines of Article 7(2) OECD MC and the corresponding rules of the bilateral DTC concerned. Here, the context of the treaty requires consistency with the rules on the attribution of profits. It follows that no direct recourse shall be made from the (deemed) service PE clause to the domestic law of either State under Article 3(2) OECD MC.

III. Article 5(3)(b) UN MC

420 As mentioned *supra* m.no. 399, Article 5(3)(b) UN MC regards the **furnishing of services**, including **consultancy services**, by an enterprise through employees or other personnel engaged by the enterprise for such purpose as a deemed PE. This characterization, too, deviates from Article 5(1) OECD MC. While both MCs require a business activity, the OECD MC ties such activity to the existence (and use) of a fixed POB, whereas Article 5(3)(b) UN MC requests that the activity is exercised for a minimum period. The UN MC abandons geographical fixation (*supra* m.no. 45 et seq.) and concentrates on temporal permanence, though in a more precise manner than Article 5(1) OECD MC (*supra* m.no. 65). Article 5(3)(b) UN MC has not modelled the time requirements after the building and construction clause (Article 5(3) OECD MC, and Article 5(3)(a) UN MC) but (like Article 15(2)(a) OECD and UN MC) comprises a clear-cut tolerance for interruptions of the services.

421 Again consistent with the **183-day rule** in Article 15(2)(a) OECD and UN MC, a service PE is deemed to exist if activities (*supra* m.no. 402) of that nature are carried out in the source State for a period or periods aggregating more than six months within any twelve-month period. Although the term '*permanent* establishment' in the title of Article 5 requires a high degree of persistence also with regard to deemed (service) PEs, the activity need not be uninterrupted. It is sufficient that the services are carried out on a regular basis (No. 7 UN MC Comm. on Article 5). Some countries have agreed on different time thresholds in their bilateral DTCs.[179]

422 Moreover, Article 5(3)(b) UN MC requires that only **homogeneous activities** qualify. This applies in a threefold manner. First, the activities need to be of the **same 'nature'**, that is, they should look alike. Secondly, the activities need to be carried on **'within a Contracting State'**. The indefinite article 'a' should be understood as 'one and the same' – otherwise, the time

179. See, e.g., Art. 5(3)(b) of the DTC between the People's Republic of China and South Africa (twelve months within any twenty-four month period).

threshold would make little sense. Thirdly, the activities need to be carried on for the **same or a connected project**. See *supra* m.no. 402.

IV. Use of Substantial Equipment as a Deemed PE

423 Some bilateral DTCs rule that the use of substantial equipment for, or under contract with, the enterprise shall be deemed as a PE.[180] **Rooted** in **Australian domestic law**,[181] these clauses are placed at the intersection of Article 5(1) OECD and UN MC (*supra* m.no. 12 et seq.), Article 5(3) OECD MC (Article 5(3)(a) UN MC; *supra* m.no. 245 et seq.), and rules on **pure service PEs** (no. 42.23 OECD MC Comm. and Article 5(3)(b) UN MC; *supra* m.no. 398 et seq.). Like Article 5(1) OECD and UN MC, they connect the requirements of human activities to certain requirements on one or more assets controlled by the taxpayer. Still, they do not require that these assets be immovable (like the POB), fixed and permanent. In any case, they are usually designed with a view to the exploration and exploitation of natural resources[182].

1. Equipment

424 Since the notion of 'equipment' is relatively vague and open, it has been specified by attributes like '**substantia**l' or '**heavy**'. Alternatively, some Australian DTCs refer to 'machinery' instead of 'equipment', while the Israel/US DTC refers to 'equipment or machinery' in a parallel manner. The variety of language is a helpful means to scrutinize the meaning, or at least to set limits to the semantic field, of each of these terms.

2. Use

425 Likewise, the verbs vary. Most DTCs with a 'substantial equipment' clause employ the term 'use'. As in Article 5(4)(a) OECD and UN MC, this term implies that the asset is **functionally integrated into the enterprise** as an operating asset and not (or not only) as a product manufactured or traded by the taxpayer. Moreover, the persistent opposition of 'use' to 'alienation' in the international tax language (*infra* Article 6 at m.no. 162 et seq.) suggests that 'use' does not include the alienation of this operating asset. Thus, any equipment that was part of the taxpayer's operating assets in the State or residence (or assigned to a third-country PE) before and is now being brought to the other Contracting State for the sole purpose of being alienated is no longer 'used'. Consequently, it does not qualify as a (deemed) PE under the 'substantial equipment' clauses.

426 Alternatively or cumulatively, some DTCs require a **mere 'maintenance'** of the equipment by the taxpayer.[183] This term ties in with Article 5(4)(b) to (f) OECD and UN MC and should be interpreted as a synonym to the term 'maintenance' in these (negative) examples. Even though maintenance, too, excludes traded goods or any other circulating

180. See, e.g., Art. 4(3)(b) of Australia's DTC with Singapore (1989): 'An enterprise of a Contracting State shall be deemed to have a permanent establishment and to carry on trade or business through a permanent establishment in another Contracting State if … substantial equipment is being used in that other State by, for or under contract with the enterprise.'
181. ITAA 1936, s. 6(1)(b). See Collins & Robinson, 'Australia', in: R/S/O at m.no. 35.
182. Hamad, A., 35 *ATR* 52, 75 (2006); Collins & Robinson, *loc. cit.*, at m.no. 84.
183. E.g., Art. 5(2)(j) of the Israel/US DTC includes 'the maintenance of substantial equipment or machinery within a Contracting State for a period of more than 6 months' in its list of typical PEs. Similarly, Art. 5(4)(b) of the Australia/US DTC requires that the enterprise 'maintains substantial equipment for rental or other purposes within that other State (excluding equipment let under a hire-purchase agreement) for a period of more than 12 months'.

capital, it is less than a use. Even passive investment without any functional integration of the equipment into the value-adding process can qualify as a 'maintenance'.

3. Time Requirements

427 While most DTCs that contain a 'substantial equipment' clause do not provide for minimum time requirements, some DTCs include such **temporal thresholds**, often aligned with the six-months standard in no. 6 OECD MC Comm. on Article 5 (*supra* m.no. 67 et seq.)[184] or the twelve-month standard in Article 5(3) OECD MC.[185]

4. Control by the Taxpayer

428 In any case, the asset qualifies as a PE of the taxpayer only where it shows a qualified relation to her. Where the 'substantial equipment' clauses employ the verb 'use', the taxpayer needs to **have full factual control** over the equipment in the same manner as under Article 5(1) OECD and UN MC (*supra* m.no. 102 et seq.). However, some bilateral DTCs have added that the equipment be used 'by, for or under contract with the [taxpayer] enterprise'.[186] In these instances, the genuine content of the verb 'use' is partly overwritten by less strict requirements. Most notably, it will suffice if a third person (e.g., a subcontractor) exercises factual control over the equipment.

5. Functional Integration

429 Furthermore, the term 'use' as such implies that the taxpayer needs to work with the substantial equipment, i.e., that the equipment functions as a means, tool or instrument '**through which**' (cf. Article 5(1) OECD and UN MC) the taxpayer carries out her business. In this regard, the same standards apply as under the basic rule for POBs laid down in Article 5(1) OECD and UN MC (*supra* m.no. 124 et seq.). Where, however, the DTC provides that the equipment be used 'by, for or under contract with the [taxpayer] enterprise', the strict requirements are eased.

J. Excursus: The Concept of a 'Fixed Base' (Ex-Article 14 OECD MC)

430 For **freelance professionals** who perform independent personal services or other activities of an independent character, **Article 14 OECD MC** had contained, since 1963, a separate distributive rule.[187] Although this rule was deleted on 29 April 2000, it can still be found in the majority of DTCs world-wide.

431 The substantive scope of Article 14 OECD MC (as it read before 29 April 2000) was modelled after continental European classifications which have always distinguished between **commercial** or **entrepreneurial activities** (industry, trade, or 'lower services' of craftsmen) on the one hand, and **independent 'free' professional services** based on higher education on the other hand. While the first type of activities has always been covered by Article 7, the second type was subject to the abbreviated distributive rule of Article 14. According to

184. E.g., Art. 5(2)(j) and Art. 5(3)(g) of the Israel/US DTC (*supra* fn 270).
185. E.g., Art. 5(4)(b) of the Australia/US DTC.
186. E.g., Art. 4(3)(b) of the Australia/Singapore DTC.
187. This was in line with a long tradition of tax treaties and Model Conventions. Cf., *inter alia*, Art. VII (4) of the 1943 Mexico Draft MC and Art. VI(4) of the 1946 London Draft MC.

Article 14(2), the term 'professional services' included especially independent scientific, literary, artistic, educational or teaching activities, as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

432 Like the 1st sentence of Article 7(1) OECD MC, Article 14 OECD MC provided for exclusive taxation by the State of residence, as far as the taxpayer was **not acting through a fixed POB** in the other Contracting State. If he did so, however, primary taxing rights were assigned to this other State with regard to all profits attributable to the fixed POB situated therein.

433 While most **pre-World War II treaties and Models** used the term 'permanent establishment' for this POB,[188] later texts have employed the term 'fixed base' (FB) to describe the decisive threshold for the taxation of income from independent personal services rendered abroad.

434 Under the **OECD** there were **no intended differences** between the PE concept as used in Article 7 and the FB concept as used in Article 14, or between how profits were computed and tax was calculated under Article 7 OECD MC and Article 14. Therefore, the elimination of Article 14 in 2000 meant that the PE definition became applicable to what previously constituted a FB (no. 1.1 OECD MC Comm. on Article 5).

K. Outlook

I. Merits of the PE Concept

435 In its triple function, the PE threshold is a well-proven concept. It ensures that investors are given an **easy opportunity to get accustomed** to a **foreign market** first, before they need to comply with comprehensive duties under tax and accounting law. In terms of tax procedure and auditing requirements, the PE threshold **relieves** the tax administration of the source State from **identifying, contacting and auditing non-resident persons** who have little or no physical presence in that State. Unlike personal performances (e.g., of entertainers and sportspersons: Article 17 OECD and UN MC), business income may be economically sourced in a State even if neither the entrepreneur nor his employees or agents have ever entered the territory of that State. It may be impossible to collect information or taxes from these non-resident entrepreneurs. The combat against the danger of double non-taxation constitutes the second main justification of the PE principle.

II. Tendencies to Lower the PE Threshold

436 With the rise of the **digital economy** and the efforts of the OECD to acquire new members, the OECD Committee on Fiscal Affairs has reconsidered a **broadening of the PE** concept in the interest of **service-importing countries**. Any exaggerated broadening of the PE criterion might, however, discourage enterprises in industrialized countries from engaging in certain business activities in other countries.[189] Also from a systematic point of view, the fact that a PE is set on equal footing with a distinct and functionally separate enterprise under Article 7(2) OECD MC suggests that Article 5 OECD MC assigns the PE status only to those places, establishments and activities which could also be imagined as places, establishments or activities of an independent and separate company.

188. For an early Austrian/Czech DTC, early German DTCs, and the DTC between Poland and the City of Danzig/Gdansk see Dorn, H., 1 VjSchR 207 (1927).
189. This has even been stressed by the UN *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (2003) at 72.

III. PE Concept and Commutative Justice between the State Parties

437 In the concrete case of bilateral treaty negotiations, the design of the PE concept gains tremendous impact where **economic relations** between the two Contracting States are **asymmetric**. This is particularly true for DTCs between developed and developing countries. For these DTCs, the PE definition is the **most important element** for the allocation of taxation between the two Contracting States. Among the most seriously negotiated criteria are the acknowledgment and the concrete design of **service PEs** (Article 5(1) to (3) OECD and UN MC, see *supra* 398 et seq.) including the minimum duration for building and construction sites in Article 5(3) OECD and UN MC (see *supra* m.no. 173 et seq.), the negative list (Article 5(4) OECD and UN MC, see *supra* m.no. 247 et seq.), and the list of positive examples (Article 5(2) OECD MC, see *supra* m.no. 155 et seq.).