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I. Introduction

1. At the second session of the Committee of Experts on International Cooperation in Tax Matters, the subcommittee on the definition of permanent establishment was invited to continue its work with a mandate for the third session (2007) as follows (Report of the Committee's Second Annual Session, E/C.18/2006/10, paragraph 28):

> The subcommittee was invited to continue its work. Attention should primarily be paid to taxation of services related to articles 14 and 5 (including the possibility of deleting article 14 and adjusting article 5 to retain an appropriate balance of the taxing rights currently available under article 14) and to taxation of technical fees. As a subsidiary part of its work, the subcommittee will also address the question of taxation on a net or gross basis and the possible need for definition of the terms "business" and "enterprise". The subcommittee was mandated to propose a draft article and Commentary, reflecting both its further work and what was agreed during the session.

2. This paper is the second of the subcommittee's papers for consideration at the 2007 Annual Session of the Committee. The first paper (E/C. 18/2007/3) proposes a new Commentary for Article 5 that reflects its mandate for revising and updating the Article 5 Commentary as agreed at the 2006 Annual Session. This paper addresses the "further work" forming part of the subcommittee's mandate. The subcommittee has adopted a "staged" approach whereby the first paper addresses matters upon which there was general agreement at the 2006 Annual Session of the Committee and seeks to settle a draft Commentary based on that, while this paper addresses the further issues which are part of the subcommittee's mandate. Obviously that may lead to further Commentary changes, including to Article 5, either in the next or following versions of the UN Model, depending on the pace of this work and the timing of new versions of the UN Model. This paper therefore involves consideration of the following basic issues, which include the subsidiary issues mentioned in the mandate above (In this paper, references to Articles in the Model and paragraphs in the Commentaries on those Articles are references to Articles in the UN Model and the Commentaries thereon, unless otherwise indicated.):

- The treatment of Article 14, including possible deletion (Chapter 2) at paras 3 - 94

- The taxation of fees for technical services (Chapter 3) at paras 95 - 116

- The treatment of services generally (Chapter 4) at paras 117 - 120

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

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

(ii) Uncertainty about coverage of non-individuals

9. Another unclear area is the way Article 14 applies to different *persons*. The main issue is whether the Article applies to individuals only or whether it also applies to legal persons, such as companies. Another issue is to what extent it applies to partnerships.

10. One might think that the use of the pronoun "his", in Article 14(1), indicates that the Article should apply only to individuals. But that is not necessarily decisive: Article 4(1) applies both to individuals and to legal persons yet still uses the pronoun "his" when listing the criteria (including incorporation) that make a person liable to tax. Bringing the content of Article 14 into Article 5 would remedy this problem.

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

(iii) Unnecessarily differentiated treatment of professionals

12. It is notable that professionals incorporate more commonly now than they did when Article 14 was devised. So applying different rules to services depending on whether they are provided by an individual or a legal person, or having different articles if the rules are the

same, would seem hard to justify. That would therefore be another reason to eliminate Article 14.

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

(iv) Application to partnerships?

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

15. In the case of countries that treat partnerships as non-fiscally transparent, the result would probably be different, since, in that case, the problem of the application of Article 14 to legal persons would arise. Mixed partnerships (where some partners are individuals - natural persons - and some are legal persons) would create a problem if Article 14 were found to apply only to individuals. In that case, either the partners who are legal persons would be covered by Article 7 and the partners who are individuals would be covered by Article 14 or, alternatively, Article 14 would not apply to *any* partner where at least one partner was a legal person. Neither approach would be satisfactory. Eliminating Article 14 would remove these questions and uncertainties.

(v) Differences in time conditions

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

17. The parallel Article 14 condition is a little different. The period is expressed in days, and it is also not necessary for the activities in the source State to continue for the full period: rather, the *individual's presence alone* is sufficient to give that State taxing rights "if his stay is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-

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

C Main arguments against deletion of Article 14 – a consideration

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

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

25. Those objecting to the deletion of Article 14 often note that it is not clear that the notion of "fixed base" and "permanent establishment" are synonymous, and that the latter may be a narrower term, so that there may be some loss of source country taxing rights in the change. On one such view, the degree of permanence of a fixed base is lower than that of a permanent establishment, based on the fact that a business must be carried on through a permanent establishment, while a fixed base need only be "regularly" available.)[2]

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

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

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

27. The OECD Report on Article 14[3] had earlier noted at paragraph 28:

> Notwithstanding any such theoretical differences, the Committee [of Fiscal Affairs] could not, in practice, find examples of fixed bases that would not be permanent establishments or vice-versa. The examples of 'fixed bases' found in paragraph 4 of the Commentary on Article 14, i.e. a physician's consulting room or the office of a lawyer or architect, would, for instance, equally constitute permanent establishments.

28. The subcommittee considered whether the same view could be taken in the UN Model context and was of the view that it could be: to make the changes suggested by the subcommittee at Annex 2 to this paper would not introduce into the UN Model a change in the balance of taxing rights to that existing under the OECD Model, but would rather retain the balance of taxing rights existing under the UN Model.

29. With this in mind, the subcommittee suggests that a similar paragraph be inserted in the UN Commentary to Article 7, possibly following current paragraph 6, as part of the next stage of the subcommittee's work. It should be noted that, in suggesting this and other specific wording in this paper the subcommittee is not asking for this wording to be considered at the

Note that paragraph 55 below elaborates on the last point mentioned in the suggested wording above, the option of preserving the current position with respect to Article 14.

30.

longer term measure. The subcommittee therefore proposes (as noted above, paragraph 29) that the Article 14 text and Commentary, and a list of changes to preserve the position under the 2001 version of the UN Model be provided as an Annex to the UN Model.

(ii) Is there a distinction in the *type* of income covered as between Articles 5 and 7?

35. As noted above (paragraph 6 ff.) one view is that Article 14 deals with types of income not addressed by Article 7, so that removal would jeopardise the taxation of professional service income, for example. The subcommittee decided that this should not prevent deletion of Article 14 if it was otherwise justified (as the subcommittee ultimately considered it was) but that the application of professional services would be preserved by appropriate changes to the definitions in Article 3. The more uncertain application to "other activities of an independent character" would also be preserved by explicitly making those activities part of the definition of "business" in Article 3. This would leave the expression's precise meaning undetermined, however, since the activities would fall within Article 7, like all other business income, it would not matter in practice. Nor would there be any alteration of the balance of taxing rights from such a change.

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

36. The Commentary on Article 14 states that the provisions of Article 7 and its Commentary could guide the interpretation and application of Article 14, and it expressly confirms the application to Article 14 of the provisions of Article 7(2) and (3). However, the text of Article 14 itself contains no explicit authority for such an approach. Many countries appear to consider that paragraphs 2 to 5 of Article 7 *are* applicable to income currently falling within Article 14. However, the elimination of Article 14 would make it unnecessary to clarify that position. An issue that is currently less clear, and which would also be helpfully resolved by the elimination of Article 14, would be whether the priority rule in ould 16l23(ry)-0on ivities of apersTw -11.153 Td6l23(ry181m)8(a)28.972s precise962 284s of

44. Article 24(3) provides as follows:

> The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

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

46. While Article 24(3) strictly only refers to permanent establishments, some commentators consider that the provision implicitly applies in Article 14 cases also. The general view in the subcommittee was that in any case the non-discrimination provision is an important part of the object and purpose of tax treaties of encouraging investment and that the application of the provision in analogous former Article 14 and current Article 5 cases is best viewed as an issue of consistency of application rather than an issue of the balance of source and residence State taxation rights. The subcommittee does not consider it is an issue likely to arise often in practice, in any case.

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

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

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

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

48. The subcommittee notes that Article 14(1)(c)

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

> Paragraph 2 … singles out several examples of what can be regarded, *prima facie*, as being permanent establishments… According to the OECD Commentary, it is assumed that the Contracting States interpret the terms listed "in such a way that such places of business constitute permanent establishments only if they meet the requirements of paragraph 1".

59. The subcommittee agrees with this statement, and notes that such an approach is widely accepted[8]. Issues such as the geographical and temporal "permanence" of the presence will, for example, still need to be considered. The point was made in the subcommittee's suggested Commentary changes at Annex 1 to its companion paper (E/C. 18/2007/3 - at para 4 and following of the proposed revised Commentary) but the matter could be clarified further by changes to the provision itself. The subcommittee considers that making such a clarification to the provision itself is justified among several other proposed changes and should not lead to any negative inferences about treaties using the current ("includes especially") wording.

60. Therefore, the subcommittee proposes a text which better reflects the legal position of the examples, while staying as close as possible to Article 5(2)'s current text: "Subject to the conditions of paragraph 1, the term 'permanent establishment' includes: …"

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

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

62. The subcommittee believes that Article 5(3)(a) is not intended to be a deeming provision. This follows from the history of that paragraph: construction activities etc. originate from Article 5(2) of the 1963 OECD Model, where it was one of the examples given (at subparagraph g). In 1977 the construction activities were moved from Article 5(2) to Article 5(3) of the OECD Model, in order to prevent giving support to the erroneous view that

Article 5(1) is not relevant in respect of that item. From that, those reading the Article could come to the wrong conclusion that the same approach may be taken to the other items listed in Article 5(2) - that is, that the normal paragraph (1) indicia of a 'fixed place of business" need not be shown. To avoid this misunderstanding, the construction permanent establishment provision was moved to a separate provision.

64. The OECD Commentaries (since 2003) accept Article 5(3) as a specific case of Article 5(1) (see paragraphs 4.5, 4.6 and 5.1 of the OECD Commentary on Article 5 OECD Model).[9] The subcommittee believes this is the correct view as far as the OECD Model is concerned: a construction site etc. is only a permanent establishment if the conditions of Article 5(1) are met (place of business, carry on business, at the disposal of the enterprise), apart from the time requirement which is replaced by the criterion of 12 months in that Model.

65. The UN Model provision, however, is differently worded: "The term 'permanent establishment' also encompasses" the specified situations and is less clearly linked to paragraph 1. In any case, the conditions of Article 5(1) are almost automatically met in construction site cases: a building contractor has the factual disposal of the place of business (this is inherent in the building contract with his principal), and carries on his business there.

66. The word *encompasses* (or its synonym *includes*) express this relationship of Article 5(3) to Article 5(1), if the OECD approach is taken in respect of the UN Model. Article 5(3) could thus read: "The term 'permanent establishment' also includes a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months."

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

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

69. The subcommittee considers, however, that, in the proper maintenance of the source State's taxing rights, that step is not necessary. However, it considers to make

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

71. For the reasons expressed in the next part

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

78. Whereas current Article 5(3)(a) requires a project of 6 months, and whereas Article 5(3)(b) has specific requirements related to the furnishing of services, the triggering condition of Article14(1)(b) is merely the presence of a person during 183 days in the working State (compare this requirement to the similar condition in Article 15(2)(a) dealing with dependent personal services). Therefore, the deletion of Article 14 also needs to be accompanied by a change to Article 5, in the absence of which source taxation rights would be reduced. As the OECD Model did not have an equivalent to Article 14(1)(b), the same issue did not arise in removal of Article 14 of the OECD Model.

79. As the 183 day activities test of Article 14 is best classified as a "deemed permanent establishment" when viewed in the context of Article 5 (as under paragraph 5 of that Article[10]), and not as a permanent establishment that is a special form of the ones referred to in Article 5(1) and based on general principles (as in the Article 5(2) examples), the subcommittee proposes placing this provision as Article 5(4)(b). The new provision would read:

> 4. A permanent establishment shall be deemed to exist where: [...]
> (b) an individual who is a resident of a Contracting State performs services in the other Contracting State and his stay in that other Contracting State is for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned.

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

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

81. Consequent upon what is currently paragraph 3 being split into paragraphs 3 and 4, paragraphs 4 to 8 of the current Model need to be renumbered as paragraphs 5 to 9.

82. Article 5(1) and (2) are of the same kind, being a definition at paragraph 1 and then examples assisting in the practical application of that definition. The current Article 5(5) reference to b): T(2223iNotwiTc 0 Tw 0 -g a d

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

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

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

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

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

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

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

86. Technically, the proposed inclusion of the existing Article 14(1)(a) (independent personal services through a fixed base) as Article 5(4)(b) is made fully effective by these two proposed additions to Article 3, the General Definitions Article. These changes ensure that the full range of activities that currently come within Article 14, including the rendering of professional services, would now come within Articles 5 and 7.

87. Guidance in achieving this is provided by the OECD Model, which brought Article 14

suggested Article 5(3) and Article 5(4)(a) without the extra wording, and that would be the same with the proposed changes.

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

93. Annex 2 contains the other UN Model Articles that need to be changed as a consequence of the proposed merger of Article 14 into Articles 5 and 7. The proposed changes are to Articles 6, 10, 11, 12, 13, 15, 17, 21 and 22. They flow on naturally from the other changes proposed, with matters now dealt with by Article 5 that were previously dealt with under Article 14. The proposed change of Article 15's title from "Dependent Personal Services" to "Income from Employment" is not strictly consequential, but is useful to clarify its operation, with the proposed deletion of Article 14, and follows more ordinary usage. None of these changes involves any change in the balance of taxing rights.

(xii) Renumbering of Articles 15 and following?

94. The subcommittee does not propose the renumbering of Articles 15 and following consequential upon the proposed deletion of Article 14. This avoids further consequential changes to the Articles and Commentaries, although States may prefer to do so in their bilateral treaties.

III. Fees for Technical Services

A The UN and OECD Model Backgrounds

95. Fees for Technical Services would typically fall within the scope of Article 7 (Business Profits) of the OECD Model, under which the exclusive right to tax is allocated to the State of residence unless the services are performed through a permanent establishment that the enterprise maintains in the other State. If this is the case, the latter State may tax the profits attributable to the permanent establishment and the State of residence is obliged to grant relief from double taxation.

96. Article 12 (Royalties) of the OECD Model does not apply to services as it generally deals with payments for the use of, or the right

Given the broad definition of “information concerning industrial, commercial or scientific experience”, some countries tend to regard the provision of brain-work and technical services as the provision of “information concerning industrial, commercial or scientific experience” and to regard payment for it as royalties.

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subcommittee's view less arbitrary and less able to be directly shifted to the consumer

113. If these compliance and administrative reasons are less compelling, a solution is to adopt a provision that extends the definition of permanent establishment in tax conventions based on physical presence and/or other tests. Such a provision would allow taxation of Fees for Technical Services in the source State even in the absence of a fixed place of business in that State through which the services are performed.

114. In this regard, the OECD issued a discussion draft on the tax treaty treatment of services (in general, not only related to technical services) on 8 December 2006[12]. The draft (considered in more detail under Chapter IV below) suggests an alternative provision that could be used by countries wishing to increase source taxation rights with respect to services. This provision secures additional source taxation rights on profits from services performed in that State if these are performed over a period of 183 days. This alternative avoids a number of drafting problems that arise from the two provisions (Article 14 and Article 5(3)(b)) included in the current UN Model for that purpose. One such problem is the inclusion of a time test using months as the criterion. Some countries have already drawn attention to the difficulties encountered in the application of this time test. Clearly this type of provision also envisages a treaty which does not include the UN Article 14.

D Conclusion on Fees for Technical Services

115.

118. As part of this work, the OECD released for consultation in December 2006 (as noted above[13]) a draft paper on proposed Commentary changes to Article 5. This draft does not propose changes to the permanent establishment rules but proposes including in the Commentary an optional provision that States may wish to include as a new paragraph in Article 5 where they wish to tax services performed on their territory based on a time test. The proposed provision is as follows:

> 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 during a period or periods exceeding in the aggregate 183 days in any twelve month period, and more than 50 percent 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) during 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 performing such services in that other State or are present in that other State for the purpose of performing such services,
>
> the activities carried on in that other State in performing these services shall be deemed to be carried on through a permanent establishment that the enterprise has 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.

119. It will be seen that a standard period of 183 days is used. Subparagraph a), which covers individuals, uses a days of presence test, as found in Article 14 of the UN Model. But in order to focus only on individuals who are performing substantial activities in a State (as opposed to visiting for an extended vacation, for example), it contains an extra condition requiring that more than 50 per cent of individual's gross revenues should be attributable to activities in that State.

120. The subcommittee ultimately saw no need to include such a proposal at this stage, although it recognised that there a relevant issue of only seeking to cover substantial relevant activities and in its proposed Article 5(4)(a) it therefore sought to ensure that the period referred to was the period of actual activity, not including periods of vacation for example. Paragraph 5(4)(b) was not similarly altered, as it reflects the current content of Article 14 and to similarly amend it could have been viewed as altering taxing rights.

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[13] At paragraph 114: OECD, "The Tax Treaty Treatment of Services: Proposed Commentary Changes", 8 December 2006.

Annex 1: Current Relevant Articles of the UN Model[14]

2. the term “permanent establishment” includes especially:
   (a) A place of management;
   (b) A branch;
   (c) An office;
   (d) A factory;
   (e) A workshop;
   (f) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. The term “permanent establishment” also encompasses:
   (a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;
   (b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve-month period.

4. Notwithstanding the preceding provisions of this article, the term “permanent establishment” shall be deemed not to include:
   (a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
   (b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;
   (c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
   (d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
   (e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.
   (f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 7 applies — is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:
   (a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or
   (b) Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.

6. Notwithstanding the preceding provisions of this article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent

Annex 2: Relevant Articles of the UN Model – Proposed Amendments

Article 3

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

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

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

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

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

(e) The term “international traffic” means any transport by a ship or aircraft operated by an

2. **Subject to the conditions of paragraph 1**, the term "permanent establishment" includes ~~especially~~:

(a) A place of management;

(b) A branch;

(c) An office;

(d) A factory;

(e) A workshop;

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

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

4. A permanent establishment shall be deemed to exist where:

(a) an enterprise furnishes services through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned;

(b) an individual who is a resident of a Contracting State performs services in the other Contracting State and his stay in that other Contracting State is for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned.

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

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

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

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

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

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

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

Article 11

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in

person, that income may, notwithstanding the provisions of articles 7~~, 14~~ and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsperson are exercised.

Article 21

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in

Annex 3: Proposed Annex for those States Preferring to Retain Article 14[15]

Article 3

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

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

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

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

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

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

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

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

7. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status within the meaning of this paragraph.

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

Article 6

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

Article 10

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

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

or the undistributed profits consist wholly or partly of profits or income arising in such other State.

Article 11

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

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

Article 12

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

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

Article 13

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

Article 14: *retained*

Article 14

INDEPENDENT PERSONAL SERVICES

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

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

(b) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in

the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

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

Annex 4: A Short History of

> that State unless he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities. If he has such a fixed base, such part of that income as is attributable to that base may be taxed in that other State."

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

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

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

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

As noted in the body of this paper, Article 14 and the concept of fixed base were deleted from the OECD Model in the year 2000 and consequential amendments made, following a report produced earlier that year[18].

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