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**Economic and Social Council
Committee of Experts on International Cooperation
in Tax Matters**

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**Definition of Permanent Establishment: finalised amendments to
current Commentary on article 5 - permanent establishment**

Note by the Coordinator of the Subcommittee*

Summary

Based on the discussions and decisions taken at the third session of the Committee of Experts on International Cooperation in Tax Matters held in 2007, the subcommittee on Definition of Permanent Establishment prepared the finalised version of a new Commentary to the current article 5 of the Model Tax Convention. This reflects the minor changes agreed in discussion at the third session in 2007, when the paper was finalised, and is presented for information only.

* This paper is a revised version of the E/C.18/2007/CRP.3, which was presented at the third session of the Committee of Experts on International Cooperation in Tax Matters. The present paper was prepared by the subcommittee on permanent establishment (Coordinator: Mr. Sollund). The views and opinions expressed are those of the authors and do not necessarily represent those of the United Nations.

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I. Introduction

1. At the first session of the Committee of Experts on International Cooperation in Tax matters in December 2005, a subcommittee made up of

44. There was a discussion on the relationship between paragraphs 1 and 2 of the article, with some support for the view that paragraph 2 was “self-standing”. It was

subcommittee was mandated to continue its work on the updating of document E/C.18/2007/CRP.4 regarding a possible new article 5 and Commentary on that article in time for consideration at the Committee's fourth session, taking into account the issues raised in the discussions.

III. Purpose of this paper

ANNEX 1

Proposed Amended UN Model Commentary to Article 5

ARTICLE 5

PERMANENT ESTABLISHMENT

A. GENERAL CONSIDERATIONS

1. Article 5 of the United Nations Model Convention (the UN Model) is based on Article 5 of the OECD Model Tax Convention (the OECD Model) but contains several significant differences. In essence these are that under the UN Model:

- there is a 6 months test for a building or construction site constituting a permanent establishment, rather than the 12 months test under the OECD Model, and it expressly extends to assembly projects, as well as supervisory activities in connection with building sites and construction or installation projects (paragraph 3 of the UN Model article);
- the furnishing of services by an enterprise through employees or other personnel results in a permanent establishment where such activities continue for a total of 6 months in a twelve month period (paragraph 3(b));
- in the paragraph 4 list of what is deemed *not* to constitute a permanent establishment (often referred to as the list of “preparatory and auxiliary activities”) “delivery” is not mentioned in the UN Model, but is mentioned in the OECD Model. Therefore a delivery activity might result in a permanent establishment under the UN Model, without doing so under the OECD Model;

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2. The concept of “permanent establishment” is used in bilateral tax treaties to determine the right of a State to tax the profits of an enterprise of the other State. Specifically, the profits of an enterprise of one State are taxable in the other State only if the enterprise maintains a permanent establishment in the latter State and only to the extent that the profits are attributable to the permanent establishment. The concept of permanent establishment is found in the early model conventions including the 1928 model conventions of the League of Nations. The UN Model reaffirms the concept.

B. COMMENTARY ON THE PARAGRAPHS OF ARTICLE 5

Paragraph 1

3. This paragraph, which reproduces Article 5(1) of the OECD Model, defines the term “permanent establishment”, emphasizing its essential nature as a “fixed place of business” with a specific “situs”. According to paragraph 2 of the OECD Commentary (the 2005 version of which is cited below), this definition contains the following conditions:

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

The OECD Commentary goes on to observe:

3. It could perhaps be argued that in the general definition some mention should also be made of the other characteristic of a permanent establishment to which some importance has sometimes been attached in the past, namely that the establishment must have a productive character—i.e., contribute to the profits of the enterprise. In the present definition this course

formal legal right to use that place is therefore required. Thus, for instance, a permanent

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

The OECD Commentary then examines some examples relating to the provision of services. In quoting the following two paragraphs, the Committee notes that Article 5(3)(b) of the UN Model provides a specific provision in relation to furnishing of services by an enterprise through employees or personnel engaged for that purpose. In practice, therefore, the points made in paragraphs 5.3 and 5.4 of the OECD Model Commentary (as with other parts of the OECD Commentary to Article 5(1)) may have less significance for the UN Model than in their original context.

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

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

The OECD Commentary then continues:

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

(which may extend over a number of years). Another exception has been made where activities

such a case a permanent establishment could be deemed to exist if the criterion of permanency is met. When such activity is connected with, or is similar in character to, those mentioned in paragraph 3, the time limit of [six] months applies. Other cases have to be determined according to the circumstances.

...

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

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

Paragraph 2

4. Paragraph 2, which reproduces Article 5(2) of the OECD Model, lists examples of places that will often constitute a permanent establishment. However, the provision is not self-standing. While paragraph 2 notes that offices, factories, etc are common types of permanent establishments, when one is looking at the operations of a particular enterprise, the requirements of paragraph 1 must also be met. Paragraph 2 therefore simply provides an indication that while a permanent establishment may well exist; it does not prove that one necessarily does exist. This is also the stance of the OECD Commentary, where it is assumed that States interpret the terms listed "in such a way that such places of business constitute

Commentary points out at paragraph 13 that the term “place of management” is mentioned separately because it is not necessarily an “office” and that “where the laws of the two Contracting States do not contain the concept of a ‘place of management’ as distinct from an ‘office’, there will be no need to refer to the former term in their bilateral convention”.

5. In discussing subparagraph (f), which provides that the term “permanent establishment” includes mines, oil or gas wells, quarries or any other place of extraction of natural resources, the OECD Commentary states that “the term ‘any other place of extraction of natural resources’ should be interpreted broadly” to include, for example, all places of extraction of hydrocarbons whether on or offshore. Because subparagraph (f) does not mention exploration for natural resources, whether on or offshore, paragraph 1 governs whether exploration activities are carried on through a permanent establishment. The OECD Commentary states:

15.

project” used in the OECD Model, subparagraph 3(a) of the UN Model includes an “assembly project” as well as “supervisory activities” in connection with “a building site, a construction, installation or assembly project”. Another difference is that while the OECD Model uses a time limit of twelve months, the UN Model reduces the minimum duration to six months. In special cases, this six-month period could be reduced in bilateral negotiations to not less than three months. The Committee notes that there are differing views about whether paragraph 3(a) is a “self-standing” provision (so that no resort to paragraph 1 is required) or whether (in contrast) only building sites and the like that meet the criteria of paragraph 1 would constitute permanent establishments, subject to there being a specific six months time test. However, the Committee considers that where a building site exists for six months, it will in practice almost invariably also meet the requirements of paragraph 1. Indeed, an enterprise having a building site etc at its disposal through which its activities are wholly or partly carried on will also meet the criteria of paragraph 1.

8. Some countries support a more elaborate ve

activities connected with the exploration and exploitation of the continental shelf) divided their contracts up into several parts, each covering a period less than [six] months and attributed to a different company, which was, however, owned by the same group. Apart from the fact that such abuses may, depending on the circumstances, fall under the application of legislative or judicial anti-avoidance rules, countries concerned with this issue can adopt solutions in the framework of bilateral negotiations.

The Committee points out that measures to counteract abuses would apply equally in cases under Article 5(3)(b). The Commentary of the OECD Model continues as follows:

included because it is not appropriate to add together unrelated projects in view of the uncertainty which that step involves and the undesirable distinction it creates between an enterprise with, for example, one project of three months' duration and another with two unrelated projects, each of three months' duration, one following the other. However, some countries find the "project" limitation either too easy to manipulate or too narrow in that it might preclude taxation in the case of a continuous number of separate projects, each of four or five months' duration.

13. If States wish to treat fishing vessels in their territorial waters as constituting a permanent establishment (see paragraph 6 above), they could add a suitable provision to paragraph 3, which for example might apply only to catches over a specified level, or by reference to some other criterion.

14. If a permanent establishment is deemed to exist under paragraph 3, only profits attributable to the activities carried on through that permanent establishment are taxable in the source country.

15. The following passages of the Commentary on the OECD Model are relevant to article 5(3)(a) of the UN Model, although the reference to an "assembly project" in the UN Model and not in the OECD Model, and the six month period in the UN Model should, in particular, be borne in mind:

16. This paragraph provides expressly that a building site or construction or installation project constitutes a permanent establishment only if it lasts more than 12 months. Any of those items which does not meet this condition does not of itself constitute a permanent establishment, even if there is within it an installation, for instance an office or a workshop within the meaning of paragraph 2, associated with the construction activity. Where, however, such an office or

are engaged in activities having a preparatory or auxiliary character. Therefore, according to subparagraph

“in that State”, even if the contract is signed by another person in the State in which the enterprise is situated or if the first person has not formally been given a power of representation. The mere fact, however, that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has exercised in that State an authority to conclude contracts in the name of the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise. Since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either.

33.1 The requirement that an agent must “habitually” exercise an authority to conclude contracts reflects the underlying principle in Article 5 that the presence which an enterprise maintains in a Contracting State should be more than merely transitory if the enterprise is to be regarded as maintaining a permanent establishment, and thus a taxable presence, in that State. The extent and frequency of activity necessary to conclude that the agent is “habitually exercising” contracting authority will depend on the nature of the contracts and the business of the principal. It is not possible to lay down a precise frequency test. Nonetheless, the same sorts

premiums in that other State through an agent established there — other than an agent who already constitutes a permanent establishment by virtue of paragraph 5 — or insure risks situated in that territory through such an agent. The decision as to whether or not a provision along these lines should be included in a convention will depend on the factual and legal situation prevailing in the Contracting States concerned. Frequently, therefore, such a provision will not be contemplated. In view of this fact, it did not seem advisable to insert a provision along these lines in the Model Convention.

26. Paragraph 6 of the UN Model achieves the aim quoted above, and is necessary because insurance agents generally have no authority to conclude contracts, so the conditions of paragraph 5(a) would not be fulfilled. If an insurance agent is independent, however, the profits attributable to his activities are not taxable in the source State because the provisions of article 5(7) are fulfilled and the enterprise would not be deemed to have a permanent establishment

27. Some countries, however, favour extending the provision to allow taxation even where there is representation by such an independent agent. They take this approach because of the nature of the insurance business, the fact that the risks are situated within the country claiming tax jurisdiction, and the ease with which persons could, on a part-time basis, represent insurance companies on the basis of an “independent status”, making it difficult to distinguish between dependent and independent insurance agents. Other countries see no reason why insurance business should be treated differently from activities such as the sale of tangible

38.1 In relation to the test of legal dependence, it should be noted that the control which a parent company exercises over its subsidiary in its capacity as shareholder is not relevant in a

circumstances be used concurrently or alternatively, for example where the agent's activities do not relate to a common trade.

29. In the 1980 edition of the UN Model, the second sentence of paragraph 7 read: "However, when the activities of such an agent are devoted

company is deemed to have a permanent establishment under paragraph 5 of the Article The determination of the existence of a permanent establishment under the rules of paragraphs 1 or 5 of the Article must, however, be done separately for each company of the group. Thus, the existence in one State of a permanent establishment of one company of the group will not have any relevance as to whether another company of the group has itself a permanent establishment in that State.

33. The Committee notes that determining on a separate entity basis whether or not a permanent establishment exists may be vulnerable to abusive arrangements. Depending on the domestic law of States, safeguards against purely artificial structures may be found in applying a rule that substance overrides form. The Commentary of the OECD Model also states the following:

42. Whilst premises belonging to a company that is a member of a multinational group can be put at the disposal of another company of the group and may, subject to the other conditions of Article 5, constitute a permanent establishment of that other company if the business of that other company is carried on through that place, it is important to distinguish that case from the frequent situation where a company that is a member of a multinational group provides services

Provider (ISP). Although the fees paid to the ISP under such arrangements may be based on the amount of disk space used to store the software and data required by the web site, these contracts typically do not result in the server and its location being at the disposal of the enterprise (see paragraph 4 above), even if the enterprise has been able to determine that its web site should be

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

42.9 What constitutes core functions for a particular enterprise clearly depends on the nature of the business carried on by that enterprise. For instance, some ISPs are in the business of operating their own servers for the purpose of hosting web sites or other applications for other enterprises. For these ISPs, the operation of their servers in order to provide services to customers is an essential part of their commercial activity and cannot be considered preparatory or auxiliary. A different example is that of an enterprise (sometimes referred to as an “e-tailer”) that carries on the business of selling products through the Internet. In that case, the enterprise is not in the business of operating servers and the mere fact that it may do so at a given location is not enough to conclude that activities performed at that location are more than preparatory and auxiliary. What needs to be done in such a case is to examine the nature of the activities performed at that location in light of the business carried on by the enterprise. If these activities are merely preparatory or auxiliary to the business of selling products on the Internet (for example, the location is used to operate a server that hosts a web site which, as is often the case, is used exclusively for advertising, displaying a catalogue of products or providing information to potential customers), paragraph 4 will apply and the location will not constitute a permanent

permanent establishments). As recognised in paragraphs 18 and 20 below a single place of business will generally be considered to exist where, in light of the nature of the business, a

were of a recurrent nature; in such cases, each period of time during which the place is used needs to be considered in combination with the number of times during which that place is used (which may extend over a number of years). Another exception has been made where activities constituted a business that was carried on exclusively in that country; in this situation, the business may have short duration because of its nature but since it is wholly carried on in that country, its connection with that country is stronger. For ease of administration, countries may want to consider these practices when they address disagreements as to whether a particular place of business that exists only for a short period of time constitutes a permanent establishment.

The Committee agreed with the approach taken in paragraph 6 of the OECD Commentary.

operate the equipment provided that their responsibility is limited solely to the operation or maintenance of the ICS equipment under the direction, responsibility and control of the lessee. If the personnel have wider responsibilities, for example participation in the decisions regarding the work for which the equipment is used, or if they operate, service, inspect and maintain the

believe that a warehouse should be included among the specific examples. However, the deletion of “delivery” from the excluded activities described in paragraph 4 (a) and (b) means that a “warehouse” used for any purpose is (subject to the conditions in paragraph 1 being fulfilled) a permanent establishment under the general principles of the article. The OECD

Paragraph 3

7. This paragraph covers a broader range of activities than Article 5(3) of the OECD Model, which states, “A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months”. In addition to the term “installation project” used in the OECD Model, subparagraph 3(a) of the UN Model includes an “assembly project” as well as “supervisory activities” in connection with “a building site, a construction, installation or assembly project”. Another difference is that while the OECD Model uses a time limit of twelve months, the UN Model reduces the minimum duration to six months. In special cases, this six-month period could be reduced in bilateral negotiations to not less than three months. The Committee notes that there are differing views about whether paragraph 3(a) is a “self-standing” provision (so that no resort to paragraph 1 is required) or whether (in contrast) only building sites and the like that meet the criteria of paragraph 1 would constitute permanent establishments, subject to there being a specific six months time test. However, the Committee considers that where a building site exists for six months, it will in practice almost invariably also meet the requirements of paragraph 1. Indeed, an enterprise having a building site etc at its disposal through which its activities are wholly or partly carried on will also meet the criteria of paragraph 1.

8. Some countries support a more elaborate version of paragraph 3(a), which would extend the provision to encompass a situation: “where such project or activity, being incidental to the sale of machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or activities exceed 10 per cent of the sale price of the machinery or equipment”. Other countries believe that such a provision would not be appropriate, particularly if the machinery was installed by an enterprise other than the one doing the construction work.

9. Article 5(3)(b) deals with the furnishing of services, including consultancy services, the performance of which does not, of itself, create a permanent establishment in the OECD Model. Many developing countries believe that management and consultancy services should be covered because the provision of those services in developing countries by enterprises of industrialized countries can generate large profits.

10. A few developing countries oppose the six-month threshold in paragraph 3(a) and (b) altogether. They have two main reasons: first, they maintain that construction, assembly and similar activities could, as a result of modern e5 n7. proconsines8(ti)620 i

forms a single unit even if the orders have been placed by several persons (e.g., for a row of houses). The [six] month threshold has given rise to abuses; it has sometimes been found that enterprises (mainly contractors or sub-contractors working on the continental shelf or engaged in activities connected with the exploration and exploitation of the continental shelf) divided their contracts up into several parts, each covering a period less than [six] months and attributed to a different company, which was, however, owned by the same group. Apart from the fact that such

performed at each particular spot are part of a single project, and that project must be regarded as a permanent establishment if, as a whole, it lasts for more than [six] months.

12. Subparagraph (b) encompasses service activities only if they “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”. The words “for the same or a connected project” are included because it is not appropriate to add together unrelated projects in view of the uncertainty which that step involves and the undesirable distinction it creates between an enterprise with, for example, one project of three months’ duration and another with two unrelated projects, each of three months’ duration, one following the other. However, some countries find the “project” limitation either too easy to manipulate or too narrow in that it might preclude taxation in the case of a continuous number of separate projects, each of four or five months’ duration.

13. If States wish to treat fishing vessels in their territorial waters as constituting a permanent establishment (see paragraph 6 above), they could add a suitable provision to paragraph 3, which for example might apply only to catches over a specified level, or by reference to some other criterion.

14. If a permanent establishment is deemed to exist under paragraph 3, only profits attributable to the activities carried on through that permanent establishment are taxable in the source country.

15. The following passages of the Commentary on the OECD Model are relevant to article 5(3)(a) of the UN Model, although the reference to an “assembly project” in the UN Model and not in the OECD Model, and the six month period in the UN Model should, in particular, be borne in mind:

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

17. The term “building site or construction or installation project” includes not only the construction of buildings but also the construction of roads, bridges or canals, the renovation (involving more than mere maintenance or redecoration) of buildings, roads, bridges or canals, the laying of pipelines and excavating and dredging. Additionally, the term “installation project” is not restricted to an installation related to a construction project; it also includes the installation of new equipment, such as a complex machine, in an existing building or outdoors. On-site planning and supervision of the erection of a building are covered by paragraph 3. States

16. This paragraph reproduces article 5(4) of the OECD Model with one substantive amendment: the deletion of “delivery” in subparagraphs (a) and (b). In view of the similarities to the OECD Model provision and the general relevance of its Commentary, the general principles of article 5(4) under both Models are first noted below and then the practical relevance of the deletion of references to “delivery” in the UN Model are considered.

17. The deletion of the word “delivery” reflects the majority view of the Committee that a “warehouse” used for that purpose should, if at least the requirements of paragraph 1 are met, be a permanent establishment.

18. The OECD Model Commentary on paragraph 4 of the OECD Article is as follows:

21. This paragraph lists a number of business activities which are treated as exceptions to the general definition laid down in paragraph 1 and which are not permanent establishments, even if the activity is carried on through a fixed place of business. The common feature of these activities is that they are, in general, preparatory or auxiliary activities. This is laid down explicitly in the case of the exception mentioned in subparagraph *e*), which actually amounts to a general restriction of the scope of the

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

25. A permanent establishment could also be constituted if an enterprise maintains a fixed place of business for the delivery of spare parts to customers for machinery supplied to those

permanent establishment exists. As long as the combined activity of such a fixed place of business is merely preparatory or auxiliary a permanent establishment should be deemed not to exist. Such combinations should not be viewed on rigid lines, but should be considered in the light of the particular circumstances. The criterion "preparatory or auxiliary character" is to be interpreted in the same way as is set out for the same criterion of subparagraph *e*) (cf. paragraphs 24 and 25 above). States which want to allow any combination of the items mentioned in subparagraphs *a*) to *e*), disregarding whether or not the criterion of the preparatory or auxiliary character of such a combination is met, are free to do so by deleting the words "provided" to "character" in subparagraph *f*).

27.1 Subparagraph *f*) is of no importance in a case where an enterprise maintains several fixed places of business within the meaning of subparagraphs *a*) to *e*) provided that they are separated from each other locally and organisationally, as in such a case each place of business has to be viewed separately and in isolation for deciding whether a permanent establishment exists. Places of business are not "separated organisationally" where they each perform in a Contracting State complementary functions such as receiving and storing goods in one place, distributing those goods through another etc. An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity.

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

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

“delivery of goods” should give rise to a permanent establishment long engaged the former Group of Experts. A 1997 study revealed that almost 75 per cent of developing countries’ tax treaties *included* the “delivery of goods” in the list of exceptions in paragraph 4 (a) and (b). Nevertheless, some countries regard the omission of the expression in the UN Model as an

exercised in that State an authority to conclude contracts in the name of the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise. Since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either.

33.1

through such an agent. The decision as to whether or not a provision along these lines should be included in a convention will depend on the factual and legal situation prevailing in the Contracting States concerned. Frequently, therefore, such a provision will not be contemplated. In view of this fact, it did not seem advisable to insert a provision along these lines in the Model Convention.

26. Paragraph 6 of the UN Model achieves the aim quoted above, and is necessary because insurance agents generally have no authority to conclude contracts, so the conditions of paragraph 5(a) would not be fulfilled. If an insurance agent is independent, however, the profits attributable to his activities are not taxable in the source State because the provisions of article 5(7) are fulfilled and the enterprise would not be deemed to have a permanent establishment

27. Some countries, however, favour extending the provision to allow taxation even where there is representation by such an independent agent. They take this approach because of the nature of the insurance business, the fact that the risks are situated within the country claiming tax jurisdiction, and the ease with which persons could, on a part-time basis, represent insurance companies on the basis of an "independent status", making it difficult to distinguish between dependent and independent insurance

Commentary indicates, the subsidiary may be considered a dependent agent of its parent by application of the same tests which are applied to unrelated companies.

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

38.3

29. In the 1980 edition of the UN Model, the second sentence of paragraph 7 read: “However, when the activities of such an agent are devoted wholly or almost wholly on behalf of the enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph.” (This sentence is an addition to the corresponding paragraph in the OECD Model Convention.)

30. It was subsequently recognized that this sentence gave rise to anomalous situations. The concern was that if the number of enterprises for which an independent agent was working fell to one, the agent would, without further examination, be treated as dependent. In the 1999 version of the Model, the wording was therefore amended as follows:

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 financ

typically do not result in the server and its location being at the disposal of the enterprise (see paragraph 4 above), even if the enterprise has been able to determine that its web site should be hosted on a particular server at a particular location. In such a case, the enterprise does not even

42.9 What constitutes core functions for a particular enterprise clearly depends on the nature of the business carried on by that enterprise. For instance, some ISPs are in the business of operating their own servers for the purpose of hosting web sites or other applications for other enterprises. For these ISPs, the operation of their servers in order to provide services to customers is an essential part of their commercial activity and cannot be considered preparatory or auxiliary. A different example is that of an enterprise (sometimes referred to as an “e-tailer”) that carries on the business of selling products through the Internet. In that case, the enterprise is not in the business of operating servers and the mere fact that it may do so at a given location is not enough to conclude that activities performed at that location are more than preparatory and auxiliary. What needs to be done in such a case is to examine the nature of the activities performed at that location in light of the business carried on by the enterprise. If these activities are merely preparatory or auxiliary to the business of selling products on the Internet (for example, the location is used to operate a server that hosts a web site which, as is often the case, is used exclusively for advertising, displaying a catalogue of products or providing information