



OUTLINE OF ARTICLE 5 OF THE OECD MODEL CONVENTION

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Annotation. *The article “Outline of article 5 of the OECD model Convention” is written on a relevant topic, which is important because the object of analysis has many meanings. The author analyzes the concept of permanent establishment, provided for in Article 5 of the Organization for Economic Co-operation and Development Model Convention with respect to taxes on income and on capital. The main goal of the article is to discuss the institute of permanent establishment and to help understand it better. The author does not seek to provide a thorough analysis of the content of Article 5, but rather, to concentrate on its main aspects. Even though the study of permanent establishment, provided in this article, related only to the context of the Convention, it can also be useful while analysing the concept of permanent establishment under the US Model Income Tax Convention and the 2001 UN Model Convention.*

Keywords: *tax law, permanent establishment, a place of business, geographical permanence, temporal permanence, agency permanent establishment.*

Introduction

Article 5 of the Model Convention covers the concept of permanent establishment (hereinafter PE) in its seven paragraphs. The first paragraph contains the general definition of ‘physical PE’. The second sets out a list of potential PE cases¹. The third paragraph presents the concept of ‘project PE’² (building sites and construction or installation projects). The fifth and the sixth paragraphs contain the notion of ‘agency PE’. In paragraph four, exceptions to the notion of PE included in paragraphs 1, 3, and 5 are described. Finally, paragraph 7 clarifies that a subsidiary is not a PE of its parent company and vice-versa.

Following the structure set out by the 7 paragraphs, a brief analysis of article 5 of the Model Convention, very much based on the wording of the Commentary, will be provided in this article. The main purpose of this paper is to provide an outline of that provision, and to facilitate its understanding. Hence, it will not aim at dwelling on all the complex issues article 5 may bring about, but simply to address the most general aspects of it.

Although the analysis carried out herein will be done in the context of the OECD Model Convention, it can also be useful when analysing the concept of PE in light of the 1996 US Model Income Tax Convention and the 2001 UN Model Convention due to some similarities amongst all these instruments.

1. Definition and contents of the PE concept

The concept of permanent establishment laid down in article 5 of the OECD Model Convention plays a major role in the limitation of double taxation carried out within the scope of this Convention. This can be seen not only through the great importance the article has *per se*, but also for its relevance in the application of other provisions of the Model Convention³.

The general definition of PE is set out by the Model Convention in article 5 in the following terms: *“for the purposes of this convention, the term ‘permanent establishment’ means a fixed place of business through which the business of an enterprise is wholly or partly carried on”*. This concept was created to refer to the business activity carried out in a contracting state other than the one where

1 As it will be put forward below, this list seems to be spurious.

2 The meaning of this paragraph is arguable. Does it define a separate type of PE or is it just an extension of the ‘physical PE’ laid down in paragraph one? I will come back to this issue later.

3 Such as article 7 (business profits), article 15 (employment income) and article 24 (non-discrimination).

the taxpayer resides, and can be applied not only to the aforementioned general definition of PE, but also, as it will be shown, to the notions of ‘project PE’ and ‘agency PE’.

2. ‘Physical PE’

This type of PE, normally considered as the general definition of PE, requires several elements to be in place simultaneously. It is necessary that the location would not only be a (a) place of business, which is permanent from a geographical and (b) temporal point of view, but also that the place of business is (c) at the disposal of the entrepreneur, (d) and that the business is carried on through it.

Although the requirements set out above are explained and illustrated in the commentary of the Model Convention through several examples (some of which will be referred to throughout this paper), it should be borne in mind that those requirements cannot always be delimited in a clear-cut way⁴. In fact, delicate issues may be raised by the mismatch between the first three requirements and recent activities, such as electronic commerce and telecommunications⁵ (inexistent when the concept of PE was forged in Prussia⁶ back in 19th century). Nevertheless, during the meeting of a ministerial committee on electronic commerce, held in Ottawa in October of 1998, OECD member States restated that tax traditional rules and principles (including the concept of PE) should be applied to electronic commerce⁷.

a) A place of business

Regarding the first requirement, any physical location of any kind (no matter how small it is), which is used to carry on the business activity, is considered a

4 Skaar, A. S. *Permanent Establishment: Erosion of a Tax Treaty Principle*. Deventer: Kluwer Law International, 1991, p.40.

5 In relation to this topic see: Shalhav, S. The Revised Permanent Establishments Rules. *Intertax* 2003, 31 (4); Lau, C. Halkyard, A. From E-Commerce to E-Business Taxation. *Asian-Pacific Tax Bulletin*. IBFD January 2003; Cockfield, A. Balancing National Interests in the Taxation of Electronic Commerce Business Profits. *Tulane Law Review*. 1999, 74 (133); Skaar, A. Erosion of the Concept of Permanent Establishment: Electronic Commerce. *Intertax*. 2000, 5; OECD, The Application of the Permanent Establishment Definition in the Context of Electronic Commerce: Proposed Clarification of the Commentary on Article 5 of the OECD Model Tax Convention. *European Taxation*. IBFD, May 2000.

6 Skaar, A., *op. cit.*, p. 7, 64-101.

7 OECD Committee on Fiscal Affairs, Electronic Commerce: Taxation Framework Conditions (1998).

place of business⁸. The place of business may be located in business facilities of another enterprise⁹.

b) Geographical permanence

In relation to geographical permanence, there should be a link between the place of business and a particular geographical point. However, it is not mandatory that the place of business be physically linked to the ground, as long as it remains in a particular location¹⁰.

c) Temporal permanence

Despite the fact that not all OECD member States share the same approach in relation to the requirement at hand, it is often accepted that for a PE to exist, the place of business has to be maintained for at least six months¹¹. This period begins as soon as the enterprise commences its business activities through a fixed place of business and ceases to exist with the disposal of the fixed place of business or when all acts and measures connected with former activities are terminated¹². “*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*”¹³.

In the context of the aspect of temporal permanence, besides the considerations of strictly temporal nature, it is necessary to take into account other elements of great importance, such as: (a) the nature of the business carried out; (b) whether there are interruptions or not; (c) changes in the effective time of PE operation; (d) eventual abusive split-up of one activity between related parties.

8 Commentary on Article 5, §4.1.

9 A suggestive example is a *server* at the disposal of an enterprise, that remains in a certain location for a certain period of time, which may be considered a place of business according to article 5, § 1. See commentary on Article 5, §42.4. In relation to this subject matter, there is not solely one approach: there are more permissive states that consider that *servers and web sites* as potential PE, e.g. Spain and Italy; others, namely the UK, would never consider that a *server* could give rise to a PE.

10 Troubles arise when the place of business is a boat, a mobile shop, a market stall, an exhibition stand or other similar situations.

11 Commentary of Model Convention on Article 5, §6.

12 *Ibid.*, §11.

13 *Ibid.*

The nature of the business carried out may imply that there is still a PE, even if the temporal permanence is less than the period of time normally required. Activities of recurrent nature, such as an annual fair or other activity of short duration, given that they are fully carried out through a fixed place of business¹⁴, are examples of those exceptions.

The existence of interruptions should also be taken into account. In this context, it should be highlighted that temporary interruptions of activities carried on through a PE (such as bad weather and shortage of materials), do not necessary imply that the PE ceases to exist¹⁵.

Changes in the effective time of PE operation, as mentioned above, are another relevant issue to be looked at within the analysis of the temporal permanence requirement. In this context, if an activity of short duration (so short that could not give rise to a PE) turns out to last longer in a manner that cannot be considered temporary anymore – a PE may arise¹⁶. Conversely, if an activity that was planned to last long and thus had been eligible to give rise to a PE, ends up prematurely (after a very limited period of time), it keeps on being considered a PE¹⁷.

Finally, it is important to look at those situations where there is an abusive split-up of one activity between related parties in order to prevent the arising of a PE¹⁸. These problematic cases of tax avoidance are not able to jeopardise the general rule of temporal permanence. On the contrary, they foster adequate measures to fight abusive practices, not only on the level of the convention itself, but also on the level of member states.

d) Fixed place at the disposal of the entrepreneur

For a fixed place (i.e. geographically and temporally permanent) to be considered at the disposal of the entrepreneur, it is not necessary for him to have a formal legal right (owner or tenant). Therefore, effective use suffices¹⁹. “*Thus, for instance, a permanent establishment could exist where an enterprise illegally occupied a certain location where it carried on its business*”²⁰. However, a mere

14 Commentary of Model Convention on Article 5, §11.

15 *Ibid.*, §6.1.

16 *Ibid.*, §6.3.

17 *Ibid.*

18 *Ibid.*

19 Skaar, A., p. 327.

20 Commentary of Model Convention on Article 5, §4.1.

presence at a given place does not imply disposal of it. Alias, the human presence at the PE is not even necessary, according to 2003 commentary.

The situation can be particularly controversial if the representatives of one enterprise are present in the premises of another enterprise, because the presence of those representatives is not sufficient to indicate a disposal. A few examples are presented by the 2003 update of the Commentary in order to shed some light on those often unclear situations.

The first example²¹ focuses on a salesman who regularly visits the office of the purchasing director of a customer enterprise. In this case, it is understood that the customer's premises are not at the disposal of the enterprise for which the salesman is working and therefore do not constitute a fixed place of business of that enterprise.

Another example²² relates to an employee of the parent company, who is allowed to use the office in the headquarters of a subsidiary company. The fact that the employee carries out activities related to the business of the parent company for a sufficient time leads to the conclusion that the office constitutes a PE.

The third example²³ refers to a transportation enterprise that uses a delivery dock at a customer's warehouse everyday, for a number of years, with the purpose of delivering goods purchased by that customer. In this situation, it is considered by the commentary that the presence of the enterprise at the delivery dock is insufficient in terms of temporal permanence for a PE to arise.

e) Business carried on “through” a fixed place

According to the commentary, “*the words ‘through which’ must be given a wide meaning so as to apply to any situation where business activities are carried on at a particular location that is at the disposal of the enterprise for that purpose*”²⁴.

The commentary illustrates the expression ‘*through which*’, using two examples. The first refers to an enterprise engaging in paving a road, as a case where the business is carried out through the place where the activity takes place²⁵. The second example is that of a painter, who spends 3 days a week in his client's office

21 Commentary of Model Convention on Article 5, §4.2.

22 *Ibid.*, §4.3.

23 *Ibid.*, §4.4.

24 *Ibid.*, §4.6.

25 *Ibid.*

building to perform the most important functions of his business (i.e. to paint), and therefore carries on his business through that building²⁶.

Both examples are arguable, given that the office building and the road are the object of the business rather than the fixed place through which the business is carried on²⁷. However, we cannot overlook the fact that, differently from the 1963 Model Convention²⁸ version where there was an express reference to the place ‘in which’ the business was carried on, the Model Convention uses nowadays the expression ‘through which’. The change may be meant to allow broader interpretations, such as the one conveyed by the commentary where the object of the activity and the place where it is performed are somewhat taken indistinctly. Irrespectively of the change to the wording of the Convention, we keep some reservations in relation to the ability of the examples set out above to illustrate the fulfilment of the PE requirement addressed here – business carried on ‘through’ a fixed place.

2.1. Single place vs. multiple places of business

The solution for the issue involving the existence of a single versus multiple places of business²⁹, depends upon whether a particular location may be deemed as ‘commercially and geographically coherent whole’, in the light of the nature of the business at hand³⁰. This principle is also illustrated by some examples included in the Commentary. We will refer to those examples in the following order. First, we will look at those situations where there is a commercially and geographically coherent whole, and therefore one single place of business. Subsequently, we will look at those situations where the coherence is restricted to either the geographical or the commercial aspect and, consequently, multiple places of business will be considered to exist rather than a single place.

26 Commentary of Model Convention on Article 5, §4.5.

27 According to some authors OECD has recently broadened the scope of the expression ‘through which’, therefore whenever the object of the activity and the local where it is performed could not be separated in a clear way, it is assumed that the presence of either of them will be sufficient to fulfil the expression *through which*’. See Caridi, A. Proposed Changes to the OECD Commentary on Article 5: Part I – The Physical PE Notion. *European Taxation*. IBFD, January 2003, p. 24. See also Lüdicke, J. Recent Commentary Changes concerning the Definition of the Permanent Establishment. *Bulletin*. IBFD, May 2004, p. 191.

28 *Materials on International & EC Tax Law. Volume 1*. Leiden: International Tax Center Leiden, 2004, p. 357.

29 It is particularly important to determine whether the minimum temporal permanence requirement for a PE to exist is met.

30 Commentary of Model Convention on Article 5, §5.1.

a) Commercial and geographical coherence

A very large mine where business activities move from one location to another in the same mine site, constitutes a single place of business³¹. ”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 firm³²”. Finally, a pedestrian street or an outdoor market or a fair where a trader regularly sets up his stand, also represents a single place of business for the trader³³, even if he changes his location from time to time.

b) Absence of commercial coherence

In the absence of commercial coherence, the fact that business activities take place in a limited geographical area does not render that location a single place of business. An example would be the one of a painter who works under a series of unrelated contracts in the same large office building³⁴.

c) Absence of geographical coherence

In the absence of geographical coherence, a single project (i.e. a commercial whole) does not constitute a single place of business. The commentary³⁵ illustrates this situation with an example where a consultant moves from one bank branch to another for the purpose of training its employees under the same contract³⁶.

3. Examples of potential ‘Physical PEs’ included in § 2 of article 5

The list of examples set out throughout § 2 is merely an illustration as it flows from the expression ”*includes specially*”. Furthermore, it appears more correct to consider that those examples are only *prima facie* PEs, given that they will only be PEs if the requirements laid down in § 1 are met. Although this opin-

31 Commentary of Model Convention on Article 5, §5.2.

32 *Ibid.*

33 *Ibid.*

34 Commentary of Model Convention on Article 5, §5.3.

35 Commentary of Model Convention on Article 5, §5.4.

36 The situation would be different if the consultant moved from one office to another within the same branch location. Commentary of Model Convention on Article 5, §5.4.

ion is not unanimous and has the striking effect of rendering the aforementioned list of examples useless, we still regard it as the most correct³⁷. We find support for that in the fact that the §2 of Article 5.^o of 1963 version of the Convention used the wording ‘*shall include especially*’³⁸ which is different in the actual version, where the word ‘*shall*’ was dropped. From what has just been said, one may draw the conclusion that the examples set out in § 2 of article 5 are no longer *a priori* PEs, as it was defensible under the 1963 version.

4. ‘Project PE’

a) Scope of § 3 of article 5.1

The relationship between §3 focusing on ‘project PE’ and § 1 of the same article is not totally clear, and is giving a leeway for several interpretations.

The majority of authors have taken the position that a building site, construction, or installation project, may give rise to a PE, whether the general requirements of § 1 are met or not. This opinion tries to find support in the fact that after 1977, what was considered subparagraph g) of article 5 became an independent paragraph - §3³⁹.

Other authors, however, advocate that the ‘physical PE’ enshrined in the first paragraph of article 5, also applies to the ‘project PE’ addressed by §3. Therefore, for the advocates of this position, the application of §3 depends on the fulfilment of the requirements of § 1, except for the permanence requirement which was replaced by the 12 months requirement⁴⁰.

We support the first position, which is for the time being shared by the vast majority of scholars.

After a brief word on the relationship between §§ 1 and 3 we move now to the analysis of the ‘project PE’ itself.

37 Important scholars share this opinion. See Vogel, K. *Klaus Vogel on Double Taxation Convention*. The Hague: Kluwer, 1999, 3rd edition, p.284; Van Raad, K. Construction Project PE in the Netherlands and Taxation of Employment Income Borne by a PE: Netherlands Supreme Court Decision of 9 December 1988. *Bulletin*. IBFD, August/ September 1999, p. 42.

38 *Materials on International & EC Tax Law*. p. 357.

39 “...a building project is a PE regardless of whether the criteria of PE as laid down in the general definition of Article 5 (1) are fulfilled. In contrast, with regard to the cases listed in paragraph 2 one must always test whether the requirements of paragraph 1 have been met (potential PEs)” in Van Raad, K. p. 42.; Vogel, K., p. 305.

40 “In article 5, para. 3 cases, all elements of para.1 – except ‘permanence’ – are to be tested” in Pijl, H. The relationship between article 5, paragraphs 1 and 3 of the OECD Model Convention. *Intertax*. 2005, 33 (4):193.

The term ‘building site, construction or installation project’ includes also construction of roads, bridges or canals, the laying of pipe-lines, and excavating and dredging. On-site planning and supervision of the erection of a building are included since 2003⁴¹, whether done by a subcontractor or by a third party⁴².

A ‘building site, construction or installation project’ can be considered a PE only if it lasts more than 12 months. If it lasts less than that, even if there is an office or a workshop associated with the construction activity⁴³, a ‘project PE’ will not arise.

b) 12 month threshold⁴⁴

The 12 month threshold applies to each individual site or project. Consequently, the time spent previously on other sites or projects does not count, unless those projects form a coherent whole commercially and geographically (e.g. a row of houses).

In relation to the beginning and end of the construction site, it is accepted that it exists from the date on which the contractor begins his work, including any preparatory work, and continues to exist until the work is completed or permanently abandoned.

Whilst measuring the 12-month period, some aspects such as interruptions, existence of transparent partnerships, subcontracting, and moving projects have to be necessarily taken into account. In relation to these aspects we will highlight, in a very brief way, the main implications they may have in relation to the 12-month period measurement.

Seasonal interruptions such as interruptions due to bad weather or other temporary interruptions, such as interruptions for shortage of materials, should be included in determining the life of a site⁴⁵.

In the case of fiscally transparent partnerships, the issue whether the life of a site should be calculated at the level of the partnership or at the level of each partner has been solved by the 2000 Commentary update. In such a case, the 12-

41 Commentary of Model Convention on article 5, §17.

42 Before the 2003 amendments, planning and supervision were included only if they were carried out by the building contractor.

43 Commentary of Model Convention on Article 5, §16.

44 Article 5.3 of the Convention between the Portuguese Republic and the Republic of Lithuania for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on February 14 of 2002, where the threshold is nine months.

45 Commentary of Model Convention on Article 5, §19.

month test should be applied at the level of the partnership and each partner will be deemed to have a PE in the country where the business activity takes place⁴⁶.

In a case of subcontractors, the period spent by them must be considered as time being spent by the general contractor for the purposes of the 12-month test.

Let us finish with some words on projects that imply a continuous relocation of the contractor's activity (e.g. construction of roads and canals) to see whether or not there is a PE. In these situations, due to the nature of the projects, even if the work force is not present in a particular place for 12 months, as long as the project as a whole lasts more than 12 months⁴⁷, a 'project PE' may exist.

5. 'Agency PE'

a) General overview

If under §§ 1 and 3 of article 5 the requirements leading to the existence of a PE are not met, there may be still an 'agency PE'⁴⁸ under the rules of §§ 5 and 6.

It is important to bear in mind that the presence of a PE is a matter of tax liability of the principal (enterprise) for whom the agent acts, and not an issue of liability of the agent himself. Therefore, it is preferable to refer to the activities giving rise to a PE as activities carried on through the 'agency PE' rather than activities carried on through an agent⁴⁹.

b) 'Agency PE' requirements

For an 'agency PE' to exist several elements have to be in place.

First it is necessary to have one person⁵⁰ (individual, company or partnership⁵¹) who acts (as an agent) for an enterprise carried on by a non-resident per-

46 Commentary of Model Convention on Article 5, §19.1.

47 *Ibid.*, §20.

48 For a parallel between 'agency PE' and other types of PE see: Piltz, D. When is there an Agency Permanent Establishment? *Bulletin*. IBFD, May 2004, p. 198; Pleijsier, A. The Agency Permanent: The Current Definition – Part One. *Intertax*. 2001, 5; and, from the same author, Pleijsier, A. The Agency Permanent: The Current Definition – Part Two. *Intertax*. 2001, 6-7.

49 The agent's tax liability in the State where he acts as an agent depends on where he is resident. If the agent is a resident of that State, the fee earned by him as an agent is taxed as part of his worldwide income. Conversely, if he is a non-resident, his tax liability will depend whether the fee earned by him will be taxed by the source country under the relevant treaty rules (Art. 15 if the agent is an employee or article 7 otherwise).

50 That's why a *server*, *website* or telecommunications equipment cannot be considered 'Agency PEs'.

51 Pijl, H.; Willeme, P. Permanent Agent – With Particular Reference to Dutch Case Law. *Bulletin*. IBFD, January 1998, p. 64.

son. However, the agent is not required to be a resident or to have a fixed place of business in the country where he acts as an agent.

The agent is also required to have authorization to conclude contracts. This authority must cover contracts relating to the business operations of the general enterprise and it is deemed to exist even if the agent does not effectively sign a contract, but has power to negotiate all its ‘elements and details’⁵², binding the principal (general enterprise). Thus, substance prevails over form.

Finally, it is necessary that the contracts are concluded in the name of the enterprise, when that authority is habitually exercised by the agent. The expression ‘in the name of the enterprise’ should be interpreted in a broad manner, in order to cover all the cases where the principal is bound by the contract concluded by the agent, even if the contract is not formally concluded in the name of the enterprise⁵³. The expression ‘the agent must ‘habitually’ conclude contracts’ is easier to interpret, meaning that the authority to conclude contracts should be reiterated and not sporadic. However, the frequency of the activity must be looked at taking into consideration the nature of the good or service concerned. Thus, it is not possible to lay down a precise frequency test rule. It seems clear-cut though, that the conclusion of single contract that involved long negotiations should not qualify.

c) Independent agent

Under Article 5.6, an enterprise is not deemed to have a PE if the activity in the other State is carried out through a broker, general commission agent, or any other agent of an independent status. However, for the agent to be covered by this exception he must be both legally and economically independent of the principal and he must act in the ordinary course of his business.

The legal independence of the agent depends on the contractual relation he has with the principal, i.e., he is dependent if subjected to detailed instructions or comprehensive control by the enterprise on behalf of which he acts. An employee is the classical example of legal dependence, notwithstanding non-employees may be also legally dependent⁵⁴.

In what economic dependence is concerned, it will be determined by whether the entrepreneurial risk has to be borne by the agent or by the enterprise he represents. The number of principals for whom the agent acts⁵⁵ and eventual con-

52 Commentary of Model Convention on Article 5, §33.

53 *Ibid.*, §32.1.

54 *Ibid.*, §38.

55 According to Commentary of Model Convention on Article 5, § 38.6, an agent is less likely to be independent “if the activities of the agent are performed wholly or almost wholly on behalf of only one enterprise over the lifetime of the business or a long period of time”.

tractual protection from losses or existence of a guaranteed remuneration are factors that should be taken into account, since they can determine how much risk is borne by the agent.

Finally the agent should act in the ordinary course of his business when acting on behalf of the enterprise. In the Commentary update of 2003 it was clarified that when deciding if a particular activity falls within or outside the ordinary course of business of an agent, one should examine the business activities (commerce or industry) in which he habitually engages as a broker commission agent or other independent agent, rather than the other business activities carried out by that agent⁵⁶.

d) Interaction between § 5 and 6

Although there are several theories⁵⁷ dealing with this issue, only the one we find more suitable for an efficient application of the provisions under scrutiny will be briefly addressed – the theory of Kroppen and Huffmeier⁵⁸. In this approach § 6 refers to independent agents who will only be considered as such if they comply with the requirements laid down in that paragraph – independence and acting on the ordinary course of their business – irrespectively of whether they conclude contracts binding on their principal or not. However, if the agent is not

⁵⁶ Commentary of Model Convention on Article 5, §38.8.

⁵⁷ The first theory, advocated by J. Avery Jones and D. Ward, aims to reconcile the differences between the civil law and the common law approach. The distinctive note about this theory rests on the fact that all the agents who do not bind their principals fall outside both § 5 and 6 and in no circumstance create a PE, therefore both §§ refer to agents who bind their principals. §5 refers to civil law agents acting in the name of the principal or all common law agents. § 6 refers to all the agents who besides sharing the features of agents referred in § 5 are also independent agents (common law independent agents plus atypical civil law independent agents – who normally do not bind the principal). The second theory presented by S. Roberts, relies on the fact that § 5 expressly qualifies as PEs dependent agents concluding contracts in the name of the foreign principal. For this theory § 6 excludes the independent agents who either do not conclude contracts at all, or conclude contracts in their own name on behalf of the foreign enterprise, from originating PEs, provided they are acting in the ordinary course of their business. This theory allows room for a grey area between the two paragraphs which would imply, eventually, that in some cases, although the agent concludes contracts in his name, he does not do so acting in the course of his business, giving, as a consequence, rise to a PE. Persico, G. Agency Permanent Establishment under Article 5 of the OECD Model Convention. *Intertax*. 2000, 2: 70-82; Avery Jones, J.F.; Ward, D. Agents as Permanent Establishments under the OECD Model Tax Convention. *European Taxation*. May 1993, p. 154; Roberts, S. The Agency Element of Permanent Establishment: The OECD Commentaries from the Civil Law View (Part One). *Intertax*. 1993, 9: 396.

⁵⁸ Kroppen, H.K.; Huffmeier, S. The German Commissionaire as a Permanent Establishment under the OECD Model Treaty. *Intertax*. 1996, 4.

independent in the terms of §6, that does not mean that a PE may be implicitly constituted. For that to happen it is mandatory that the requirements set out in § 5 are satisfied, i.e., the agent has and habitually exercises authority to conclude contracts in the name of the principal. Thus, there will only be a PE if the requirements of § 5 are met.

6. List of exceptions of § 4

Article 5.4 contains a list of business activities that do not give rise to a PE, even if the activity is carried on through a fixed place of business⁵⁹. As expressly stated in subparagraph e), the common features of these activities are the fact that they have preparatory and auxiliary character and that they are carried out solely for the general enterprise and not for third parties. However, the Commentary adverts⁶⁰ that if the activity forms an essential part of the business activity of the enterprise as a whole, it will not be able to be considered preparatory or auxiliary. Looking at the statutes of association of the company is normally a good way of determining whether a certain activity has preparatory or auxiliary character. If those activities are included in the social aim, that is a sign that those activities are essential and therefore will not be able to be considered preparatory or auxiliary. Although there are some instruments to determine the nature of the activity, such as the one we have just referred to, that is not an easy task. Therefore the Commentary, once more, gives some illustrative examples.

The first example is that of a management office that supervises and coordinates all departments of an enterprise in a certain region. That office would normally be considered a PE if that activity constituted an essential part of the business operations of the enterprise⁶¹.

It follows an example that refers to an after sales service. In this regard, it is said that if in a fixed place of business established for the delivery of spare parts to customers, activities such as maintenance or repairs of machinery are done,(as it implies going beyond the pure delivery mentioned in sub-paragraph (a) of paragraph 4), a PE may arise⁶².

A third example focuses on facilities such as pipelines and cables, which have a major importance nowadays. The use of these facilities by an enterprise

59 Commentary of Model Convention on Article 5, §21 to §30. Arnold, B. Threshold Requirements for Taxing Business Profits under Tax Treaties. *Bullentin*. IBFD, October 2003, p. 16.

60 Commentary of Model Convention on Article 5, §24.

61 *Ibid.*

62 *Ibid.*

solely for the purpose of transporting its products has preparatory or auxiliary character if that transport is merely incidental to the business of that enterprise and not its main business activity⁶³.

To sum up, two important ideas should be highlighted. First, when in addition to an activity that is preparatory or auxiliary, other activities that are not of that nature are carried on through the fixed place of business, the place of business may be considered a PE⁶⁴. Second, when two or more preparatory or auxiliary activities are carried on simultaneously through a place of business, the decision whether there is a PE or not, will rest upon the preparatory or auxiliary character of the overall business activity.

7. The case of a company which is part of a group of companies

Under § 7 a company that is part of a group of companies shall not automatically constitute a PE of any other company of the group (even if that company controls or is controlled by any of the companies of the group), given that each company is a separate legal entity in terms of tax liability. However, if one of the companies meets the requirements of any of the PE types, a PE may exist⁶⁵.

Conclusions

According to article 5 of the OECD Model Convention there are 3 types of permanent establishment.

The first to be addressed was the ‘physical PE’ and because of its importance it is also called the general type of PE. In order to exist, this type of PE requires a place of business, geographically and temporally permanent, at the disposal of the entrepreneur, through which the business activity is carried on.

Then, the notion of ‘project PE’ which relies mainly on the 12 month duration requirement in relation to the building site, construction or installation project was looked at.

Subsequently, the concept of ‘agency PE’ was presented. In this respect it was pointed out that a person acting on behalf of the enterprise, with authority to

63 Commentary of Model Convention on article 5, §26.1.

64 *Ibid.*, §30.

65 Italian Ministry of Finance v Philip Morris, Corte Suprema di Cassazione, N°.7682/02 of May 25 of 2002.

conclude contracts in the name of a principal, on a regular basis, in the name of a principal are elements that should be in place in order for a PE to arise.

Finally, it was stated, on the basis of §4 of article 5, that whenever the activity carried out is of preparatory or auxiliary character no PE, of whatever type, can arise.

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PAGRINDINIAI EBPO PAVYZDINĖS KONVENCIJOS 5 STRAIPSNIO PRINCIPAI

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Santrauka. Straipsnis parengtas aktualia tema, kurios svarbą lemia analizuojamo objekto daugiareikšmiškumas. Autorius tiria Ekonominės plėtros ir bendradarbiavimo organizacijos pavyzdinės konvencijos (toliau – Konvencijos) dėl pelno ir pajamų mokesčių 5 straipsnyje įtvirtintos nuolatinės buveinės (toliau – NB) koncepciją. Šį straipsnį sudaro septynios dalys, kuriose detalizuojama NB samprata. Pirmoje dalyje pateikiamas bendrasis fizinės NB apibrėžimas. Antroje dalyje atskleidžiamas termino NB turinys. Trečioje dalyje aptariama statybos vietos, konstrukcijų bei instaliacijos projektų reikšmė nustatant NB. Penktoje ir šeštoje dalyse aiškinama, kas yra „NB atstovavimas“. Baigiamojoje, septintoje, dalyje atskleidžiama, kad antrinės bendrovės nėra pagrindinės kompanijos NB ir vice-versa. Straipsnio autorius atliekamą analizę grindžia šios Konvencijos komentaru.

Pagrindinis straipsnio tikslas yra aptarti NB institutą ir padėti jį suprasti. Autorius nesiekia itin išsamiai išanalizuoti 5 straipsnio turinį, o dėmesį sutelkia į pagrindinius jo aspektus.

Nors šiame straipsnyje pateiktas NB apibrėžimo tyrimas yra atliktas remiantis tik Konvencija, jis gali būti naudingas analizuojant NB koncepciją, pateikiamą 1990 metų Jungtinių Amerikos Valstijų pavyzdinėje pajamų mokesčio konvencijoje bei 2001 metų Jungtinių Tautų pavyzdinėje konvencijoje.

Reikšminiai žodžiai: *mokesčių teisė, nuolatinė buveinė, verslo vieta, geografinė buveinė, laikina buveinė, nuolatinės buveinės atstovavimas.*

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