Definition of Permanent Establishment

Note by the Secretariat on Definition of Permanent Establishment: Proposed Amendments

Summary

This paper has been provided by the secretariat in consultation with the Coordinator of the subcommittee on Definition of Permanent Establishment, for consideration by the Committee. It represents the final stage of the mandate given to the subcommittee. The first stage of that mandate represented by paper E/C. 18/2007/3/Rev.1 (considered by the Third Annual Session of the Committee and approved with some amendments) proposed a new Commentary for the existing Article 5. The second stage of the Mandate requested the subcommittee to consider the desirability or otherwise of amending Article 5 (including its attendant Commentary) to address issues arising from the treatment of Article 14, including possible deletion of that Article; the issue of taxation of fees for technical services; and the treatment of services generally.

This paper updates E/C.18/2008/CRP.3, which was presented for consideration at the Fourth Annual Session of the Committee in 2008, and which addressed those three issues. It reflects the acceptance by the Committee at that Annual Session of the following approach for the work of the subcommittee, as outlined at paragraph 38 of the Report of that Committee, that the subcommittee should:

(a) Reconfigure the way the issue was addressed, so that Article 14 was retained in the United Nations Model Convention;
(b) Provide an alternative for those preferring to remove Article 14 and apply Articles 5 and 7 to situations previously dealt with under Article 14, without reducing the source country rights under the current Article 14;
(c) [liaise] with some of the Committee members and observers who had raised specific issues that should be addressed in the further work of the subcommittee; and
(d) Focus at present on that part of the subcommittee mandate relating to the possibility of an alternative to Article 14, with a view, as far as possible, to completing its consideration by the end of June 2009 when the terms of the current members of the Committee expired, leaving further work on fees for technical services and a possible

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paper does not repeat, or elaborate upon, this subcommittee's work on fees for technical services in particular or treatment of services more generally. The subcommittee conclusions on those topics are contained in E/C.18/2008/CRP.3.

4. In 2009, the previous membership of the Committee was asked to approve by written procedure some proposed new wording modified to address issues raised at the 2008 Annual Session. These were:

(i) **the proposed Alternative B version of Article 5 for States wishing to delete Article 14**, as

1. Elimination of "especially" in Article 5 (2)

I do not agree with the elimination of the word “"especially”. It is a word that is in the current OECD Tax Model and I and many Committee members took the view,

Furthermore the problem with using the word "includes" and "also includes" in paragraph 2 and 3 is that those words with a literal understanding may be understood as a deeming provision. A literal interpretation is followed by a great deal of countries and when there is no guidance available through the OECD Model commentaries the problem may be acute. These problems are the problems which I understand the UN committee should discuss and try to clarify. The problem is illustrated in the proposed article 5 paragraph 3) text which uses the words "also includes". The great discussion that we had on and if "also encompasses" is a deeming provision could easily be carried on with respect to the words "also includes", especially as we do not have any guidance on this wording from the OECD. The only guidance which some countries (not all) has accepted with respect to "includes" in paragraph 2 and that it is not a deeming provision is because the OECD commentaries have such an understanding, see UN Model commentary 4 to Article 5 (above). In my view these problems are best dealt with explaining the options in the Commentary and thereby giving the Parties to a negotiation a text which is as clear and certain as possible.

My conclusion therefore is that using the words "also includes" does not solve any interpretation issue as they in any case may be understood to be a deeming provision. Therefore I am not in favor of accepting the proposal by the subcommittee.

Perhaps a way forward for countries that believe that paragraph 2 and new 3 (old 3 a) are not deeming provisions is to simply add the "content" of the new paragraph 3 to a new subparagraph under paragraph 2. This could be explained in the Commentary to the UN Model.

3. Rewording and renumbering Article 5 (3) b) as Article 5 (4) a)

The mandate for the subcommittee was to reword Article 5 (3) b) as a result of the proposed deletion of Article 14 and therefore we should have a proposed new Article 5 (4) a) but keeping the taxation threshold as in Article 14. The new paragraph should

Furthermore, it is advisable to change the wording in a) and b) where it uses the words "employees or other personnel". This issue was pointed out at the last meeting; as there is no difference between employees and personnel the wording should be changed. If the negotiators would like to include persons other than employees, the wording could be changed as follows: "employees or other persons engaged by the enterprise".

ii) Proposed text of Alternative A to Article 5 (Annex 2)

There are three changes to Article 5 proposed in Annex 2. I disagree with the first two for the reasons mentioned in part (i) above. The third change, i.e. six months to

taxation principles as expressed in the current UN Model, and to retain the appropriate taxation balance between source and residence States. While one member of the subcommittee had expressed a preference for retaining Article 14 in the circumstances of his country, ultimately the subcommittee considered that the benefits of deleting Article 14 and relying in such cases on the established "permanent establishment" terminology would assist administrators, potential investors and advisors, while not disturbing the balance of source and residence country taxing rights.

10. The subcommittee was therefore in favour of deletion of Article 14, but had always recognised that there was not yet a uniform view on this, as reflected in the 2008 Committee decision noted above[2]. The deletion of Article 14 is therefore presented in this paper as an alternative to the current approach, and would need to be presented as such in the Commentary to Article 5 of the UN Model Convention. The subcommittee did not view the approach of having alternative provisions, determined by the Committee at its Fourth Annual Session, as promoting a "non-deletion" approach over a "deletion approach" but as a recognition that, amongst the 192 Members of the United Nations, some would prefer the *status quo* (though perhaps with some amendments unrelated to Article 14, as noted below) and some would prefer deletion of Article 14. As the UN Model was ultimately a recommendation of the UN Tax Committee, it was important to reflect both options, to consider why a country may choose one or the other option and the consequences that would follow, and to effectively put each country in the best possible position to make decisions in this regard in the light of its own situation and priorities.

11. **Annex 1** to this paper therefore provides the current relevant articles of the UN Model (Articles 3, 5 and 14). **Annex 2** contains the current Article 5, as amended by some changes, unrelated to the deletion of Article 14 (i.e., Alternative A), which are recommended for those retaining Article 14. **Annex 3** contains proposed amendments for those wishing to delete Article 14 (i.e., Alternative B). **Annex 4** contains a proposed indicative structure suggested by the subcommittee for a possible new version of the Commentary on Article 5. This will deal with both Alternatives A and B. The subcommittee would expect that the Commentaries would be drawn from the Commentary on the existing Article approved by the Committee in 2008, as modified by the material in this paper in relation to: 1) amendments suggested whether or not Article 14 is deleted (i.e., for Alternatives A and B) and 2) amendments relating to the deletion of Article 14 (i.e., where alternative B is preferred). The actual text of the draft Commentary is not provided in draft, as the subcommittee considered that it was better to, at this stage, describe the changes proposed in this paper, seek Committee approval of the proposed text of Articles, and leave the elaboration of the Commentary to be addressed as the Committee sees fit. **Annex 5** indicates proposed consequential changes to Commentaries on articles other than Article 5 of the UN Model, in cases where Article 14 is deleted, as the subcommittee found it important to contextualise the proposed changes. **Annex 6** gives a brief account of the "fixed base" concept relevant to this paper, in particular to the deletion or otherwise of Article 14.

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[2] At paragraph 2.

B Main arguments for deletion of Article 14 – a Consideration[3]

12. The main reasons in *favour* of deleting Article 14 were, in the subcommittee's view, the following:

(i) Coverage of activities other than professional services

13. The subcommittee noted the *uncertain coverage* of Article 14. In particular, the issue of to which activities it applies, including whether it covers activities other than the performing of professional services. On one view, 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 considered this view and felt that while the application of Article 14 to professional services was clear; its application to "other activities of an independent character" was ambiguous. It is not clear how extensive this formulation is intended to be, or how much overlap, if any, might be created with activities falling within Article 7 (Business Profits). Literally, it goes beyond professional services because it includes "other activities of an independent character (i.e. not merely of a "similar" character, which is a formulation that appears in some earlier treaties), but there is an issue of how far it goes beyond professional services. For example, do the activities of sub-contractors in the construction industry, which would otherwise come under Article 7, fall within this formulation?

14. 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" as services "it is believed … should be covered because the provision of such services in developing countries by corporations of industrialized countries often involves very large sums of money." 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.

15. The reference to "other activities of an independent character"

approach taken by the OECD in deleting Article 14. Some states might wish to go further

Article 14, or else, 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 thresholds

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services", the paragraph may be applied to someone who *is not* performing the services referred to in the paragraph but who *is deriving income* from these services. That approach reduces the possible scope for differences between Article 14 and Article 7 but would also indirectly seem to support the view that Article 14 also applies to companies, rather than being limited to applying to individuals.

28. The second approach is to consider that Article 14 only allows State S to tax income attributable to a fixed base that is used by a non-resident to provide his personal services so that A, B and C are not taxable in State S as long as they do not personally provide any services there. Under that approach, the words in Article 14(1)(a): "for the purpose of

C Main Arguments for Retaining Article 14

32. The main arguments expressed 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?

33. 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 as a result of the change. On one such view, the degree of permanence required of a fixed base is lower than that required of a permanent establishment, based on the fact that a business must be

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.

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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 latter definition is not exhaustive. However, since all the Article 14 activities would now fall within Article 7, together with all other business income, it would not matter in practice. Nor would there be any alteration of the balance of taxing rights resulting 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?

44. 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 paragraphs (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 Article 7(6) (i.e. that other articles take precedence) applies in relation to Article 14.

45. That raises a key question: would moving the coverage of independent personal services from Article 14 (which has no explicit exception for "preparatory and auxiliary" activities) to Article 5 (which *has* such an exception) change the balance of taxation rights? The subcommittee considers that this is a theoretical, rather than a practical possibility, as it considers that, with the proposed special provisions for the taxation of the performing of services under proposed Article 5(4), any reduced source tax coverage could relate only to the provision of independent personal services through a fixed place of business but which were "preparatory and auxiliary" under the existing Article 5(4).

46. The subcommittee reviewed the matter, as noted below, and ultimately did not consider that cases of preparatory and auxiliary activities to non-fixed place of business permanent establishments are likely to actually arise in practice, and was of the view that any such cases would be so rare (if they occurred at all) as to not have a practical impact on the balance of taxing rights. Further the Committee noted that the personal services referred to in existing Article 14 and proposed Article 5(4) are services provided to others, which reduces the possibility that any "preparatory or auxiliary activities" exception could apply to them. It is unlikely that there would be any significant fee charged for, or income attributable to, the provision of such preparatory or auxiliary services, in any case.

47. The subcommittee noted that paragraph 4 of Article 5, which excluded certain activities from the concept of "permanent" establishment" would only apply to "independent personal services" cases in a few instances. Subparagraphs (a) to (c) would not apply in such a case, subparagraph (d) would not seem to apply, as purchasing of goods or collection of

information for the enterprise would not also represent the provision of a service to another person. Subparagraph (f) merely addresses "combinations of activity", so that subparagraph (e) is the only potentially relevant provision in its own right: "[t]he 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".

48. The question is, then, whether the application of this extra requirement (that it not be a subparagraph (e) activity) to what were formerly "fixed base" cases under Article 14 results, in any real sense, in a diminution of source State taxing rights, and it can be immediately observed that subparagraph (e) is a general provision referring to other instances of preparatory or auxiliary activities, and that what constitutes such activities naturally takes meaning from the examples given in the other subparagraphs.

49. In the proposed redrafted Article paragraph 5, which deals with preparatory and auxiliary activities, applies "[n]otwithstanding the preceding provisions of this article" so that it applies to both aspects of proposed paragraph 4 dealing with the performing of services. In providing for this, the subcommittee nevertheless considers that there is little or no scope for the provision of a service, meeting the test of either subparagraphs (a) or (b) of proposed paragraph 4, to be regarded as merely preparatory or auxiliary. In any case, only the amount attributable to the provision of services could generally (depending to some extent upon the wording of paragraph 1 of Article 7 in a particular treaty) be taxed in the host state, not amounts attributable to other activities. The subcommittee therefore does not consider that there is in any practical sense, a diminution of source State taxing rights by making proposed paragraph 4 subject to the preparatory and auxiliary activities exception in proposed paragraph 5.

50. The subcommittee notes that the 2008 changes to the OECD Model[12] provide the following option ("the OECD alternative provision") at paragraph 42.23 of the new OECD Commentary on Article 5:

> Notwithstanding the provisions of paragraphs 1, 2 and 3, where an enterprise of a Contracting State performs services in the other Contracting State
>
> a) through an individual who is present in that other State for a period or periods exceeding in the aggregate 183 days in any twelve month period, and more than 50 per cent of the gross revenues attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State through that individual, or
>
> b) for a period or periods exceeding in the aggregate 183 days in any twelve month period, and these services are performed for the same project or for connected projects through one or more individuals who are present and performing such services in that other State

[12] "The 2008 Update to the Model Tax Convention", OECD, 18 July 2008.

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

51. The subcommittee notes that in this formulation, there is a preparatory and auxiliary test which in effect applies subparagraphs (d), (e) and (f), (subparagraphs which in their terms address the use of a fixed place of business) but applies the test in a way that "switches off" the "fixed place of business" requirements. In other words the provisions apply subparagraphs (d) (e) and (f) to the extent of enquiring, in a services provision case, whether the services are merely those of collecting information for the enterprise, or carrying on other preparatory or auxiliary activities. The preparatory or auxiliary tests drawn from Article 5 situations ultimately do not give much guidance in the area of services and there might also be difficulties conceptually and practically in hypothesising a fixed place of business but then attributing a real purpose to that hypothesised fixed place, since subparagraphs (d) and (e) look to the *purpose* of the maintenance of the fixed place of business, and paragraph (f) implicitly does the same.

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(iv) Does Article 14 permit the taxation of gross income, with Articles 5 and 7 only allowing taxation of net income, so that there is a loss of source State taxing rights?

54. The argument has been made that to delete Article 14 and bring independent personal services into the "net income concept" of Articles 5 and 7 from their previous home of the "gross income concept" of Article 14 represents a loss of source country taxing rights, and imposes extra burdens upon the administrations of developing countries.

55. Article 7 allows the source State to tax *profits* attributable to a permanent establishment. Article 14, however, allows the source State to tax *income* attributable to a fixed base. The concept of profits clearly means "net" income, i.e. after the deduction of those expenses permitted by domestic law[13], as confirmed by Article 7(3). The concept of income in Article 14 has sometimes been interpreted more broadly so as to allow taxation on *either* a gross or net basis. The proponents of such interpretation point to the fact that the phrase "income derived" is also found in Article 6 (Income from Immovable Property) and Article 17 (Artistes and Sportsmen), where the Commentary explicitly contemplates taxation of the gross amount. Arguably, a further confirmation of that interpretation is the fact that paragraph 3 of Article 24 (Non-discrimination), which has a direct effect on the deduction of expenses related to a permanent establishment, is not expressed as applicable to fixed bases.

56. On the other hand, the existing Commentary on Article 14 clearly states at paragraph 10 that countries should tax only the net amount:

> …expenses incurred for the purposes of a fixed base… should be allowed as a deduction in determining the income attributable to a fixed base in the same way as such expenses incurred for the purposes of a permanent establishment.

57. In addition, the fact that Articles 10 to 12 clearly specify that the source State may levy tax on the "gross" amount of the dividends, interest, etc, might be argued to imply that in cases where there is no such specific provision, only the net amount should be taxed under Article 14.

58. The subcommittee considered this issue and concluded that the only issue for its current consideration was whether the taxation of some providers of services who were previously dealt with under Article 14 and not Article 7 would be affected so that the State where the services are performed would no longer be able to tax the gross receipts from that provision of services, but would instead now be able only to tax the net receipts, by virtue of the limited taxing right under Article 7 as compared with Article 14. An example might be the

[13] The subcommittee notes that the requirement that the host State should allow deductions in calculating the profits of a permanent establishment only means that it must allow those deductions that are provided for under its domestic law. Most countries will have rules about the sort of deductions that are generally permitted, and they are not required to give a deduction for items not on that list. Entertainment expenditure is an example of an item that is frequently disallowed. Accounting depreciation is another, where capital allowances are given instead. In such cases, a State could tax a permanent establishment on its gross income without allowing such deductions and yet the State would not thereby be offending the principles of Article 7 (or of course Article 14).

meaningless over time and would potentially only limit the import of services, and because it was little used. The subcommittee considers that countries wishing to preserve such a rule in relation to the performing of services could still do so if they wanted, even if included under the head of Article 5, rather than under Article 14. Existing treaties with the former 14(1)(c) would, of course, be unaffected by the proposed change.

D Subcommittee Conclusions on Article 14

(i) General conclusions

69. After considering the arguments for and against deletion of Article 14, the subcommittee concluded that retaining the combination of Article 14 and Articles 5 and 7 would continue to cause difficulties, ambiguities and uncertainty in application that benefit neither administrations nor taxpayers. These difficulties include: the uncertainties over the personal scope of Article 14; the scope of activities that fall under Article 14; the possible interpretation of a difference between the concepts of permanent establishment and fixed base that serves no policy or administrative purpose; and difficulties over the taxation of partnerships under Article 14 (especially those of a mixed individual/company character) and in relation to the taxation of large worldwide partnerships of lawyers etc. The subcommittee notes that the OECD, for these and other reasons, deleted Article 14 from the OECD Model in 2000, and merged this Article into Articles 5 and 7 of the OECD Model.

70. The subcommittee considered that the UN Model should do the same, while recognising that this will only be one option provided in the Model, in accordance with its mandate. It believes that this can be done without raising the threshold for taxation in source countries. The draft wording at Annex 3 of this paper for the various provisions affected by the deletion of Article 14 seeks to achieve this. The structure of those proposed amendments is considered below.

(ii) The structure of the suggested changes

71. The integration of Article 14 concepts into Articles 5 and 7 is reflected in the subcommittee's proposed text for Article 5 of the UN Model, which can be found at Annex 3 of this paper. Structurally, the proposal is as follows:

- the existing Article 5(3)(a) (building sites) is mirrored in the proposed Article 5(3);

- the existing Article 5(3)(b) (furnishing of services)is proposed to become Article 5(4)(a);

- the content of existing Article 14(1)(b) (stays of 183 days or more) is expressed in the proposed Article 5(4)(b) as complemented by Article 7; and

72. Finally, the subcommittee also proposes some changes of a logical and stylistic nature, to assist in the clarity and readability of the relevant provisions.

73. The existing Article 14(1)(a) (taxation on the basis of a "fixed base") does not explicitly find a place in the proposed articles. However, its contents are covered by the existing Article 5(1) in combination with Article 7, Article 3(1)(c) and Article 3(1)(h). The concept of a "fixed base" is therefore replaced by the concept of "permanent establishment", with alterations to clarify that all cases previously dealt with in Article 14 are now dealt with by Articles 5 and 7.

(iii) Transition to a Model with Article 14 and non-Article 14 alternatives.

74. Without departing from its view in favour of removing Article 14, the subcommittee had always recognised that some States may wish, for administrative or other reasons, to retain Article 14 as it was in the 2001 UN Model, whether as a shorter or longer term measure. The subcommittee also recognised that a consideration of Article 14 will be relevant to existing treaties for some time to come. It had therefore proposed that the existing Article 14, as well as its Commentaries and the 2001 versions of those provisions in other articles which the subcommittee suggests need consequential amendments, should be preserved, in their 2001 state as an Annex to the next version of the Model. A draft Annex addressing such changes was attached to the 2008 version of this paper (E/C.18/2008/CRP.3) as Annex 3.

75. This approach was discussed in the 2008 Annual Session of the UN Tax Committee and, as outlined at paragraph 38 of the Report of that Committee (E/2008/45; E/C.18/2008/6) the subcommittee was asked to:

(a) Reconfigure the way the issue was addressed, so that Article 14 was retained in the United Nations Model Convention;

(b) Provide an alternative for those preferring to remove Article 14 and apply Articles 5 and 7 to situations previously dealt with under Article 14, without reducing the source country rights under the current Article 14;

(c) [Liaise] with some of the Committee members and observers who had raised specific issues that should be addressed in the further work of the subcommittee (which has been done with secretariat assistance); and

(d) Focus at present on that part of the subcommittee mandate relating to the possibility of an alternative to Article 14, with a view, as far as possible, to completing its consideration by the end of June 2009 when the terms of the current members of the Committee expired, leaving further work on fees for technical services and a possible revision of Article 14 and its commentary as matters for consideration by a future membership of the Committee.

76. As noted at paragraph 39 of that Report, the issue of updating and improving Article 14 was an important one that should be dealt with by a new subcommittee on Article 14 and the Tax Treatment of Services, coordinated by Ms. Liselott Kana.

(iv) Personal scope not addressed

80. The proposed changes do not attempt to resolve the debate on the "personal scope" of Article 14; that is, the issue of whether the current Article 14 only covers individuals (see discussion at paragraphs 18-19 above). This issue is currently unresolved under the UN Model, just as it was not resolved under the OECD Model before the Article was removed. In view of the conclusions of the subcommittee in favour of removing Article 14, which solves the problem, the subcommittee has taken the question no further. Any further work on this aspect would need to be dealt with by the new subcommittee on Article 14 and the Tax Treatment of Services.

(v) Rewording of Article 5(2)

81. It has occasionally been suggested that the current text of Article 5(2) ("The term 'permanent establishment' includes especially…") means that the paragraph deems each of the items to *automatically* be a permanent establishment. The subcommittee rejects this view.

82. 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

84. The list in paragraph 2 is clearly not intended to be an exhaustive list of places capable of meeting the test of paragraph 1 and the proposed removal of the word "especially" should not be read as seeking to make such a change. In the subcommittee's view, Article 5(2) should be interpreted in the same way whether or not the change suggested, removing the word "especially", is adopted in a treaty or not. Some members of the subcommittee nevertheless preferred retaining the word "especially" on the basis that its removal was not likely to appreciably improve clarity or certainty. That view was shared by two Members of the Committee in the written procedure of this year, as noted above, and if the Committee decides on balance to retain the word "especially", so long as the same approach is taken whether or not countries are deleting Article 14 in their treaties, such a retention would be compatible with the other recommendations suggested by this subcommittee.

85. Another option 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, feels that this understates the meaning of Article 5(2), which helpfully suggests what are *prima facie* likely to(i)TD.0011 Tc. are

the enterprise), apart from the time requirement which is replaced by the more than 12 months criterion in that Model.

88. The UN Model provision, however, is differently worded, so the question must be addressed of whether that difference is significant. The UN Model provides that "[t]he term 'permanent establishment' also encompasses" the specified situations, rather than saying, as in the OECD Model, that it "includes especially". The UN Model also provides at paragraph 3(b) a second type of permanent establishment, the so-called "services permanent establishment" as well as the construction site or project related permanent establishment in both Models. The subcommittee considered that each of these elements of paragraph 3 needed separate consideration.

89. In the changes to the Commentary agreed by the Committee in 2007[18] and which address the current text of the Article, it was noted at paragraph 7 that:

> 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.

90. The subcommittee considered this issue further and noted that paragraph 3(a), like paragraph 2, did not address all the elements of the PE requirement in that, while it addresses which activities might constitu4(entr.3)-.5(nt186o40 TD( )Tj/TTTc)t establishment and also give specific test of the time during which such activities must continu.3for there3to be a permanent establishment, it does not deal with the question of *whose* permanent establishment it is in relation to the activities. That question is only informed by the reference in paragraph 1 to the "enterprise". The subcommittee considers that the *whole* of paragraph 3(a) is so informed by the basic rule at paragraph 1. St urally, paragraph 3(a) cannot be a stand-alone provision as it answers the "what activities" and "how long" questions relating to permanent establishments, but not the "who" question, recalling that a permlishment as a concept is he lpful only in the context of identifying an enterprise *of which* it is the permanent establishment.

91. Paragraph 3(b) is different: it is truly self-contained and self-standing in that it addresses those activities that constitute the permanent establishment (the "what activities" question), the relevant period of time (the "how long" question), and the link between the enterprise and the activities that is required – performance of services by the enterprise through others (the "who" question). No reference back to Articles 1 or 2 is required.

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92. The subcommittee, however, recognises the distinct differences of interpretation between States treating paragraph 3(a) as a deeming provision, and others viewing it as a provision to be read in conjunction with the basic rule at paragraph 1. The subcommittee did not consider that sufficient agreement could be reached on this point, so it did not seek to clarify the point by amended wording.

93. In this respect, the subcommittee was also particularly taking into consideration its view that the question of whether or not paragraph 3(a) is self-standing was a more theoretical than practical issue. As 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. The word *encompasses* (or its synonym *includes*) expresses this relationship of Article 5(3) to Article 5(1), if the same approach as taken by the OECD Model 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.”

94. 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 probably 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.

95.

difference in meaning, and could confuse those who would expect different phrases used in the same article to have some intended differentiation in meaning. The subcommittee therefore suggests that the same terminology should be used in the two paragraphs – (“includes in paragraph (2) and “also includes” in paragraph (3)). The word “also” has been retained simply to clarify that no attempt is being made to change the balance of this provision, and because it is the second such instance of an “includes” paragraph in the Article. The subcommittee considers that even States retaining Article 14 might wish to alter the words “also encompasses” in Paragraph 3 to “also includes” where convenient.

99. For States agreeing that a more specific provision is needed to clarify that paragraph 3 must be read in the context of paragraph 1: the following wording is a possible solution:

> A building site, construction, assembly or installation project or any supervisory activity in connection therewith, constitutes a permanent establishment only if such site, project or activity lasts more than six months.

100. For States agreeing that a more specific “deeming provision” is needed to clarify the self-standing aspect of paragraph 3, the following wording is a possible solution:

> The term “permanent establishment” shall be deemed to include–a building site, a construction, assembly or installation project or any supervisory activity in connection therewith, but only if such site, project or activity lasts more than six months.

101. For the reasons expressed in the following part of the paper, the subcommittee proposes including the current Article 5(3)(b) in a separate, reworded Article 5(4)(a).

(vii) Rewording and renumbering Article 5(3)(b) as Article 5(4)(a)

102. The “furnishing” or “performing” of services often takes place without the physical place of business of Article 5(1), which is Article 5(3)(b)’s reason for existence. The provision should be understood as providing for a “deemed” permanent establishment: in other words, if the activities of this provision are met a permanent establishment exists, even though the terms of Article 5(1) may not be met. This analysis can therefore be done without needing to consider the terms of Article 5(1).

103. This is a different situation to that of a construction permanent establishment, where the terms of Article 5(1) are relevant, subject to a special “time test” replacing the normal paragraph 1 time tests. The subcommittee therefore proposes, in cases where Article 14 is deleted, separating the construction permanent establishment paragraph from the services permanent establishment paragraph to reflect these differences.

104. The proposed text, without altering the current substance of Article 5(3)(b), reads:

4. A permanent establishment shall be deemed to exist:

(a) where an enterprise performs services through employees or other

clear the subcommittee's intention of streamlining the operation of Article 5, by fully covering Article 14 situations, while not altering the balance of taxing rights.

109. The subcommittee considered it unnecessary to provide for an explicit reflection of Article 14(1)(a) (taxation based on existence of a "fixed base") in Article 5, as that provision is fully covered by existing Article 5(1). This is because the "permanent establishment" concept fully covers "fixed base" situations in the subcommittee's view, as noted above, and Alternative B will clarify that.

110. 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 referred to in order to preserve the current balance of taxing rights in the UN Model, as the current Article 5(3) does not contain a similar "presence", as opposed to "activities" based, time test.

111. Whereas current Article 5(3)(a) requires a project of 6 months, and whereas Article 5(3)(b) has specific requirements related to the performing of services, the triggering condition for Article 14(1)(b) is merely the *physical 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 an addition 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 the removal of Article 14 from the OECD Model.

112. As the 183 day activities test of Article 14 is best classified as a "deemed permanent establishment" when viewed in

effect, where there is not an employment or the like situation as covered by paragraph 4 (a). This is a way of reflecting the difference under the current Model between “dependent personal services” and “independent personal services” without using those largely outmoded terms, and while ensuring that between them, paragraphs 4(a) and (b) give the same coverage as Article 5(3)(b) and Article 14(1)(b) of the current Model.

114. In part because of the uncertainty about what constitutes “professional services”, despite the partial definition at Article 14(2), and also because of the increasingly tenuous distinctions between “professional” and “commercial” activities, proposed new paragraph 4(b) has avoided references to that term, or to independent personal services, and has been made applicable to “services” generally.

115. In doing so, it might be argued that source country taxing rights are being extended, however the subcommittee considered that as the current Article 14 extends not just to professional services, but to other activities of “an independent character”, this is not the case. Any services performed by an individual under paragraph 4(b), that is - in a non-employment situation, would in the subcommittee’s view, come within the definition of professional services or would be “other activities of an independent character”. Again, the way in which paragraphs 4(a) and (b) complement each other, rather than overlap, reflects the intended complementary relationship between Articles 14 and 5 under the current Model, as reflected in the Commentary on Article 14.

116. The proposal also deletes the Article 14(1)(b) requirement that the individual referred to must be a resident of one Contracting State staying in the other Contracting State . It replaces it by a reference to “the enterprise” to conform to the structure of Article 5 and ensure that the operation of the provision could not be avoided by the enterprise of the first State simply utilising residents of the State where performance of services occurs, or by an individual changing the State of his or her residence.

117. Article 7 will then address the “profits of an enterprise of a contracting State”, so that in effect the focus has shifted from the State of residence of the individual performing the services to whether the enterprise connected to such performance is an enterprise of a Contracting State. This is consistent with the way Article 5 operates and interacts with Article 7.

118. The subcommittee did not regard this change as altering the balance of taxing rights, as the enterprise will, in the actual operation of subparagraph (b), generally be synonymous with the State of residence of the individual, and in other cases either paragraph 5(4)(a) is likely to apply or else the matter would be treated as a purely domestic situation unaffected by the treaty.

119.

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.

122. The proposed wording for paragraph 4, if Article 14 is deleted, is:

4. A permanent establishment shall be deemed to exist:

(a) where an enterprise performs services through employees or other personnel engaged by the enterprise for such purpose:

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) where an enterprise performs services *other than* through employees or other personnel engaged by the enterprise for such purpose;

if the services are performed through an individual and the individual's stay in the Contracting State where the services are performed is for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned.

123. The question has arisen of which of paragraphs 5(3) or 5(4) would take precedence under the proposed amended Article. Both of these provisions have determinative force. Paragraph 4 is a deeming provision, while the relevant aspect of paragraph 3 for current purposes is that if the site, activities etc last for 6 months or less they are *not* a permanent establishment under this provision, and resort could not be had to paragraphs 1 and 2 to render them a permanent establishment on general grounds where they have been ruled out as such by the specific provision at paragraph 3. The issue therefore does not depend on whether paragraph 3 is viewed as a deeming provision or not (an issue left open in the proposed paragraph), because in either case, it has this impact on the time requirement for a permanent establishment to exist.

124. Take, for example, the case of an engineer, Z, who carries on the engineering business of an enterprise for a total period of 8 months in a State, but at two different and unrelated construction sites (4 months at each site). Are Z's activities deemed to constitute a PE of the enterprise under 5(4) when 5(3) states that a construction site is a PE ***only if*** it lasts more than six months? *Prima facie*, because the engineer spends less than six months at each construction site, paragraph 5(3) prevents the site from being a PE. But *prima facie* , paragraph 4 deems there to be a PE of the enterprise because of the *presence* of the employee there for over 183 days, or where the *activities* of a self-employed person exceed that time test.

125. The analysis of such a situation most in keeping with the wording of the Article would seem to be as follows: the sites do not each constitute a permanent establishment, since they are unrelated and cannot be treated as a single site under paragraph 5(4). Whatever would be the case under paragraph 1 of the Article, and whether or not one regards paragraph 3 as a "deeming provision" as to what is a permanent establishment, a construction, assembly or installation project or (perhaps most importantly here) supervisory activities in connection therewith, are protected from being permanent establishments by Article 5(3) when they do not meet the more than 6 months time threshold,

126. Article 5(4) can, however, deem there to be a permanent establishment where the time test has been met in relation to either the provision of services or the presence of an employee in the State where services are performed. If the services provided are not covered by paragraph 3 then there is no difficulty, Article 5(3) is not relevant and Article 5(4) has full effect.

127. However, if the services performed are covered by paragraph 3, the most relevant legal analysis would be that this is a case where the well accepted principle of "lex specialis" applies: ***Lex specialis derogat legi generali***. The doctrine states that a provision governing a specific subject matter (*lex specialis*) is not overridden by a provision which only governs general matters (*lex generalis*). In the context of services contemplated in paragraph 3, the *lex specialis* is at paragraph 3, and paragraph 4 would be overridden and inapplicable to the extent of the conflict.

128. The OECD "alternative" services provision appears on first examination, however, to provide just the opposite result. In providing that: "[n]otwithstanding the provisions of paragraphs 1, 2 and 3, where an enterprise of a Contracting State performs services in the other Contracting State" ... the "services permanent establishment" rule is therefore prima facie overriding paragraph 3, the "construction permanent establishment" rule: "A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months". Note however, that the OECD paragraph 3 does not refer to "supervisory activities" so that there is less possibility for a conflict in practice.

131. An alternative policy approach would be to reverse the position suggested above and reduce the special position of construction–related permanent establishments under the Model, and therefore allow paragraph 4 to operate without hindrance from paragraph 3, by wording such as:

> 4. Notwithstanding the provisions of paragraphs 1, 2 and 3, a permanent establishment shall be deemed to exist where:

132. Another wording for this same approach would be:

> 4. Notwithstanding the preceding provisions of this article, a permanent establishment shall be deemed to exist where:

133. Perhaps most accurately, since only paragraph 3 *excludes* activities from being permanent establishments, and since only that paragraph provides the risk of a conflict with the function of paragraph 4 in deeming activities to *constitute* a PE, the wording should be:

> 4. Notwithstanding the provisions of paragraph 3, a permanent establishment shall be deemed to exist where:

134. In choosing between preserving, or confirming, the precedence of paragraph 3 on the one hand, and giving precedence to paragraph 4 on the othe

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> not, in the scheme of the two Articles, be circumvented by reference to Article 14.

136. A specific "rule of precedence" of the type noted above is ultimately not proposed by the subcommittee, as there a

useful to put that beyond doubt now that independent personal services previously covered by Article 14 had been introduced into the scheme of Article 5.

(x) Ensuring full coverage of professi

which were previously covered by Article 14, was intended to prevent that the term "business" be interpreted in a restricted way so as to exclude the performance of professional services, or other activities of an independent character, in States where the domestic law does not consider that the performance of such services or activities can constitute a business. Contracting States for which this is not the case are free to agree bilaterally to omit the definition.

147. The subcommittee also suggests building upon the OECD Commentary changes relating to Article 3 by incorporating part of paragraph 4 of the OECD Commentary into paragraph 5 of the UN Commentary to Article 3 along the following general lines. Note that that the drafting will, of course, have to be integrated with any other changes to the Commentary to Article 14 in future, and that the phrase "are free" as used in the last sentence of paragraph 10.2 of the OECD Commentary is changed to "may wish", to better reflect the UN Model's role and application:

(c) The term "enterprise"

The question whether an activity is performed within an enterprise or is deemed to constitute in itself an enterprise has always been interpreted according to the provisions of the domestic laws of the Contracting States. No exhaustive definition of the term "enterprise" has therefore been attempted in this Article. However, it is provided that the term "enterprise" applies to the carrying on of any business. Since the term "business" is expressly defined to include the performance of professional services and of other activities of an independent character, this clarifies that the performance of professional services or other activities of an independent character must be considered to

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by Article 14, was intended to prevent that term "business" from being interpreted in a restricted way so as to exclude the performance of professional services, or other activities of an independent character, in States where the domestic law does not consider that the performance of such services or activities can constitute a business. Contracting States for which this is not the case may wish to agree bilaterally to omit the definition.

150. For the proposed redrafted Article 5(3) and Article 5(4)(a), the proposed changes to Article 3 have no significance. Article 5(3) currently covers the situations that would be covered by suggested Article 5(3) and Article 5(4)(a) without the ex

Annex 1:
Current Relevant Articles of the UN Model[22]

Article 3

2. the term “permanent establishment” includes especially:

(a) A place of management;

(b) A branch;

(c) An office;

(d) A factory;

(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 14

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:

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Annex 2:

Article 5 of the UN Model – Proposed Amendments for those Wishing to Retain Article 14 (Alternative A)

Article 5

1. 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.

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~~ **includes**:

(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) witp(th-4(p)-.,)1w

(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.

Annex 3:

Relevant Articles of the UN Model – Proposed Amendments for those Wishing to Delete Article 14 (Alternative B)

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 enterprise that has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State;

(f) The term "competent authority" means:

(i) (In State A): ....

(ii) (In State B): ....

(g) The term "national" means:

(i) Any individual possessing the nationality of a Contracting State

(ii) Any legal person, partnership or association

Article 5

1. 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.

2. The term “permanent establishment” includes ~~**especially**~~:

(a) A place of management;

(b) A branch;

(c) An office;

(d) A factory;

(e) A workshop;

(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;

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: *Deleted*

Article 15

Title "Dependent Personal Services" replaced by "Income from Employment"

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(a) The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and

(b) The remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and

(c) The remuneration is not borne by a permanent establishment ~~or a fixed base~~ which the employer has in the other State.

Article 17

1. Notwithstanding the provisions of Articles 14~~ and ~~15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as a sportsperson, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.

Paragraph 5 of Alternative A/ *Paragraph 6* of Alternative B

[Common Commentary, reflecting that accepted by Committee in 2007, except for consequential renumbering of paragraphs referred to.]

Paragraph 6 of Alternative A/ *Paragraph 7* of Alternative B

[Common Commentary, reflecting that accepted by Committee in 2007]

Paragraph 7 of Alternative A/ *Paragraph 8*of Alternative B

[Common Commentary, reflecting that accepted by Committee in 2007]

Paragraph 8 of Alternative A/ *Paragraph 9* of Alternative B

[Common Commentary, reflecting that accepted by Committee in 2007]

C. CONSEQUENTIAL CHANGES WHERE ALTERNATIVE B IS ADOPTED

For those States deleting Article 14, and relying on this alternative version of Article 5 (Alternative B), certain consequential changes are suggested to ensure that former Article 14 cases are all now dealt with under a combination of Article 5 and Article 7.

The suggested consequential changes are to Articles 3, 6, 10, 11, 12, 13, 15, 17, 21 and 22. They flow on naturally from the changes proposed in this alternative Article 5. A proposed change to the title of Article 15 from "Dependent Personal Services" to "Income from Employment" is not strictly consequential, but is useful to clarify its operation after the proposed deletion of Article 14, and follows more ordinary usage.

The renumbering of Articles 15 and following Articles upon the proposed deletion of Article 14 is not proposed in Alternative B, especially as the removal of Article 14 is only one option provided in this Model, although States may prefer to do so in their bilateral treaties.

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 that other State independent personal services from a fixed base situated therein,~~ and the right or property in respect of which the income is 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.

Article 22

2. Capital represented by movable property form2

Annex 5:

Convention, unlike the OECD Model Convention, adopts a limited force of attraction rule in Article 7, defining the income that may be taxed as business profits, a conforming change is made in Article 11, paragraph 4, of the United Nations Model Convention. This modification makes paragraphs 1 and 2 of Article 11 inapplicable if the debt claim is effectively connected with the permanent establishment **(or fixed base, where applicable)** ~~or fixed base~~ or with business activities in the source country of the same or similar kind as those effected through

Annex 6:

A Short History of the "Fixed Base" Concept

Historically, the "fixed base" concept goes back to the work of the Organisation for European Economic Cooperation (OEEC – the predecessor to the OECD) in its Reports of 1959. The London (1946) and Mexico (1943) Drafts had used the concept of permanent establishment in the context of independent personal services without reference to a "fixed base".

Article VII(4) of the Mexico Draft read:

> "Income derived by an accountant, an architect, a doctor, an engineer, a lawyer or other person engaged in the practice of a liberal profession shall be taxable only in the contracting State in which the person has a permanent establishment at, or from, which he renders services."

Article VI(4) of the London Draft read:

> "Income derived by an accountant, an architect, an engineer, a lawyer, a physician or other person engaged on his own account in the practice of a profession shall be taxable in the contracting State in which the person has a permanent establishment at, or from, which he renders services."

Prior to that, the Report presented by the Committee of Technical Experts on Double Taxation and Tax Evasion (League of Nations) (April 1927) Model Article 5 read:

> "Income from any industrial, commercial or agricultural undertaking and from any other trades or professions shall be taxable in the State in which the persons controlling the undertaking or engaged in the trade or profession possess permanent establishments."

Also the 1928 report presented by the General Meeting of Governmental Experts on Double Taxation and Tax Evasion (C.562.M.178.1928.II), Text of Draft Convention Ia, made no difference in Article 5[26] [27]:

> "Income, not referred to in Article 7, from any industrial, commercial or agricultural undertaking and from any other trades or professions shall be taxable in the State in which the permanent establishments are situated".

In 1931 a distinction was made in the Fiscal Committee Report to the Council on the Work of the Third Session of the Committee (C.415.M.171.1931.II.A). For industrial, commercial or agricultural enterprises the permanent establishment concept was used (Article 5 of the Draft Plurilateral Convention "A" for the Prevention of the Double Taxation of Certain Categories of Income), whereas Article 7 provided:

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[26] Article 7, to which Article 5 refers, deals with dependent personal income: salaries, wages etc.

[27] Nor did the other Models Ib (Article 2) and Ic (Article 3).

> "The income of the liberal professions shall be taxable only in the States in which they are regularly exercised."

The 2nd OEEC Report (July 1959) dealt with personal services by including the concept of fixed base (Annex B, Article VI):

> "Income derived by a resident of a Contracting State in respect of professional services or other independent activities of a similar character shall be taxable only in 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[28].

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