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## **Committee of Experts on International Cooperation in Tax Matters**

New York, 23-26 April 2019

Item 3 (b) of the provisional agenda

### **Update of the UN Model Double Taxation Convention between Developed and Developing Countries - Permanent Establishment**

#### *Summary*

This note contains a number of possible changes to the Commentary to Article 5 of the UN Model for the Committee to consider for the next update of the UN Model. The proposed changes aim to achieve two objectives.

First, in its efforts to revise Article 5 and its Commentaries for the 2017 UN Model update, the former Committee prioritized adopting the changes to the OECD Model and Commentary that resulted from the Action 7 work of the BEPS project. Prior to initiating



## **B. COMMENTARY ON THE PARAGRAPHS OF ARTICLE 5**

### ***Paragraph 1***

3. This paragraph, which reproduces Article 5, paragraph 1 of the OECD Model Convention,

Commentary, this definition contains the following conditions:

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

The OECD Model Commentary goes on to observe:



Paragraph 9 does not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance and wishes to quote it in the UN Model.

**COMMENTS RECEIVED:**

Determination of PE independent of nature of income is the principle laid in this para. Purpose is stated to be for application of Article 11(5,6), 15(2)© and 24(3). As per Art 11(4), carrying on of business through the PE to which debt claim is effectively connected is the condition for application of Art 7 instead of Art 11(1&2). Even if a PE is determined for a farm irrespective of nature of income falling under Article 6, application of Article 7 may not be possible for interest income as per Art 11(4) if income is falling under Article 6. The reason for determination of PE independently of what would be nature of income through it

**RESPONSE:** The value added by OECD Commentary paragraph 9 is to refute arguments that a permanent establishment cannot exist if the taxation of the relevant income is not governed by Article 7. The example given is that of a farm that derives income from agriculture falling under Article 6. Commentary paragraph 9 makes clear that even though the taxation of the income is governed by Article 6, the farm may nevertheless constitute a permanent establishment if it satisfies the definition in Article 5, and that the PE determination may be relevant for applying other provisions of the Convention. In the example of interest paid to a farm put forth in the above comments, Commentary paragraph 9 would provide that the interest, being attributable to a PE, would be taxed under Article 7, by virtue of Article 11(4). Article 7(6) would then apply to resolve any conflicts between Articles 6 (if, for instance, the interest is characterized as income from agriculture falling under Article 6) and 7. If, on the other hand paragraph 9 is not adopted, the argument that the farm may be precluded from being considered a PE is not clearly rejected. In such a case, the two potentially applicable Articles of the treaty would be Articles 6 and 11, and there is no rule to resolve that conflict. Therefore, it would seem desirable to clarify that the

it is less clear that it would prevail over Article 11).

[410](#)

carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A place of business may

~~4.1~~11. As noted above, the mere fact that an enterprise has a certain amount of space at its disposal which is used for business activities is sufficient to constitute a place of business. No formal legal right to use that place is therefore required. Thus, for instance, a permanent establishment could exist where an enterprise illegally occupied a certain location where it carried on its business.

EXPLANATION: This is merely a paragraph numbering change to conform to the current OECD Model Commentary.
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~~4.2~~12. Whilst no formal legal right to use a particular place is required for that place to constitute a permanent establishment, the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise. *Whether a location may be considered to be at the disposal of an enterprise in such a way that it may constitute a “place of business through which the business of [that] enterprise is wholly or partly carried on” will depend on that enterprise having the effective power to use that location as well as the extent of the presence of the enterprise at that location and the activities that it performs there. This is illustrated by the following examples. Where an*

(depending on the circumstances, however, paragraph 5 could apply to deem a permanent establishment to exist).

Paragraphs 12-14 above are revisions to prior paragraph 4.2. New paragraph 12 provides additional guidance including through an example to the concept of a place of business being at the disposal of an enterprise.

The revised paragraphs do not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance. If so, quoted paragraph 4.2 should be deleted and replaced with new paragraphs 12-14.

COMMENTS RECEIVED:

It will be difficult to draw a line how intermittent presence at a location should be to regard it as a place of business. It will depend on facts and circumstances of each case. This part is hence suggested to be not quoted.

RESPONSE: The above comment is with regard to the fifth sentence of OECD *This will not be the case, however, where the enterprise's presence at a location is so intermittent or incidental that the location cannot be considered a place of business of the enterprise (e.g. where employees of an enterprise have access to the premises of associated enterprises which they often visit but without working in these premises for an extended period of time).*” The Subcommittee should determine how widely held the view expressed in the comment is within the Subcommittee. If that view is held only by a small number of Subcommittee members, then assuming the same is true for the full Committee, a possible way forward could be to quote the OECD Commentary while also expressing the dissenting view of a minority of arguably exists as a general matter for the interpretation of Article 5 paragraph 1.

COMMENTS RECEIVED:

India Position on this OECD Commentary is of disagreement. (See SI 54 of Position on page 623 of OECD MTC. This sentence is not suggested to be quoted in UN MTC Commentary

RESPONSE: The above comment is with regard to the sixth sentence of OECD *Where an enterprise does not have a right to be present at a location and, in fact, does not use that location itself, that location*

a possible way forward could be to quote the OECD Commentary while also expressing the dissenting view of a minority of Committee members.

[4.315](#). A second example is that of an employee of a company who, for a long period of time, is allowed to use an office in the headquarters of another company (*e.g.* a newly acquired





of the enterprise for that purpose. Thus, for instance, an enterprise engaged in paving a road takes place.

~~21~~<sup>5</sup>

normal way there has to be a link between the place of business and a specific geographical point. It is immaterial how long an enterprise of a Contracting State operates in the other Contracting State if it does not do so at a distinct place, but this does not mean that the equipment constituting the place of business has to be actually fixed to the soil on which it stands. It is enough that the equipment remains on a particular site (but see paragraph ~~20~~<sup>57</sup> below).

~~5.1~~<sup>22</sup>. Where the nature of the business activities carried on by an enterprise is such that these activities are often moved between neighbouring locations, there may be difficulties in

occupied and the other requirements of Article 5 are met, the enterprise will, of course, have two permanent establishments). As recognised in paragraphs ~~18~~<sup>51</sup> and ~~20~~<sup>57</sup> below a single place of business will generally be considered to exist where, in light of the nature of the business, a particular location within which the activities are moved may be identified as constituting a coherent whole commercially and geographically with respect to that business.

~~5.2~~<sup>23</sup>. This principle may be illustrated by examples. A mine clearly constitutes a single place of business even though business activities may move from one location to another in what may be a very large mine as it constitutes a single geographical and commercial unit as



that there were many cases where a permanent establishment has been considered to exist where the place of business was maintained for a period longer than six months). *[the rest of the paragraph is moved to new paragraphs 29 to 31]*

29. One exception to *this general practice* has been where the activities were of a recurrent nature; in such cases, each period of time during which the place is used needs to be considered in combination with the number of times during which that place is used (which may extend over a number of years). *That exception is illustrated by the following example. An enterprise of State R of which 59.100% (the 19.00% of which is owned by the local location in 66.83% of the cases) conditions at that location prevent such operations from going on for more than three months each year but the operations are expected to last for five years. In that case, given the nature of the business operations at that location, it could be considered that the time*

EXPLANATION: WP1 had developed the changes above before the Action 7 work began. The changes update prior paragraph 6, which is quoted in the UN Commentary. The revisions are intended to provide additional guidance, including through examples, of how and when activities of a recurring nature constitute a fixed place of business.

These changes do not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance. If so, the quote of prior paragraph 6 should be replaced with a quotation of the above paragraphs 28-31.

COMMENTS RECEIVED:

Operation of catering facilities in this example meets the time requirement for constituting a PE. See India Position also (Para 56/Page 623, OECD MTC 2017).

Last two sentences are not suggested to be quoted in UN MTC.

RESPONSE: The comment above is with regard to the final two sentences of OECD Commentary paragraph 30, which read as follows— *This would not be the situation, however, where a company resident of State R which operates various catering facilities in State R would operate a cafeteria in State S during a four month production of a documentary. In that case, the company's business, which is permanently carried on in State R, is only temporarily carried on in State S.* The Subcommittee should determine how widely held the view expressed in the comment is within the Subcommittee. If that view is held only by a small number of Subcommittee members, then assuming the same is true for the full Committee, a possible way forward could be to quote the OECD Commentary while also expressing the dissenting view of a minority of Committee members.

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

The Committee agrees with the approach taken in paragraph 6 of the OECD Commentary, while recognizing that such exceptional situations will not often arise in practice, and that special care should therefore be taken when relying on paragraph 6 as applicable in an actual case. The OECD Commentary continues:

~~6.132.~~ As mentioned in paragraphs ~~41 and 49~~<sup>44 and 55</sup>, temporary interruptions of activities do not cause a permanent establishment to cease to exist. Similarly, as discussed in paragraph 6, where a particular place of business is used for only very short periods of time, but such



paragraph 55, which deals with how to take into account days of activity by an enterprise, either through employees or subcontractors, at a construction site, even after the construction has been completed and the site delivered to the customer. Paragraphs 52 and 53 are already quoted in the UN Commentary. Paragraph 7 is already quoted in the UN Commentary as paragraph 3.

3109. *There are different ways in which an enterprise may carry on its business. In most cases, the business of an enterprise is carried on mainly by the entrepreneur or persons who are in a paid-employment relationship with the enterprise (personnel). This personnel includes employees and other persons receiving instructions from the enterprise (e.g. dependent agents). The powers of such personnel in its relationship with third parties are irrelevant. It makes no difference whether or not the dependent agent is authorised to conclude contracts if he works of the fixed place of business of the enterprise* (see paragraph 10035)

41. ~~But a~~ **Also, a** permanent establishment may exist if the business of the enterprise is carried on mainly through automatic equipment, the activities of the personnel being restricted to setting up, operating, controlling and maintaining such equipment. Whether or not gaming and vending machines and the like set up by an enterprise of a State in the other State constitute a permanent establishment thus depends on whether or not the enterprise carries on a business activity besides the initial setting up of the machines. A permanent establishment does not exist if the enterprise merely sets up the machines and then leases the machines to other enterprises. A permanent establishment may exist, however, if the enterprise which sets up the machines also operates and maintains them for its own account. This also applies if the machines are operated and maintained by an agent dependent on the enterprise.

EXPLANATION: WP1 had developed the changes above before the Action 7 work began. New paragraphs 39-41 are a revision of prior paragraph 10. The new paragraphs are intended to provide clarification regarding the issue of when an enterprise should be considered as carrying on its business through the activities of



enterprise carried on by a resident of a Contracting State, whether this enterprise is legally set up as a company, partnership, sole proprietorship or other legal form. Different enterprises may collaborate on the same project and the question of whether their collaboration constitutes a separate enterprise (e.g. in the form of a partnership) is a question that depends on the facts and the domestic law of each State. Clearly, if two persons each carrying on a separate enterprise decide to form a company in which these persons are shareholders, the company constitutes a legal person that will carry on what becomes another separate enterprise. It will often be the case, however, that different enterprises will simply agree to each carry on a separate part of the same project and that these enterprises will not jointly carry on business activities, will not share the profits thereof and will not be liable for each other's activities related to that project even though they may share the overall output from the project or the remuneration for the activities that will be carried on in the context of that project. In such a case, it would be difficult to consider that a separate enterprise has been set up. Although such an arrangement would be referred to as a "joint venture" in many countries, the meaning of "joint venture" depends on domestic law and it is therefore possible that, in some countries, the term "joint venture" would refer to a distinct enterprise.

43. In the case of an enterprise that takes the form of a fiscally transparent partnership, the enterprise is carried on by each partner and, as regards the partners' respective shares of the profits, is therefore an enterprise of each Contracting State of which a partner is a resident. If such a partnership has a permanent establishment in a Contracting State, each partner's share of the profits attributable to the permanent establishment will therefore constitute, for the purposes of Article 7, profits derived by an enterprise of the Contracting State of which that partner is a resident (see also paragraph 56 below).

EXPLANATION: WP1 had developed the changes above before the Action 7 work began. New paragraph 42 is intended to provide clarification regarding the issue of when two enterprises that may be collaborating in a business capacity should be viewed as creating a single enterprise of a Contracting State. New paragraph 43 clarifies the application Articles 5 and 7 when the enterprise takes the form of a fiscally transparent entity such as a partnership.

With respect to the cross references, a previous version of paragraph 56, numbered 19.1, has already been quoted. The Committee will need to consider new paragraph 56 as part of deciding whether to quote paragraph 43.

New paragraphs 42 and 43 does not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance and wishes to quote it in the UN Model.

COMMENTS RECEIVED:

Paras 42 and 43 may be discussed to see if these really add much clarity. Depending on that, decision to quote these may be taken.

~~11~~[44](#). A permanent establishment begins to exist as soon as the enterprise commences to carry on its business through a fixed place of business. This is the case once the enterprise prepares, at the place of business, the activity for which the place of business is to serve permanently.



respect of fishing activities, should make that explicit by adopting it as a new and separate category in the list contained in this Article. Consequently, the interpretation on the nature of this activity has been left to negotiations between Contracting States so that, for example,



assembly] or installation project [or supervisory activities in connection therewith] and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding [six] months, and

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The Commentary of the ~~2014~~ OECD Model Convention contains the following relevant passages:

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of material or labour difficulties. Thus, for example, if a contractor started work on a road on 1 May, stopped on 1 November because of bad weather conditions or a lack of materials but resumed work on 1 February the following year, completing the road on 1 June, his construction project should be regarded as a permanent establishment because thirteen months elapsed between the date he first commenced work (1 May) and the date he finally finished (1 June of the following year). *Work that is undertaken on a site after the construction work has been completed pursuant to a guarantee that requires an enterprise to make repairs would normally not be included in the original construction period. Depending on the circumstances, however, any subsequent work (including work done under a guarantee) performed on the site during an extended period of time may need to be taken into account in order to determine whether such work is carried on through a distinct permanent establishment. For example, where after delivery of a technologically advanced construction project, employees of the contractor or subcontractor remain for four weeks on the construction site to train the owner's employees, that training work shall not be considered work done for the purposes of completing the construction project. Concerns related to the splitting-up of contracts for the purposes of avoiding the inclusion of subsequent construction work in the original construction project are dealt with in paragraph 52 above.*

EXPLANATION: WP1 had developed the changes above before the Action 7 work began. New paragraphs 54 and 55 are revisions to former paragraph 19. Revised paragraph 54 is intended to provide clearer guidance about how Article 5 will apply in the case that a foreign enterprise subcontracts some or all parts of a contract to other enterprises. Revised paragraph 55 is intended to provide guidance about how to count days for the purpose of determining if a construction site constitutes a PE.

If new paragraph 54 is quoted in the UN Commentary, the clarification immediately below would no longer be needed and thus could be deleted.

With respect to the cross references, paragraph 52 of the OECD Commentary is already quoted in the current UN Commentary.

New paragraphs 54 and 55 do not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance and wishes to quote them in the UN Model.

COMMENTS RECEIVED:





*the share attributable to the partner who is a resident of State A. This results from the fact that whilst the provisions of paragraph 3 of each treaty are applied at the level of the same enterprise (i.e. the partnership), the outcome differs with respect to the different shares of the profits of the partnership depending on the time-threshold of the treaty that applies to each share.*

EXPLANATION: WPI had developed the changes above before the Action 7 work began. New paragraphs 56 revises former paragraph 19.1, which is already quoted in the UN Model. The revised paragraph provides greater guidance, by way of an example, about how the time thresholds of paragraph 3 will apply to a fiscally transparent partnership, including when the foreign partners are residents of countries that have different time thresholds.

New paragraph 56 does not conflict with anything in the UN Model. Therefore, the Committee should discuss if it is in agreement with the substance and wishes to quote it in the UN Model.

~~20~~<sup>57</sup>. The very nature of a construction or installation project may be such that the project progresses. This would be the case for instance where roads or canals were being constructed, waterways dredged, or pipelines laid. Similarly, where parts of a substantial structure such as an offshore platform are assembled at various locations within a country and moved to another location within the country for final assembly, this is part of a single project. In such cases the fact that the work force is not present for [six] months in one particular location is immaterial. The activities performed at each particular spot are part of a single project, and that project must be regarded as a permanent establishment if, as a whole, it lasts for more than [six] months.

EXPLANATION: The above change is merely paragraph numbering change to conform to the current OECD Model Commentary.

connected

unreasonable especially in light of technological advances. However, for countries that are concerned about the uncertainty involved in adding together unrelated projects and the undesirable distinction it creates between an enterprise with, for example, one project of 95 days duration and another enterprise with two unrelated projects, each of 95 days duration, one following the other, may add the subparagraph (b).

12.1 The Committee observed in general terms that broadening the scope of subparagraph 3(b) means that the revised provision will apply in certain circumstances instead of the new Article 12A in relation to technical service fees.

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

ees

also includes the installation of new equipment, such as a complex machine, in an existing building or outdoors. On-site planning and supervision of the erection of a building are covered by paragraph 3. States wishing to modify the text of the paragraph to provide expressly for that result are free to do so in their bilateral conventions. *Alternative text for countries wishing to delete Article 14*

15.1 Some countries have taken the view that Article 14 should be deleted, and its coverage introduced into Articles 5 and 7. Countries taking such a view often do so because they

accommodate the taxing rights covered by Article 14. This approach is expressed by the Commentary on Article 5 of the ~~2017~~OECD Model Convention as follows:

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



interpretation found in paragraph 9 of the Commentary on Article 14, to the effect that Article 14 deals only with individuals. The Committee notes that some countries do not accept that view and should seek to clarify the issue when negotiating Article 14.

15.10 It should also be noted that the last part of Article 14, paragraph 1, subparagraph (*b*) has

for this is that Article 7 provides its own attribution rules, which, in most cases, means that only the profits of an enterprise attributable to that permanent establishment (that is, the *c*) of paragraph 3) may be taxed by the State where the permanent establishment exists. Where  
Article

performance of the activities which were previously covered by Article 14, was<sup>e</sup>  
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







if the requirements of paragraph 1 are met, be a permanent establishment.

17.1 In view of the similarities to the recommended text and the general relevance of its Commentary, the general principles of Article 5, paragraph 4 under both Models are first noted

Nations Model Convention is considered.

18. Following the changes to the OECD Commentary to reflect the changes to paragraph 4 of Article 5 of the OECD Model Convention, the 2017 OECD Model Commentary now reads as follows:

58. This paragraph lists a number of business activities which are treated as exceptions to the general definition laid down in paragraph 1 and which, when carried on through fixed places of business, are not sufficient for these places to constitute permanent establishments. The final part of the paragraph provides that these exceptions only apply if the listed activities have a preparatory or auxiliary character. Since subparagraph e) applies to any activity that is not otherwise listed in the paragraph (as long as that activity has a preparatory or auxiliary character), the provisions n gns. es-159(c)4(o2 841.9t0 595

60. As a general rule, an activity that has a preparatory character is one that is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole. Since a preparatory activity precedes another activity, it will often be carried on during a relatively short period, the duration of that period being determined by the nature of the core activities of the enterprise. This, however, will not always be the case as it is possible to carry on an activity at a given place for a substantial period of time in preparation for activities that take place somewhere else. Where, for example, a construction enterprise trains its employees at one place before these employees are sent to work at remote work sites located in other countries, the training that takes place at the first location constitutes a preparatory activity for that enterprise. An activity that has an auxiliary character, on the other hand, generally corresponds to an activity that is carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a whole. It is unlikely that an activity that requires a significant proportion of the assets or employees of the enterprise could be considered as having an auxiliary character.

61. Subparagraphs a) to e) refer to activities that are carried on for the enterprise itself. A permanent establishment would therefore exist if such activities were performed on behalf of other enterprises at the same fixed place of business. If, for instance, an enterprise that maintained an office for the advertising of its own products or services were also to engage in advertising on behalf of other enterprises at that location, that office would be regarded as a permanent establishment of the enterprise by which it is maintained.

62. Subparagraph a) relates to a fixed place of business constituted by facilities used by an enterprise for storing, displaying or delivering its own goods or merchandise. Whether the activity carried on at such a place of business has a preparatory or auxiliary character will have to be determined in the light of factors that include the overall business activity of the enterprise. Where, for example, an enterprise of State R maintains in State S a very large warehouse in which a significant number of employees work for the main purpose of storing and delivering goods owned by the enterprise that the enterprise sells online to customers in State S, paragraph 4 will not apply to that warehouse since the storage and delivery activities that are performed through that warehouse, which represents an important asset and requires a number of employees,

therefore, a preparatory or auxiliary character.

63. Subparagraph a) would cover, for instance, a bonded warehouse with special gas facilities that an exporter of fruit from one State maintains in another State for the sole purpose of storing fruit in a controlled environment during the custom clearance process in that other State. It would also cover a fixed place of business that an enterprise maintained solely for the delivery of spare parts to customers for machinery sold to those customers. Paragraph 4 would not apply, however, where an enterprise maintained a fixed place of business for the delivery of spare parts to customers for machinery supplied to those customers and, in addition, for the maintenance or repair of such machinery, as this would go beyond the pure delivery mentioned in subparagraph a) and would not constitute preparatory or auxiliary activities since these after-sale activities constitute an essential and significant part of the services of an enterprise vis-à-vis its customers.

64. Issues may arise concerning the application of the definition of permanent establishment to facilities such as cables or pipelines that cross the territory of a country. Apart from the fact that income derived by the owner or operator of such facilities from their use by other enterprises is covered by Article 6 where these facilities constitute immovable property under paragraph 2 of Article 6, the question may arise as to whether subparagraph a) applies to them. Where these facilities are used to transport property belonging to other enterprises, subparagraph a), which is restricted to delivery of goods or merchandise belonging to the enterprise that uses the facility, will not be applicable as concerns the owner or operator of these facilities. Subparagraph e) also will not be applicable as concerns that enterprise since the cable or pipeline is not used solely for the enterprise and its use is not of preparatory or auxiliary character given the nature of



constitutes a permanent establishment because that purchasing function forms an esse

- *Example 2:* RCO, a company resident of State R which operates a number of large discount stores, maintains an office in State S during a two-year period for the purposes of researching the local market and lobbying the government for changes that would allow RCO to establish stores in State S. During that period, employees of RCO occasionally purchase supplies for their office. In this example, paragraph 4 applies because subparagraph f) applies to the activities performed through the office (since subparagraphs d) and e) would apply to the purchasing, researching and lobbying activities if each of these was the only activity performed at the office) and the overall activity of the office has a preparatory character.

69. The second part of subparagraph d) relates to a fixed place of business that is used solely to collect information for the enterprise. An enterprise will frequently need to

enterprise or of a group of the concern cannot be regarded as doing a preparatory or

76. If, under paragraph 4, a fixed place of business is deemed not to be a permanent establishment, this exception applies likewise to the disposal of movable property forming part of the business property of the place of business at the termination of the

13). Where, for example, the display of merchandise during a trade fair or convention is excepted under subparagraphs *a)* and *b)*, the sale of that merchandise at the termination of the trade fair or convention is covered by subparagraph *e)* as such sale is merely an auxiliary activity. The exception does not, of course, apply to sales of merchandise not actually displayed at the trade fair or convention.

77. Where paragraph 4 does not apply because a fixed place of business used by an enterprise for activities that paragraph 4 is also used for other activities that go beyond what is preparatory or auxiliary, that place of business constitutes a single permanent establishment of the enterprise and the profits attributable to the permanent establishment with respect to both types of activities may be taxed in the State where that permanent establishment is situated.

19. The Committee took note that some members thought that the scope of paragraph 4 is too wide and poses challenges (see above paragraph 18 quoting paragraph ~~24.1~~<sup>59</sup> of the OECD Commentary) which may be particularly difficult for developing countries to handle due to the lack of administrative capacity. Countries that have those concerns may consider eliminating the paragraph entirely. Another option that may also be considered for those that want to limit the scope of the paragraph is to eliminate subparagraphs which may be regarded as too extensive in scope, in particular members mentioned subparagraphs *e)* and *f)*. However, negotiators of an agreement should make sure that the application of the remaining paragraph is limited by the preparatory or auxiliary requirement in order for the paragraph to only eliminate from the permanent establishment concept in paragraph 1, work being of no or very little significance in view of the other work performed by the enterprise.

19.1 It was also noted that some States may consider that the activities in paragraph 4 are intrinsically preparatory or auxiliary in nature and take the view that these activities should not be subject to the preparatory or auxiliary condition since any concern about the inappropriate use of these exceptions are addressed through the provisions of paragraph 4.1. States that share this view are free to amend paragraph 4 as follows (and may also agree to delete some of the activities listed in subparagraphs *a)* to *d)* below if they consider that these activities should be subject to the preparatory or auxiliary condition in subparagraph *e)*):

aph *e)*):



- (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;  
or
- (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.

20. As noted above, the United Nations Model Convention, in contrast to the OECD Model Convention, does not

exercised must constitute a permanent establishment or, if that is not the case, the overall activity resulting from the combination of the relevant activities must go beyond what is merely preparatory or auxiliary.

80. The provisions of paragraph [9] are applicable in order to determine whether an enterprise is a closely related enterprise with respect to another one (see paragraphs 119 to 121 below).

81. The following examples illustrate the application of paragraph 4.1:

- *Example A:* RCO, a bank resident of State R, has a number of branches in State S which constitute permanent establishments. It also has a separate office in State S where a few employees verify information provided by clients that have made loan applications at these different branches. The results of the verifications done by the employees are forwarded to the headquarters of RCO in State R where other employees analyse the information included in the loan applications and provide reports to the branches where the decisions to grant the loans are made. In that case, the exceptions of paragraph 4 will not apply to the office because another place (i.e. any of the other branches where the loan applications are made) constitutes a permanent establishment of RCO in State S and the business activities carried on by RCO at the office and at the relevant branch constitute complementary functions that are part of a cohesive business operation (i.e. providing loans to clients in State S).
- *Example B:* RCO, a company resident of State R, manufactures and sells appliances. SCO, a resident of State S that is a wholly-owned subsidiary of RCO, owns a store where it sells appliances that it acquires from RCO. RCO also owns a small warehouse in State S where it stores a few large items that are identical









property

Some countries believe that a narrow formula might encourage an agent who was in fact dependent to represent himself as acting on his own behalf.

26. The former Group of Experts understood that paragraph 5, subparagraph (b) was to be interpreted such that if all the sales-related activities take place outside the host State and only delivery, by an agent, takes place there, such a situation would not lead to a permanent establishment.<sup>2</sup> The former Group of Experts noted, however, that if sales-related activities (for example, advertising or promotion) are also conducted in that State on behalf of the resident (whether or not by the enterprise itself or by its dependent agents) and have contributed to the sale of such goods or merchandise, a permanent establishment may exist.<sup>3</sup>

### ***Paragraph 6***

27. This paragraph of the United Nations Model Convention does not correspond to any provision in Article 5 of the OECD Model Convention and is included to deal with certain aspects of the insurance business. The Commentary of the OECD Model Convention nevertheless discusses the possibility of such a provision in bilateral tax treaties in the following terms:

[39114](#). According to the definition of the term company of one State may be taxed in the other State on its insurance business, if it has a fixed place of business within the meaning of paragraph 1 or if it carries on business through a person within the meaning of paragraph 5. Since agencies of foreign insurance companies sometimes do not meet either of the above requirements, it is conceivable that these companies do large-scale business in a State without being taxed in that State on their profits arising from such business. In order to obviate this possibility, various conventions concluded by OECD member countries include a provision which stipulates that insurance companies of a State are deemed to have a permanent establishment in the other State if they collect premiums in that other State through an agent established there other than an agent who already constitutes a permanent establishment by virtue of paragraph 5 or insure risks situated in that territory through such an agent. The decision as to whether or not a provision along these lines should be included in a convention will depend on the factual and legal situation prevailing in the Contracting States concerned. Frequently, therefore, such a provision will not be contemplated. In view of this fact, it did not seem advisable to insert a provision along these lines in the Model Convention.



E/C.18/2019/CRP.

instructions or to comprehensive control by it, such person cannot be regarded as independent of the enterprise. Another important criterion will be whether the entrepreneurial risk has to be borne by the person or by the enterprise the person represents. In any event, the last sentence of paragraph 6 provides that in certain circumstances a person shall not be considered to be an independent agent (see paragraphs 119 to 121 below). The following considerations should be borne in mind when determining whether an agent to whom that last sentence does not apply may be considered to be independent.

105.

for example, a company that acts on its own account as a distributor for a number of companies also acts as an agent for another enterprise, the activities that the company undertakes as a distributor will not be considered to be part of the activities that the company carries on in the ordinary course of its business as an agent for the purposes of the application of paragraph 6). Activities that are part of the ordinary course of a business that an enterprise carries on as an agent will, however, include intermediation in 10 595(1)-11(ud







125. Computer equipment at a given location may only constitute a permanent establishment if it meets the requirement of being fixed. In the case of a server, what is relevant is not the possibility of the server being moved, but whether it is in fact moved. In order to constitute a fixed place of business, a server will need to be located at a certain place for a sufficient period of time so as to become fixed within the meaning of paragraph 1.

126. Another issue is whether the business of an enterprise may be said to be wholly or partly carried on at a location where the enterprise has equipment such as a server at its disposal. The question of whether the business of an enterprise is wholly or partly carried on through such equipment needs to be examined on a case-by-case basis, having regard to whether it can be said that, because of such equipment, the enterprise has facilities at its disposal where business functions of the enterprise are performed.

127. Where an enterprise operates computer equipment at a particular location, a permanent establishment may exist even though no personnel of that enterprise is required at that location for the operation of the equipment. The presence of personnel is not necessary to consider that an enterprise wholly or partly carries on its business at a location when no personnel are in fact required to carry on business activities at that location. This conclusion applies to electronic commerce to the same extent that it applies with respect to other activities in which equipment operates automatically, *e.g.* automatic pumping equipment used in the exploitation of natural resources.

128. Another issue relates to the fact that no permanent establishment may be considered to exist where the electronic commerce operations carried on through computer equipment at a given location in a country are restricted to the preparatory or auxiliary activities covered by paragraph 4. The question of whether particularity

to provide services to customers is an essential part of their commercial activity and cannot be considered preparatory or auxiliary. A different example is that of an

products through the Internet. In that case, the enterprise is not in the business of operating servers and the mere fact that it may do so at a given location is not enough to conclude that activities performed at that location are more than preparatory and auxiliary. What needs to be done in such a case is to examine the nature of the activities performed at that location in light of the business carried on by the enterprise. If these activities are merely preparatory or auxiliary to the business of selling products on the Internet (for example, the location is used to operate a server that hosts a web site which, as is often the case, is used exclusively for advertising, displaying a catalogue of products or providing information to potential customers), paragraph 4 will apply and the location will not constitute a permanent establishment. If, however, the typical functions related to a sale are performed at that location (for example, the conclusion of the contract with the customer, the processing of the payment and the delivery of the products are performed automatically through the equipment located there), these activities cannot be considered to be merely preparatory or auxiliary.

131. A last issue is whether paragraph 5 may apply to deem an ISP to constitute a permanent establishment. As already noted, it is common for ISPs to provide the service of hosting the web sites of other enterprises on their own servers. The issue may then arise as to whether paragraph 5 may apply to deem such ISPs to constitute permanent establishments of the enterprises that carry on electronic commerce through web sites operated through the servers owned and operated by these ISPs. Whilst this could be the case in very unusual circumstances, paragraph 5 will generally not be applicable because the ISPs will not constitute an agent of the enterprises to which the web sites belong, because they will not conclude contracts or play the principal role leading to the conclusion of contracts in the name of these enterprises, or for the transfer of property belonging to these enterprises or the provision of services by these enterprises, or because they will act in the ordinary course of a business as independent agent, as evidenced by the fact that they host the web sites of many different enterprises. It is also clear that since the web site through which an enterprise carries on its business is not

establishment to exist by virtue of the web site being an agent of the enterprise for purposes of that paragraph.

37. The Committee of Experts notes that the OECD Commentary, in paragraph 124, draws a distinction between a contract with an Internet Service Provider and one with a place of business at the disposal of the enterprise. In this regard, the Committee recognizes that some businesses could seek to avoid creating a permanent establishment by managing the contractual terms in cases where the circumstances would justify the conclusion that a permanent establishment exists. Such abuses may fall under the application of legislative or judicial anti-avoidance rules.