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Date
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From

Our reference

Subject
Discussion Draft on the interpretation and application of Article 5 (permanent establishment) of the OECD Model Tax Convention

Your reference

Dear Grace,

Please allow me to express my admiration for the wealth of topics discussed in the Discussion Draft on the interpretation and application of Article 5 (permanent establishment) of the OECD Model Tax Convention[1]. Thank you also for your invitation to provide comments.

This letter contains my thoughts on a number of issues addressed in the DD, inspired by a legal analysis of the OECD Model Convention[2] and a critical appraisal of the OECD Commentary. I do realise, however, considering the field of forces in which the OECD and the Member countries' delegations find themselves, that the Commentary pursues its own objectives sometimes. Representing the interests and expressing the views of the Ministries of Finance of so many Member countries is sometimes different from my approach.

The OECD is part of a long income tax treaty history that started in 1869, and it builds upon that past. However, from the OECD's (OEEC's) start in the late 1950s, certain further developments were fundamental changes of this historic system, creating problems elsewhere in the system if these fundamental changes were not sufficiently taken into account. The agency PE paragraphs of the Commentary is where this problem particularly shows itself. Similar issues arose in the post 1963 development of the problematic "at the disposal of" concept developed between 1970

1 Hereafter: DD.

2 Hereafter: OECD MC.

and 1974. As the fundamental problems of this concept keep on showing themselves in a constantly changing Commentary, it should perhaps be considered to drop the concept altogether.

Your organization faces several threats to how external parties perceive you. As you are an organization, whose products are generally not controlled by the Member countries' Parliaments, your first threat is a temptation: provided the Member countries agree, your organization can make any statement it likes. The second threat for the OECD, due to the different views of the delegations, is that it is sometimes unable to aid taxpayers in their legitimate wish to pay taxes only once. I wish the Member countries' delegations and the people at the Secretariat, many of whom I know personally and all of whom I hold in high esteem, wisdom in finding the proper balance.

1. **Meaning of "at the disposal of" (section 2)**

For more than a century tax treaties - from the first one in 1869 via the Draft Conventions of the League of Nations (the last two of that organization of 1946), to the 1963 OECD Draft Convention - have been effective without "at the disposal of". Only the 1977 OECD MC introduced the concept of "at the disposal of", which would not have been needed in the light of the historic criterion whether the persons manning the places of business were carrying on the business of the enterprise or their own. In the century before the OECD's 1977 introduction of the abstract "at the disposal of", the criterion of the concrete "use" for purposes of the enterprise's business was enough, and the test simply was –for physical and agency PEs- whether the enterprise's own business was carried on in the location under consideration. This criterion found its revival in the Knight of Columbus decision[3], where the Canadian judge found –in its interpretation of "at the disposal of"- insufficient support in the Commentary, and returned to the basic criterion of whose business was done in the place of business:

> "Once it has been determined that the Field Agents are independent contractors, which has been agreed, that is, that they are in business on their own account, then it is illogical to find that all the organizing and recordkeeping that they conduct at home is anything other than business activities of their own business. ... The agents are not carrying on the Knights of Columbus' core business from these premises. Their premises cannot therefore be found to be a fixed place of business permanent establishment."[4]

The Commentary to the agency PE (which historically split off from Art. 5-1 before the OECD gave birth to "at the disposal of") still carries a relic of these physical roots: in distinguishing dependent and independent agents, the relevant criterion is whether it is the business of the

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3 16 May 2008, 2008TCC307.

4 Ibid., par. 80.

enterprise that is carried on by the agent, or whether it rather is the agent's own business. Maintaining that criterion would have been sufficient for Art. 5-1 as well, and the combination with the other conditions of that paragraph would have offered the proper tools for distinguishing PEs and non-PEs.

Historically, Working Party 1's Preliminary Report of 1970[5] in the review of the 1963 OECD Draft Convention did without the abstract "at the disposal of" and only the factual "use" was relevant:

> "The carrying on of the business of the enterprise by the PE. In the concrete, this means usually that persons dependent on the enterprise (personnel) conduct business of the enterprise in the State in which the PE is situated, and that, in doing so, such persons make use of the place of business."[6]

It may even be inferred from other statements in this Preliminary Report that the abstract "at the disposal ("become available") was rejected, and that only the factual "use" counted:

> "When does a PE begin to exist: at the time when the place of business *becomes available* or only at the time when it is *used*? (United States Delegation, TFD/FC 218, p. 12) A PE requires that a place of business exists and that the enterprise carries on an activity at this place of business … It can be concluded from the foregoing that a PE does not come into being *until the time when an enterprise takes up its activities* in the place of business. … A PE ceases to exist when the *place of business is no longer used* by the enterprise."[7]

Instead of "at the disposal of", the relevant criterion was whether the enterprise actually used the place of business through employees and through other persons dependent on the enterprise.

Working Party No. 1's second report[8], however, introduced the "permanent disposal" criterion, but it is still somewhat difficult to distinguish whether it already had the central role it acquired

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5 Preliminary Report on the questions in connection with the definition in Article 5 of the term "permanent establishment". 17th August, 1970, FC/WP1(70)1.

6 Ibid., p. 3.

7 Ibid, p. 4.

8 Permanent Establishment; second report by Working Group No. 1 on potential amendments to Article 5 and to the Commentary thereon. 18 May, 1973, DAF/CFA/2697.

later. In any case, in the 1974 Revised Report[9] the ambivalence is removed and (replacing "permanent" by "constant") "constant disposal" becomes the core criterion. This 1977 Commentary advocates "constant disposal" as a separate requirement, distinct from "use" and "carry on business", and this seems the Commentary's position until today ("a certain amount at the disposal which is used for business activities"[10]).

The problematic criterion of "constant disposal" in par. 4 Commentary simply cried out for attention. As a result, par. 4.1 (2003) tried to clarify the term "disposal" in itself (without *constant*), suggesting to disregard the legal background of disposal. However, to read the separate criterion "at the disposal of" as availability whatever the legal background removed its distinguishing potential, as many locations are theoretically open for illegal occupation and thus are "available".

In addition, the problem was not only in "disposal" it itself, it was also in "*constant* disposal". This second element was problematic as it introduced a second "permanence" test (which was even the original word in the 1977 drafting) in the application of Art. 5-1, next to the general permanence test of the article, and as explained in par. 6 through par. 6.3 of the Commentary (2010). The OECD has not solved the problem of this second permanence condition so far, and **my first suggestion would be to explain par. 4 of the Commentary's "constant disposal" in the light of par. 6 Commentary (1977-2010), which requires "that a permanent establishment can be deemed to exist only of the place of business has a certain degree of permanency."** What is the additional role of the Commentary's criterion of "*constant* disposal" next to the treaty text's "permanence" requirement?

Possibly because explaining the term is somewhat cumbersome, the 2003 Commentary took refuge with examples (par. 4.2 through 4.5 Commentary), which were intended to support the rather delicate "constant disposal" concept. However, the lack of an explanation of the term "constant disposal" and the 2003 Commentary's recourse to examples did not really help but rather underlined that "constant disposal" was a condition that was not only difficult to found in the text of Art. 5-1 itself, but, even if an interpreter were to follow the Commentary, lacked clarity. Naturally, leaving the term undefined offers great opportunities for giving it an ever changing scope varying with the case (e.g., see the example in proposed par. 4.8 discussed below), but this is not a convincing way of practicing law.

My second suggestion would therefore be to explain what the term "constant disposal" means. If such a definition cannot be found, it would be my advice to drop the disposal criterion, for which we already find a good example in the judicial practice (see Knights of Columbus

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9 Revised Report on Article 5. 30 August 1974. CFA/WP1(74)6, p. 9.

10 Par. 4.1 of the Commentary to Art. 5.

above): **If the OECD is unable to explain the term, my advice is to eliminate the criterion and to replace it by the criterion of whose business is actually carried on in the place of business**.

If the OECD were to maintain the examples in par. 4.2 through par. 4.5 Commentary, it would be a simple improvement (these paragraphs only say "disposal") to align them with par. 4 Commentary, which uses the phrase "*constant* disposal". All the examples have a strong temporal character[11] and the conclusions in these examples should thus be that the premises are at the "constant disposal" rather than only at the "at the disposal of" the enterprise. The latter creates uncertainty as to what the OECD wants to achieve at this point. Is the time element an element of "constant" or an element of the basic concept of "at the disposal of"? **It would be my fourth suggestion on this point to clarify what the examples try to achieve and add "constant" here.**

The examples are also somewhat confusing as –next to the *constant* element- they seem to say something about the basic concept of "disposal" as well, and suggest in several instances that it is the actual "use" by the enterprise that counts and not the principle of abstract "availability" (which is the normal meaning of "at the disposal of"[12]). Par. 4.4, e.g., connects "at the disposal of" only to "use", just like par. 4.5, which focuses on how many days are actually spent at the location. This is confirmed by par. 4.4 which concludes that in that case "at the disposal of" does not apply, as the "presence of the enterprise is so limited", which implies the criterion of factual "use" only. Par. 4.2 and 4.3 are, however, perhaps less clear, as does the wider context. **Does disposal mean the abstract "availability" (the lexical meaning of the term "at the disposal of") or is it the concrete "use" (expressed in par. 4.1, 4.4 and 4.5)?**

The proposed addition (par. 11 DD) to par. 4.2 regrettably leads to confusion. The 2nd sentence of the proposed 4.2 analyses "at the disposal" in the light of the extent of an enterprise's (actual) presence at the location, and the (actual) activities performed, which purely concern "use". However, par. 4.2's proposed 6th sentence takes this just acquired certainty away, by saying:

> "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 is clearly not at the disposal of the enterprise."

Here the combination of availability and use is decisive. However, as par. 4.1 assures us that it is irrelevant whether or not there is a legal basis for availability, and illegal occupation also counts, the availability element of disposal has lost its potential of distinction. The quoted sentence thus

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11 The few hours the salesman uses the office in par. 4.2, the long period of time in par. 4.3, and the use of the dock every day for a number of years in par. 4.4.

12 The power or authority to dispose or make use of as one chooses.

seems to say that, its first part being irrelevant, the only relevant thing for "at the disposal of" is "use".

The last sentence (7th) of par 4.2 seems to express the obvious, and could be omitted in my view.

The other proposed (3, 4, 5 and 6) sentences of par. 4.2 are examples of cases, not supported by a rule. They appear somewhat isolated from each other and do not permit a conclusion where variations on these examples are made. For example, the proposed 3rd sentence of par. 4.2 says:

> "Where an enterprise has an exclusive legal right to use a particular location which is used only for carrying on that enterprise's own business activities, that location is clearly at the disposal of the enterprise."

This has a high degree of acceptability, but in the light of par. 4.1, which states that no legal right is required, this paragraph also creates uncertainty as to whether the conclusion would be the same if the enterprise would *not* have an exclusive legal right. The answer would likely be the same and it does then not make a difference whether a legal right exists or not. Nevertheless, the example's explicit mention of the exclusive legal right, where par. 4.1 has confirmed that the nature of the right is irrelevant, creates uncertainty. **Could this be clarified, e.g. by changing the last quotation into "Where an enterprise has an exclusive legal right (or not) to use a location which is in fact only used for carrying on that enterprise's own business activities …"**

In general, the 2003 examples and the 2011 DD proposed additional examples offer only limited help. The lack of a definition of the 1977 concept of "constant disposal" cannot be replaced by examples. **The best would be to return to Art. 5-1 itself, to give up the hybrid "at the disposal of" condition, or to replace it by or define it as actual "use", and to apply the criterion of whether the business of the enterprise is carried on through the place of business. "At the disposal of" would thus be reduced to a factual criterion and freed of an abstract availability test.**

2. **Contract manufacturing (section 3)**

As a matter of terminology, where raw materials are supplied by the principal, manufacturing of the nature sketched in the example is usually referred to as *toll* manufacturing. Contract manufacturing is used for manufacturing companies that purchase the raw materials themselves.

3. **Home offices (section 4)**

Also for home offices, "at the disposal of" is made dependent of time (e.g. see the 3rd sentence of the proposed par. 4.8's intermittent or incidental use). As explained above, time is not an element of "at the disposal of" in itself but of "*constant* disposal" as meant in par. 4 of the Commentary. **If the OECD maintains this sentence, its conclusion should rather read "… that the home will not be considered to be a location at the *constant* disposal of the enterprise …".**

It would seem that the focus on the time element (*constant* disposal) in proposed par. 4.8 avoids the problem, i.e., whether the location at the employee's or contractor's private dwellings is at the disposal of the enterprise at all. The 4th sentence of par. 4.8 focusses on "use", which I would agree to (and not on the more abstract availability issue).

Here the Commentary uses the convenience of the undefined term "at the disposal of" (availability) by giving it an unexpected and ad hoc additional meaning, i.e. whether "the enterprise had required the individual to work from home". As, in my view, this latter criterion cannot be considered inherent in "disposal", the term "at the disposal of" thus becomes the feature of a *deus ex machina* that solves certain difficult cases. (It was Horace's advice to poets that they must not resort to gods from the machine to solve their plots.)

Also here the decisive criterion should be whether the enterprise's business is carried on in the location (and not the business of another enterprise). (Knights of Columbus, mentioned above.)

The proposed par. 4.8 also creates another uncertainty. "Intermittently" raises the practical question what the required intervals are, and whether employees that work from home and use their home office as the starting and ending point of the day, fall under "intermittent" or not. **Is there a potential PE if a worker (a very common situation) is on the road for 12 hours a day but works in his private study for one hour?**

The example in the 2nd sentence of proposed par. 4.9 raises doubts, too. The example concerns a cross-frontier worker who works from his own house in another State (e.g. Canada) than the State of the enterprise (e.g. France), and who also has an office made available by the enterprise in the other State (e.g. in the rue André Pascal). The example therefore addresses cross-border aspects of the "New Working Reality". Even if the activities performed in the home office are not auxiliary, the DD believes that this does not lead to a PE. This is helpful in practice and the business community will gratefully embrace the statement, but, from the treaty perspective, it is difficult to properly understand what makes this case essentially different from traditional cases of employees working from home.

4. **Shops on ships (section 5)**

It should perhaps be added that the possible existence of an agency PE under art. 5-5 is not affected by the proposed par 5.5 of the Commentary. This is also expressed elsewhere in the Commentary (e.g. in par. 4.2) where it is stated that the non-existence of a physical Art. 5-1 PE does not prevent the existence of an Art. 5-5 PE.

5. **Time requirement (section 6)**

It follows from the nature of the Commentaries and the Council Recommendation relating to the Commentary that the Commentaries serve to enhance a coordinated behaviour by tax authorities,

and do not to lay down a rule that intends to provide guidance for all parties involved. In addition to this general notion, par. 6 of the Commentary to Art. 5 even more explicitly states this in its 7th sentence, after having dealt with the varied ways how the domestic tax traditions of the Member countries regard the time requirement issue in the PE's "permanent". It follows from par. 6 that the Member countries' delegations were unable to give up their domestic interpretation of "permanent" (which in some traditions involves aspects such as the *nature of the business* and *recurrence*). The 7th sentence expresses the OECD's acquiescence in this respect but also calls for mutual respect and lenience: let the Member countries at least favourably consider the local traditions when trying to solve disagreements amongst themselves. No other paragraph in the Commentary to Art. 5 than par. 6 is so strongly directed at the tax authorities and the Executive in general.

It is only natural that the Norwegian Court in the PGS[13] case rejected the application of paragraph 6's criteria. As the Court confirmed, the criteria of this paragraph clearly do not lay down an internationally accepted standard. It's equally natural that the international business community would appreciate more clarity on the points raised in par. 6 (see e.g. BIAC's letter quoted in par. 32 DD), but requesting the Member countries to give up their local fiscal traditions is, at this stage of the development of international tax law, probably asking for the impossible. It seems that any suggestion for more clarity on this point is thwarted by disparity in the Member countries. Regrettably, at the same time, this indecisiveness exposes the business community to double taxation.

I will not repeat BIAC's request for more clarity (which I share), and will address an issue where perhaps the new, proposed example of par. 6.1 could provide more information.

If one takes a period of six months as the generally acceptable "main rule" (Par. 6, 4th sentence), the new example (the "fair example") in proposed par. 6.1 could be written to arrive at this total amount of (more than) six months: 15 times 5 weeks = 75 weeks, which exceeds half a year in total. Naturally, the example as it reads now is a statement in itself, but **it would be even more illustrative if the OECD could unify the Member countries' view on a slightly different scenario where the presence of the foreign enterprise for the fair is only one week a year. 15 times 1 week is clearly less than 6 months in total. Is that also sufficient for a PE?**

6. Presence of foreign enterprise's personnel (section 7)

Art. 5-1 requires that the business is wholly or partly carried on in the other Contracting State. Some States consider that there is a case of carrying on business in the other State if personnel on the payroll of an enterprise in a Contracting State is seconded to the other Contracting State,

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13 Appeals Court nr. 2-02662 A/03, 13 August 2003.

so that at least one of the conditions (carrying on a business) is fulfilled for the creation of a PE in the other State.

The latter view was also shared by the Indian Supreme Court in its Morgan Stanley decision[14] (this decision was, more precisely, on the services article Art. 5-2-l of the US-Indian treaty), where the Supreme Court relied on a formal criterion, i.e., the enterprise in the United States being the legal employer, responsible for paying the salaries, disciplinary action, etc., to answer the question whether that foreign enterprise performed services in India.

The most obvious way to solve potential differences between the Member countries would be to explain in the Commentary when an enterprise can be considered to carry on business in the other State. Based on a general understanding of this term, this would mean that the enterprise itself acts and/or runs risks *in* the other State. The argument would thus be that an employee on secondment neither runs the Lender's business in the other State - but rather the business of the Hirer -, nor that this employee is exposing his employer to substantial risks in the other State. The current par. 10 is in line with this.

In the context of hiring out labour - in an unfriendly comparison between people and machines -, a similar issue arises on hiring out industrial, commercial or scientific equipment to an enterprise in the other State. In this respect, par. 8 of the Commentary (2010) takes the position that the letting or lease of such equipment does not lead to a PE of the lessor, unless the lessor's business is carried on in the PE State, e.g., when the personnel in a fully manned charter take business decisions "under the responsibility and control of the lessor". In secondment cases it is, in essence, not different.

In my article on the Indian Morgan Stanley[15] decision, I suggested that a possible way to solve the dilemma for Art. 5 would be by referring to the criteria proposed on substantial employment in the OECD Discussion Drafts on Art. 15 (at the time of writing of that article there were only Discussion Drafts), the essence of which is nowadays incorporated in the Commentaries to Art. 15. I therefore share the proposed text which also refers to those criteria.

The proposal only refers to pars. 8.13 to 8.15 to decide whether the business in the other State is carried on by the Lender (enterprise of a State) or by the Hirer (enterprise of the other State). Whether an employee carries on business for the Hirer or Lender is determined only by the objective criteria of the mentioned paragraphs, so that the primary domestic law classification (pars. 8.3 to Art. 15) is disregarded. In my view, no mismatch can arise.

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[14] 9 July 2007.

[15] H. Pijl. Morgan Stanley: Issues regarding Permanent Establishments and Profit Attribution in Light of the OECD View. In: Bulletin for International Taxation, May 2008, p. 174-182.

7. Main contractor who subcontracts all aspects of a contract (section 8)

Subcontractors have to be judged on their own merits to see whether they have a PE themselves. To the extent the individual subcontractor's job qualifies under Art. 5-3 as a building site or construction or installation project and lasts long enough, the subcontractor himself has a PE. The Commentaries since 1977 confirm this logical interpretation of art. 5-3: "The subcontractor himself has a permanent establishment at the site if his activities there last more than twelve months."

The dispute on the consequences of subcontracting does not concern the subcontractor himself, but rather the general contractor. Does the general contractor only have a PE if he is constantly or at least part of the time on site with his employees? Or is he also considered to have a PE if all activities - both building and supervisory activities - are outsourced to subcontractors, whereas the general contractor remains responsible towards the principal for the final result of the building work - as is usually the case? In other words: does it make a difference whether the onsite tasks for which the general contractor is responsible are (partly) performed by his employees or rather by subcontractors only?

In both cases, physical persons perform the work necessary to fulfil the general contractor's obligation towards his client. Thus, there is a theoretical argument not to make a difference in these cases and to recognize a PE of the general contractor if the 12 months threshold is exceeded, regardless of who performs the general contractor's tasks on site and under whatever arrangement (employment or subcontracting) the general contractor's tasks are completed. As the work under an employment contract is attributed to the entity that uses the workers, so should the work under a subcontracting agreement.

This basic principle is expressed in the current par. 10 of the OECD Commentary: the personnel that counts in determining whether the enterprise's business is carried on includes "employees and other persons receiving instructions from the enterprise (e.g., dependent agents)". The same principle (with a curious twist in the wording stressed in *italics* in the quote below, which is discussed further down) is also expressed the 8th sentence of par. 19 of the current Commentary when it comes to the attribution of the period spent by the subcontractor to the general contractor:

> "If an enterprise (general contractor) which has undertaken the performance of a comprehensive project subcontracts *parts of* such a project to other enterprises (subcontractors), the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor on the building project."

No observations were made on this part of the Commentary, and there is no doubt that the period spent by the subcontractor is considered time spent by the general contractor, and that the general contractor in such cases is deemed to spend time on a building project, as if he works with employees, so that the attribution under Art. 5-3 may take place.

On closer observation, the precise condition of this sentence is that the attribution of the subcontractor's time only takes place if the general contractor subcontracts "parts of" the comprehensive project. Art. 5-3 and the Commentaries thereon arrived late in the drafting process that led to the 1977 Commentaries, and were introduced by the fundamental 1975 discussion within Working Party No. 1 on the appropriateness of the place of the building site in Art. 5-1-g of the OECD Draft Convention (1963). The Netherlands delegation's proposal to deal with building sites in a separate paragraph was adopted, and this led to a redesigned Art. 5 with the new Art. 5-3 on building sites and a completely new Commentary[16]. From the start, the Commentary contained the phrase "parts of". (It may be relevant for the appraisal of this phrase that the German and the UK delegation manned Working Part No. 1.)

In any case, in respect of the phrase "parts of", the 8th sentence does not apply to situations where the general contractor outsources the whole project. The question thus arises what happens if the project is fully outsourced. It seems that since the Commentary (1977-2010) is silent on this point, the Member countries are free to either recognise a PE or not.

However, par. 8 has led to a logically fallacious *e contrario* reasoning that, since the Commentary says there is time attribution only in a case of partly outsourcing, there is no attribution in case of full outsourcing. Naturally, this reasoning does not hold in terms of logic. It was for reasons of providing clarity (and excluding arguments of this nature) to users of the United Nations Model Convention, that the Commentary to the United Nations Model Convention (which was recently reviewed and adopted) now contains language that clarifies this point, in accordance with my suggestions when I was a member of the Sub-group of Experts at the United Nations. It says:

> "The Committee considers that the reference in the penultimate sentence of this paragraph of the OECD Commentary to "parts" of such a project should not be taken to imply that an enterprise subcontracting all parts of the project could never have a permanent establishment in the host State."

The limitation to "parts of" in the 1977 Commentary was perhaps inspired by an early German Supreme Court's decision of 1963 which allotted the subcontractor's time to the general contractor, but found it relevant that the general contractor also worked onsite. The German inclination not to recognize a PE if the general contractor is not onsite already becomes clear in this judgment:

> "… the general contractor was directly involved in the building activities with his own employees, and … the subcontractors used later were just assisting the general contractor. Also when using the subcontractor, the general contractor has further employed his own

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16 Third Report on Article 5. 13 October 1975. 13 October 1975.

> employees, who have been supervising the subcontractor constantly, although they were not involved in the building activities themselves."

It may thus well be that the 1977 limitation to "parts of" was deliberate in order to accommodate the German view. The OECD made unsuccessful attempts to address the issue some years ago, which follows from an OECD preparatory document that has found its mysterious way to the internet[17] (the OECD archives for 2003 are not open yet). From this document follows that the 2011 DD uses the same language as proposed a decade earlier. The preparatory OECD document of some years ago on the internet says:

> "The Working Party recommends to replace the last two sentences of paragraph 19 of the Commentary on Article 5 by the following (proposed additions are in bold italics):
>
> 1. '… If an enterprise (general contractor) which has undertaken the performance of a comprehensive project subcontracts **all or** parts of such a project to other enterprises (subcontractors), the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor on the building project. ***In that case, the site should be considered to be at the disposal of the general contractor during the time spent on that site by any subcontractor because the general contractor has overall responsibility for the site and the site is made available to that general contractor for the purposes of carrying on its construction business.*** The subcontractor himself has a permanent establishment at the site if his activities there last more than twelve months.'
>
> While that change was included in the first draft of the 2003 update that was released in October 2001, it was pulled out at the request of one country that wanted to have it reconsidered."

Assuming - see the case law referred to - that Germany was the "one country" that could not agree to change "parts of" into "all or parts of", it is doubtful whether Germany would now be happy to accept the proposed change or would prefer to make an observation. On the other hand, the current Commentary's use of "parts of" is in itself clear: it leaves the Member countries the freedom to follow their own approach**. Changing the current text to "all or parts of" –with a German (and perhaps other Member country's) observation made- or leaving it as it is - with the freedom for the Member countries to follows their national tradition- would therefore not make a difference.**

In case of a change, in line with my previous comments on "disposal", the text should be adapted, bringing the term "disposal" in conformity with the required review of that term

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[17] See: http://www.uscib.org/docs/OECD_Note_PE_Definition.pdf

(see above), and the proposed new 3rd sentence of par. 19 should read "… the site should be considered used by the general contractor during the time spent by any subcontractor …"

8. Application of paragraph 3 to joint ventures and partnerships (Section 9)

Par. 10.3's opening reads:

> "It follows from the definition of 'enterprise of a Contracting State' in Article 3 that this term, as used in Article 5, refers to any form 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."

In my view, the proposed par. 10.3 is incorrect in its reading of art. 5-1's term "enterprise". Art. 5-1 uses the term "enterprise" which is an undefined term, not equal to "enterprise of a Contracting State", which is a defined term, and involved matters of residence.

Art. 5 merely defines what a PE is, and is unconnected to any residence issues. Residence is a matter of article 7 only:

> "Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein."

Art. 5 does not express itself as to who carries on business in the other State "through which the business of *an enterprise* is wholly or partly carried on." Had the drafter of the OECD Draft Convention (1963) intended to recognize a PE only if run by a resident (enterprise of a Contracting State) he would have said so. Grammatically, nor purposively, nor historically there is a reason for reading Art. 5-1 in the way the proposed par. 10.3 suggests.

Systematically, this interpretation would also run afoul of Art. 15-2-c. Art. 15-2-c entitles the working state to tax if a resident of State R works in the other State W, and if, amongst other possibilities, R's salary is born by a PE which employer E has in State R. There is nothing in the treaty R-W that requires employer E to be a resident of either State R or State W to make Art. 15-2-c applicable. Art. 15-2-c of the R-W treaty also applies if employer E is a resident of State E, but has a PE in State W under the criteria of the R-W treaty. This result is in line with Art. 15-2-c's purpose to allow taxation where the worker's remuneration is borne by a PE. Art. 5-1's enterprise could also be one run by a resident in a 3rd State.

In Netherlands case law (the Swedish partner case[18]), the silent partner - who was only entitled to a profit share - was only regarded to be taxable in the PE State under art. 7. Not because this

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18 Supreme Court, 10 March 1993, BNB 1993/227.

partner had a PE or "used" the location, but because of secondary characteristics, e.g., that he carried on his business (i.e., run entrepreneurial risks) through the PE, which was attributed to him under art. 7-1st sentence's "through" because of the partnership agreement. (Likewise is the PE's income attributed to him under art. 7-1's 2nd sentence.)

Only Art. 7 refers to an enterprise that is a resident of a State and allows to include an enterprise of a Contracting State if entrepreneurial risks in the PE State *through the PE* therein are run. Who operates it, is irrelevant for Art. 7. It could be a PE run by anybody.

The introductory sentence seems to be misleading given the following text and should be adapted.

9. Meaning of "to conclude contracts in the name of the enterprise" (par. 32.1) (section 19) and the question whether paragraph 5 is restricted to situations where sales are concluded (section 20)

This part of my comments combines two Sections of the OECD DD, as these are closely related and both concern the moot topic of the commissionaire.

"Soccer helps men show emotion", was the outcome of a UK survey, that tried to find the essential means through which the male part of the human kind is able to emotionally express itself. Had the Mental Health Foundation (a leading United Kingdom charity, responsible for this survey) done a similar survey amongst tax lawyers, it would, most likely, have identified the subject matter of "commissionaire" to be the emotional outlet for tax lawyers.

Art. 5-5 and 5-6 and the OECD Commentaries are, in the literature, explained either as a main rule (5-5) with an exception (5-6), or as two separate rules. The OECD tells us that, as a consequence of non-matching terms in the MC's paragraphs and conflicting statements in the Commentary, the question how Art. 5-5 and Art. 5-6 relate cannot be addressed merely through changes in the Commentary.

Before addressing this topic, please let me draw your attention to a minor matter, which is almost a typing error. **Par. 120 DD that outlines the difference between the French and English version of one of the examples of art. 5-6 should read "… to correspond to the term *commissionaire général* used in the French version."** The 1963 use of "general" and "général" was deliberate and should not be omitted in a proper comparison. (Naturally, I do realize that commission agent and commissionaire differ.) As par. 120 now reads, it suggests that the presence of the English term "general" and the lack of "général" in French makes the OECD assert that the terms do not match.

I am currently working on a rather lengthy article to be published later this year, the more detailed results of which may hopefully also be taken into account for your further study of this

matter. At this stage I summarize my findings for your convenience and for your further internal discussions.

My article explains the relationship of the two paragraphs. It is based on research of the historic documents of the League of Nations (on whose results the OEEC and OECD started) and of the OEEC (the latter, roughly, in the late 1950s). The easy accessibility of the OEEC drafting documents on the internet is a great advantage for interpretation purposes. The historic documents show us that Art. 5-5 rather originated in English, not in French, which creates a very different starting point for the matter of the relationship between Art. 5-5 and Art. 5-6.

My article shows that the "conflicting statements" that Par. 120 DD refers to in the Commentaries can be very easily understood. The current agency PE system (treaty paragraphs and Commentary together) suffers from certain changes in the late fifties that were not properly taken into account elsewhere.

The development of the agency PE from its inception in the latter half of the 19th century to where it is in 2012, is an organic development from a very wide agency PE concept (which included any agency, not limited by matters of "in the name", "binding" the principal and independent agents) to the restricted concept we apply nowadays. In the course of history some important changes took place.

- A limitation in the 1920s (League of Nations) was the exception of the independent agent from constituting an agency PE.

- Then, also in the League of Nations, the agency PE was further narrowed down, i.e., to certain cases of which the two essential ones are the following. 1. The agent who vis-à-vis the enterprise was authorised to *act on the latter's behalf* (the wording of those days). 2. Any agent, whether having full powers to bind the enterprise or not, who had, for the purposes of sale, a depot or a stock of goods belonging to the enterprise (stock holding agents). Fully authorized agents with authority to bind thus fell under 1 (and possibly under 2.), less authorized agents (such as brokers only bringing parties together, and civil law commissionaires who could only bind themselves), fell under 2, provided they held stock.

- In the OEEC drafting (the late 1950s), the agency PE was further narrowed down. An important limitation in the context of the current commissionaire discussion, was the removal of the stock holding agent (referred to above). Before the removal, under the OEEC Working Party No. 1 Reports, an agent with whatever authority, such as a commissionaire constituted a PE if he held stock for the enterprise. After lengthy discussions the stock holding agent was –deliberately- removed from the catalogue of PE constituting possibilities, leaving the article with an agent having the authority to bind as the only agency PE constitution ground (and leaving it completely open how the effect of

binding the principal was reached under civil and common law). This change actually removed the commissionaires, who were previously provided for under art. 5-5.

- A further and essential change was a somewhat unlucky and undeliberate development in the finalization of the 1958 draft PE articles and Commentary on their way from the Fiscal Committee to the Council for approval. The Reports of OEEC's Working Party No. 1 had always been drafted in English as the original language, using consistently "to conclude contracts on behalf of" and not "in the name of", and the final Report had in accordance with that been approved by the Fiscal Committee using "on behalf of".

  The French translation of the several English draft Reports at first correctly translated "on behalf of" into "pour le compte de", but then, as a translation error, started using "au nom de", where the English original continued with "on behalf of". Although the Chairman of the Fiscal Committee had explicitly asked the French version to be redrafted, and to change "au nom de" back into "pour le compte de", this regrettably never happened, and due to circumstances further addressed in my article, also the English version ended up with "in the name of". This undeliberate change of the wide concept of "on behalf of" into the formalistic "in the name of" naturally further limited the agency PE concept, as the general "on behalf of" (which had historically developed into a concept expressing that the principal is legally bound) was -as the literal term was concerned- given up for a needy formal, legal criterion. In the UK, this had (regarding UK case law) a disturbing effect, as judges in that country indeed read "in the name of" literally. It also potentially created problems for civil law countries, as under some of those countries' systems the principal was sometimes also bound when a contract was not "in the name of" the enterprise.

The interpretation of the current Commentary cannot do without taking this OEEC curtailment of the PE concept into account. It was a deliberate choice to remove agents without the authority to bind the principal, such as the commissionaire, from the agency PE catalogue, and it was an unlucky event that "in the name of" replaced "on behalf of".

9.1.In the name of

After the 1994 adaptation, the Commentary provides that "in the name of" also includes cases where the contracts are not "in the name of" the enterprise, to the extent they are "binding" on the enterprise (par. 32.1).

Naturally, the delegations to the OECD may agree on anything they want, but explaining the meaning of the limited "in the name of" as "binding" even if the contract was not "in the name of" was not without a risk, as the tension between the text of the OECD MC ("in the name of") and the new Commentary ("binding") could not be larger. The risk of non-acceptance by the Judiciary, however, is reduced regarding the historical sketch above, describing what happened as an unnoticed translation issue.

In the meantime, the phenomenon of commissionaire started raising concerns, and in various Court cases the scope of the term "binding" was tested: this led to the Norwegian Supreme Court's *Dell* and the French *Zimmer* decision. In both cases "binding" was taken in a legal meaning. The answer to the question whether a commissionaire can legally bind the principal to the client was found in the applicable general law. As under that local law a commissionaire did not bind his principal, a commissionaire created no PE. I honestly would not know how else "binding" should have been understood, and how the two judgments should have read.

Abstracting from a deviating Spanish lower Court's decision in *DSM*, the prospects for future decisions deviating from the Supreme Court's *Zimmer* and *Dell* approach are not good. Judges in other countries may well find confirmation in their colleagues' earlier decisions as to the natural interpretation of "binding". Their preparedness to read "in the name" as "binding" seems the most the OECD can expect, and it would be an overestimation of chances to expect interpreters to read "binding" (which is used in a legal context with a long history) as something else than legally binding.

Clearly, the OECD is not fond of how commissionaires are used, but it seems that a normal and natural interpretation of Art. 5-5, accompanied by an understanding of the historic development of the article, and by what the highest Courts in two countries have now consistently held, should put this matter to rest. **This could be done by adding to par. 32.1, instead of the text proposed (see par. 110 DD): "An enterprise is only considered bound if the applicable general law (taking the principles of international private law into account) binds the enterprise to the customer."**

9.2.Par. 6 as an exception

As regards the 1956-1958 elimination of the stock holding agent, the OECD's position is not enviable. The OEEC's first Working Party's draft Reports did include the stock holding agent, under which the commissionaire could have been taxed (assuming that the agent held stock). The deliberate good-bye to this type of agent causing a PE makes it extremely difficult to assume that the commissionaire is actually a PE constituting person. Indeed, the drafting history shows that the OEEC deliberately bid farewell to any agency PE triggering factor other than the legally binding agent.

It was clear from 1928 until 1958 (when the stock holding agent was eliminated) that nothing in the then existing Commentaries resisted the reading of the (corresponding) Art. 5-6 as an exception to Art. 5-5. It follows from the historic development that some of the sentences in the draft Commentary of 1958 relate to the stock holding agent, which could have been eliminated after the stock holding agent was removed in the ultimate OECD Draft Convention (1963). It is probably these sentences that the DD refers to as "conflicting statements".

It seems however that, in interpreting the current 2010 Commentary in light of its historic development, that there are no "conflicting statements".

The OECD could decide to adapt the Commentary and thus remove these conflicting statements. The last sentence of par. 120 DD, which suggests that changes to the Commentary would not help, should therefore better be removed, as the issue *can* be addressed by amending the Commentary. The issue is rather whether the OECD *wants* to amend it. The DD seems to answer this in the negative.

Continued uncertainty on this point is detrimental to the business community. **It would be preferable if OECD would make a positive statement that Art. 5-6 is Art. 5-5's exception. My advice is to make this statement**: there is no other conceivable way how the relationship is to be interpreted regarding the existing and historic materials. A positive OECD statement would anticipate these decisions, and put the matter to rest. I admit that I do not consider this to be likely to happen, as the delegations would give up what they regard as a possibility to challenge the in their eyes unwanted commissionaire.

The OECD's options are limited. Changing the MC's text to strengthen the desired outcome would only help for later treaties. Changing the Commentary to strengthen the Member countries' preferred interpretation would in most countries find its judicial barrier in the limited interpretational use of fundamental Commentary changes. Therefore, doing nothing seems the best option, fostering hope that other judicial decisions are more favourable. Regarding the DD's text, I fear your organization will take this unfavourable path.

I hope I have provided you with useful comments and I trust you and your Staff, and the Member countries' delegations, will find the strength, perseverance and wisdom on the road to the Commentary of 2014.

Yours faithfully,

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