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**Economic and Social Council
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in Tax Matters**

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**Proposal for amendments to article 5 of the United Nations Model
Double Taxation Convention between Developed and Developing
Countries: Further Issues Relating to Permanent Establishment***

Summary

This is the second paper by the subcommittee on Definition of Permanent Establishment for consideration at the Third Annual Session of the Committee. The first paper (E/C.18/2007/3) proposed a new Commentary for Article 5.

This paper addresses the “further work” forming part of the subcommittee’s mandate, which comprises:

- the treatment of Article 14, including possible deletion (Chapter II) at paragraphs 3 – 94;
- the taxation of fees for technical services (Chapter III) at paragraphs 95 – 116; and
- the treatment of services generally (Chapter IV) at paragraphs 117 – 120.

*The present paper was prepared by the subcommittee on Definition of permanent establishment (Coordinator: Mr. Sollund). The views and opinions expressed are those of the authors and do not necessarily represent those of the United Nations.

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I. Introduction

1. At the second session of the Committee of Experts on International Cooperation in Tax Matters, the subcommittee on the definition of permanent establishment was invited to continue its work with a mandate for the third session (2007) as follows (Report of the Committee's Second Annual Session, E/C.18/2006/10, paragraph 28):

The subcommittee was invited to continue its work. Attention should primarily be paid to taxation of services related to articles 14 and 5 (including the possibility of deleting article 14 and adjusting article 5 to retain an appropriate balance of the taxing rights currently available under article 14) and to taxation of technical fees. As a subsidiary part of its work, the subcommittee will also address the question of taxation on a net or gross basis and the possible need for definition of the terms "business" and "enterprise". The subcommittee was mandated to propose a draft article and Commentary, reflecting both its further work and what was agreed during the session.

2. This paper is the second of the subcommittee's papers for consideration at the 2007 Annual Session of the Committee. The first paper (E/C. 18/2007/3) proposes a new Commentary for Article 5 that reflects its mandate for revising and updating the Article 5 Commentary as agreed at the 2006 Annual Session. This paper addresses the "further work" forming part of the subcommittee's mandate. The subcommittee has adopted a "staged" approach whereby the first paper addresses matters upon which there was general agreement at the 2006 Annual Session of the Committee and seeks to settle a draft Commentary based on that, while this paper addresses the further issues which are part of the subcommittee's mandate. Obviously that may lead to further Commentary changes, including to Article 5, either in the next or following versions of the UN Model, depending on the pace of this work and the timing of new versions of the UN Model. This paper therefore involves consideration of the following basic issues, which include the subsidiary issues mentioned in the mandate above (In this paper, references to Articles in the Model and paragraphs in the Commentaries on those Articles are references to Articles in the UN Model and the Commentaries thereon, unless otherwise indicated.):

- The treatment of Article 14, including possible deletion (Chapter 2) at paras 3 - 94
- The taxation of fees for technical services (Chapter 3) at paras 95 - 116
- The treatment of services generally (Chapter 4) at paras 117 - 120

II. Possible Deletion of Article 14 and Incorporation in Articles 5 and 7

A General

3. The subcommittee's starting point and aim in addressing the possible deletion of Article 14 was, in accordance with its mandate, to maintain the source taxation principles as expressed in the current UN Model, and to keep the appropriate taxation balance between source and residence States. While one member of the subcommittee noted a preference for retaining Article 14 in the circumstances of his country, ultimately the subcommittee considered that the benefits of deleting Article 14 and relying in such cases on the established "permanent establishment" terminology would assist administrators, potential investors and advisors, while not disturbing the balance of source and residence country taxing rights.

4. Annex 1 to this paper therefore provides the current relevant Articles of the UN Model (Articles 3, 5 and 14). Annex 2 contains the subcommittee's proposed texts of Articles 3, 5 and 14 (deleted), and the texts of the other articles that need change as a consequence of the changes in Articles 5 and 14. Annex 3 contains text for use by countries wanting to preserve the existing structure, including Article 14, and Annex 4 gives a brief account of the "fixed base" concept relevant to this discussion.

B Main arguments for deletion of Article 14 – a consideration¹

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

(i) Coverage of activities other than professional services

6. The subcommittee noted the uncertain coverage of Article 14: the issue of to which activities it applies, including whether it covers activities other than the furnishing of professional services. On one view, Article 14 deals with types of income not addressed by Article 7, so that removal would jeopardise the taxation of professional service income, for example. The subcommittee felt that while the application of Article 14 to professional services was clear, its application to "other activities of an independent character" was ambiguous. It is not clear how extensive this formulation is intended to be, nor how much overlap is created with activities falling within Article 7. Literally, it goes beyond professional services because it includes "other activities of an independent character (i.e. not merely of a "similar" character, which is a formulation that appears in some earlier treaties). For example, do the activities of sub-contractors in the construction industry, which would otherwise come under Article 7, fall within this formulation?

¹ The subcommittee acknowledges the 2000 OECD Report: *Issues Related to Article 14 of the Model Tax Convention*, on which this section draws. Quotation marks are dispensed with to assist the flow of the argument.

7. In practice, many countries apply Article 14 only to professional services, thereby effectively ignoring the reference to “other activities of an independent character”. This is not surprising since, if read literally, the phrase could potentially apply to any activity falling under Article 7, thereby making that article redundant. A narrow approach is favoured by paragraph 10 of the Commentary on Article 14, which states (quoting paragraph 1 of the OECD Commentary) that the Article excludes “industrial and commercial activities”, and paragraph 9 of the Commentary on Article 5 explicitly mentions “management and consultancy services”. The apparent inconsistency between the literal words of the Article and the assertion in the Commentary indicates that there is scope for debate on the point, although in practice significant difficulties do not seem to have arisen in this area.

8. The reference to “other activities of an independent character” could be completely removed when deleting Article 14 and bringing the coverage of professional services under Articles 5 and 7, but that might be perceived as altering the balance of taxing rights between source and residence countries. While doubting such an effect in practice, the subcommittee has ultimately proposed amendments to Article 3 (definition of “business”) to make clear that the performance both of professional services and of other activities of an independent character would henceforward be covered by Article 5 and 7 – this was also the approach taken by the OECD in deleting Article 14.

(ii) Uncertainty about coverage of non-individuals

9. Another unclear area is the way Article 14 applies to different *persons*. The main issue is whether the Article applies to individuals only or whether it also applies to legal persons, such as companies. Another issue is to what extent it applies to partnerships.

10. One might think that the use of the pronoun “his”, in Article 14(1), indicates that the Article should apply only to individuals. But that is not necessarily decisive: Article 4(1) applies both to individuals and to legal persons yet still uses the pronoun “his” when listing the criteria (including incorporation) that make a person liable to tax. Bringing the content of Article 14 into Article 5 would remedy this problem.

11. Another factor is the existence of the 183-day rule in Articles 5 and 14, with only the former being drafted in a way that makes it readily applicable to a legal person. Moreover, paragraph 9 of the Commentary on Article 14 notes that the former Ad Hoc Experts Group on Cooperation in International Tax Matters generally agreed that a payment for services made to an individual would fall under Article 14 whereas “payments made to an enterprise in respect of the furnishing by that enterprise of the activities of employees or other personnel are subject to articles 5 and 7.” Nevertheless, uncertainty remains, and the Commentary provides for parties believing that the relationship between Articles 5 and 14 needs to be clarified to do so in the course of negotiations.

(iii) Unnecessarily differentiated treatment of professionals

12. It is notable that professionals incorporate more commonly now than they did when Article 14 was devised. So applying different rules to services depending on whether they are provided by an individual or a legal person, or having different articles if the rules are the

same, would seem hard to justify. That would therefore be another reason to eliminate Article 14.

13. The subcommittee recognised that some countries may apply separate rules as between (a) the taxation of professional services and (b) other business profits – for example, where cash accounting applies to professional services but not to other activities. However, the elimination of Article 14 would not prevent countries from continuing to apply such a distinction, provided they did it in a way that did not discriminate against non-residents (Article 24). In the same way, the obligation in Article 7 to allow expenses when determining the profits attributable to a permanent establishment does not mean that States must allow *all* expenses. It remains permissible to specify that certain expenses (e.g. entertainment expenses) are not deductible.

(iv) Application to partnerships?

14. The application of Article 14 to partnerships presents other problems. Countries that treat partnerships as fiscally transparent generally recognise that Article 14 applies to the individuals who are members of that partnership. But must the partners personally perform services in the source country to be taxable there on their share of the partnership's income attributable to a fixed base in that country?

15. In the case of countries that treat partnerships as non-fiscally transparent, the result would probably be different, since, in that case, the problem of the application of Article 14 to legal persons would arise. Mixed partnerships (where some partners are individuals - natural persons - and some are legal persons) would create a problem if Article 14 were found to apply only to individuals. In that case, either the partners who are legal persons would be covered by Article 7 and the partners who are individuals would be covered by Article 14 or, alternatively, Article 14 would not apply to *any* partner where at least one partner was a legal person. Neither approach would be satisfactory. Eliminating Article 14 would remove these questions and uncertainties.

(v) Differences in time conditions

16. There is also an issue relating to the differences in time conditions between the two Articles. The UN Model permits source State taxation under Articles 7 and 14 not only where a permanent establishment (Article 5) or a fixed base (Article 14) exists, but also where a time condition is fulfilled. The conditions are slightly differently expressed between the two Articles. Article 5(3)(b) provides that a permanent establishment exists in the case of the furnishing of services where the *activities continue* in the source State “for a period or periods aggregating more than six months within any twelve-month period”.

17. The parallel Article 14 condition is a little different. The period is expressed in days, and it is also not necessary for the activities in the source State to continue for the full period: rather, the *individual's presence alone* is sufficient to give that State taxing rights “if his stay is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-

month period...”. The elimination of Article 14 would present the opportunity of rationalising and improving these time tests.

(vi) Application to furnishers of services only, or those earning income from it?

18. Another issue that could be resolved by the suggested changes, is whether the application of source taxation under Article 14 is restricted to the person who provides the services or whether it also applies to anyone who derives income from these services. For example, A, B and C, three lawyers who are residents of State R, form a partnership. The partnership opens an office in State S, where only D, a new partner resident of State S, will provide services. It is agreed that the partnership’s income will be divided equally among the four partners so that each partner will derive a share of the income from services rendered in State R as well as in State S. Under Article 14, can State S tax that part of the income related to the services performed in State S that accrues to the partners resident in State R, even though these partners have not, themselves, rendered any services in State S?

19. The first approach is to say that Article 14, like Article 7, applies to any person who derives income from the services performed through a fixed base so that partners A, B and C are taxable in State S although the services were provided by D alone. Under that approach, it is argued that since Article 14(1) refers to “income derived by a resident ... in respect of ... services” rather than to “income derived by a resident... in respect of... *his* services”, the paragraph may be applied to someone who *is not* performing the services referred to in the paragraph but who *is deriving income* from these services. That approach reduces the differences between Article 14 and Article 7 but would also indirectly seem to support the view that Article 14 also applies to companies.

20. The second approach is to consider that Article 14 only allows State S to tax income attributable to a fixed base that is used by a non-resident to provide his personal services so that A, B and C are not taxable in State S as long as they do not personally provide any services there. Under that approach, the words in Article 14(1)(a): “for the purpose of performing his activities” are interpreted so that the office in State S is not considered to be a fixed base regularly available to A, B and C for the purposes of performing their activities, since they do not perform any activities in that office. On this approach it may also be relevant that in Article 14 (1)(b) reference is to “*his* stay” and “derived from *his* activities performed in that other State” – reflecting the individual’s presence and provision of services in State S.

21. The second approach narrows considerably the scope of source taxation under Article 14. It would seem to create tax avoidance opportunities since it would allow all the profits related to professional services rendered through a fixed base to escape source taxation as long as they are allocated to non-resident partners. Similarly, that approach would prevent the State where the fixed base is located from taxing any of the partnership’s profits attributable to that fixed base if the partnership’s activities in that State were exclusively carried out by employees.

22. The second approach, clearly, would therefore produce a result that would be at odds with that under Article 7, particularly when taking into account the implications of Article 5(5) (the “agency permanent establishment” rule) in the legal context of a partnership.

23. To properly judge as between these two approaches one has to take into account the administrative difficulties that would result from the first approach, which would require each of the partners of a partnership that has offices in many countries to comply with the tax requirements of all these countries (e.g. possibly having to file a great number of tax returns). Taxpayers and tax authorities have to distinguish between the attribution of income to fixed bases and the distribution of the income to the partners in different countries. However, even if the first approach produces the correct result; eliminating Article 14 would ensure that the second approach was no longer argued.

C Main arguments against deletion of Article 14 – a consideration

24. The main arguments in favour of retaining Article 14 from the UN Model, and the subcommittee's response to them, are as follows:

(i) “Fixed base” and “permanent establishment” – are they synonymous?

25. Those objecting to the deletion of Article 14 often note that it is not clear that the notion of “fixed base” and “permanent establishment” are synonymous, and that the latter may be a narrower term, so that there may be some loss of source country taxing rights in the change. On one such view, the degree of permanence of a fixed base is lower than that of a permanent establishment, based on the fact that a business must be carried on through a permanent establishment, while a fixed base need only be “regularly” available.)²

26. The subcommittee ultimately took the view that there was no intended difference between the two concepts and that any differences in practical application were not only not justified by a reading of the provisions, but also inimical to the purpose of tax treaties in encouraging investment. The subcommittee considered that the reasoning of the OECD in deleting Article 14 was equally relevant to the UN Model and did not represent a distinction between the two Models in terms of source and residence taxation balances. Paragraph 1.1 of the OECD Commentary on Article 5 says in this respect:

Before 2000, income from professional services and other activities of an independent character was dealt 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 applicable to what previously constituted a fixed base.

² E. Michaux. “An analysis of the notion ‘fixed base’ and its relation to the notion ‘permanent establishment’ in the OECD Model”. *Intertax* 1987 (“Michaux”) at 70.

27. The OECD Report on Article 14³ had earlier noted at paragraph 28:

Notwithstanding any such theoretical differences, the Committee [of Fiscal Affairs] could not, in practice, find examples of fixed bases that would not be permanent establishments or vice-versa. The examples of 'fixed bases' found in paragraph 4 of the Commentary on Article 14, i.e. a physician's consulting room or the office of a lawyer or architect, would, for instance, equally constitute permanent establishments.

28. The subcommittee considered whether the same view could be taken in the UN Model context and was of the view that it could be: to make the changes suggested by the subcommittee at Annex 2 to this paper would not introduce into the UN Model a change in the balance of taxing rights to that existing under the OECD Model, but would rather retain the balance of taxing rights existing under the UN Model.

29. With this in mind, the subcommittee suggests that a similar paragraph be inserted in the UN Commentary to Article 7, possibly following current paragraph 6, as part of the next stage of the subcommittee's work. It should be noted that, in suggesting this and other specific wording in this paper the subcommittee is not asking for this wording to be considered at the same time as the wording proposed for the Commentary in the companion paper (E/C.18/2007/3) or proposing that such wording be finally settled at the Committee's 2007 Annual Session). The proposed paragraph would read:

Paragraph 2.1 of the OECD Model Commentary on Article 7 notes the following:

Before 2000, income from professional services and other activities of an independent character was dealt 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. However, it was not always clear which activities fell within Article 14 as opposed to Article 7. 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 effect of the deletion of Article 14 is that income derived from professional services or other activities of an independent character is now dealt with under Article 7 as business profits. This was confirmed by the addition of a definition of the term "business" which expressly provides that this term includes professional services or other activities of an independent character.

The Committee, considers that the reasoning of this OECD text holds equally true for the United Nations Model, although it accepts that for administrative or other reasons some countries may wish, in their bilateral tax treaties, to retain Article 14, whether as a shorter or longer term measure. For this reason, and to assist in the interpretation of existing treaties containing Article 14, the Article 14 text and Commentary, as well as a list of changes to preserve the position under the 2001 version of the United Nations Model are included as Annex * to this version of the United Nations Model, as a reference for use in such situations.

³ OECD, *Issues Related to Article 14 of the OECD Model Tax Convention*, 2000

Note that paragraph 55 below elaborates on the last point mentioned in the suggested wording above, the option of preserving the current position with respect to Article 14.

30. A short note at Annex 4 to this paper outlines the history of the “fixed base” concept – it is a relatively recent concept originating in the work of the Organisation for European Economic Cooperation (OEEC – the predecessor of the OECD) Reports of 1959, with earlier League of Nations Models generally relying on the “permanent establishment” concept. However, none of the more recent Models, including the UN Model, have sought to define what the term “fixed base” means in any detail.

31. Often the distinction has been made between industrial and commercial activities (to which the permanent establishment test applies) on the one hand, and professional activities (to which the “fixed base” test applies) on the other. While noting that some authors defend the appropriateness of making this sort of distinction between professional and commercial activities,⁴ the subcommittee considers that the distinction is increasingly irrelevant in the light of modern ways of conducting both the professions and business generally, and that in any case the distinction would not justify differing tax treatment under bilateral tax treaties. Both case law⁵ and many commentators’ views on the matter⁶ lend support to the subcommittee’s conclusion.

32. The subcommittee takes the view that the changes to the OECD commentary in 2003 lowered the permanent establishment threshold. In its companion paper (E/C.18/2007/3), the subcommittee is recommending that these commentary changes be essentially incorporated into the UN Model. This would further reduce the need to maintain the separate concept of the fixed base. Indeed, the difference between the leniently interpreted “at the disposal” (paragraphs 4 to 4.5 of the OECD Commentary to Article 5 OECD Model) and “available” of Article 14(1)(a) UN Model seems to be in practice irrelevant.

33. Also, the revision in 2003 to paragraph 6 of the OECD Commentary to Article 5 (which, again, the subcommittee is recommending be adopted by the Committee) indicates a wider application of the permanent establishment concept than previously. Indeed, the “regularly available” test of Article 14 is now fully covered by paragraph 6 of the OECD Commentary to Article 5 (see, e.g., “recurrent activities”), which seems to go even further (“short duration” permanent establishments). In other words, the subcommittee believes that the source State principle is neither reduced nor extended by the merger of the fixed base concept into the permanent establishment concept.

34. The subcommittee believes that the proposed UN Model changes, which would in effect confirm that the fixed base concept and the permanent establishment concept mean the same thing, would have a harmonizing global effect, including as to the decisions of judiciaries in States, without changing the taxation balance between resident and source States. However, the subcommittee recognised that for administrative or other reasons some countries might wish, in their bilateral tax treaties, to retain Article 14, whether as a shorter or

⁴ E.g. Michaux, *supra* fn 2.

⁵ See e.g., Dutch Supreme Court 25 March 1992, BNB 1992/245 (photo model), Dutch Supreme Court, 24 June 1981, BNB 1981/236 (accountant).

⁶ See e.g. Huston, *Intertax* 1988, 282; Vollebregt WFR 1992, 831.

longer term measure. The subcommittee therefore proposes (as noted above, paragraph 29) that the Article 14 text and Commentary, and a list of changes to preserve the position under the 2001 version of the UN Model be provided as an Annex to the UN Model.

(ii) Is there a distinction in the *type* of income covered as between Articles 5 and 7?

35. As noted above (paragraph 6 ff.) one view is that Article 14 deals with types of income not addressed by Article 7, so that removal would jeopardise the taxation of professional service income, for example. The subcommittee decided that this should not prevent deletion of Article 14 if it was otherwise justified (as the subcommittee ultimately considered it was) but that the application of professional services would be preserved by appropriate changes to the definitions in Article 3. The more uncertain application to “other activities of an independent character” would also be preserved by explicitly making those activities part of the definition of “business” in Article 3. This would leave the expression’s precise meaning undetermined, however, since the activities would fall within Article 7, like all other business income, it would not matter in practice. Nor would there be any alteration of the balance of taxing rights from such a change.

(iii) Article 5 has deemed exclusions which mean that source States are not able to tax “preparatory and auxiliary” activities. Article 14 does not – will this mean a loss of source State taxing rights if Article 14 is deleted?

36. The Commentary on Article 14 states that the provisions of Article 7 and its Commentary could guide the interpretation and application of Article 14, and it expressly confirms the application to Article 14 of the provisions of Article 7(2) and (3). However, the text of Article 14 itself contains no explicit authority for such an approach. Many countries appear to consider that paragraphs 2 to 5 of Article 7 *are* applicable to income currently falling within Article 14. However, the elimination of Article 14 would make it unnecessary to clarify that position. An issue that is currently less clear, and which would also be helpfully resolved by the elimination of Article 14, would be whether the priority rule in Article 7(6) (i.e. that other articles take precedence) applies in relation to Article 14.

37. That raises a key question: would moving the coverage of independent personal services from Article 14 (which has no explicit exception for “preparatory and auxiliary” activities) to Article 5 (which *has* such an exception) change the balance of taxing rights? The subcommittee considers that this is a theoretical, rather than a practical possibility, as it considers that, with a proposed special provision for the taxation of the furnishing of services (see paragraph 117 ff below), a theoretically reduced source tax coverage would relate only to the provision of independent personal services through a fixed base but which were “preparatory and auxiliary” under Article 5(4). The subcommittee does not consider that such cases are at all likely to actually arise in practice, and is of the view that any such cases would be so rare (if they occurred at all) as to not have a practical impact on the balance of taxing rights.

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

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

39. Article 7 allows the source State to tax *profits* attributable to a permanent establishment. Article 14, however, allows the source State to tax *income* attributable to a fixed base. The concept of profits clearly means “net” income, i.e. after the deduction of those expenses permitted by domestic law⁷, as confirmed by Article 7(3). The concept of income in Article 14 has sometimes been interpreted more broadly so as to allow taxation on either a gross or net basis. The proponents of such interpretation point to the fact that the phrase “income derived” is also found in Article 6 (Income from Immovable Property) and Article 17 (Artistes and Sportsmen), where the Commentary explicitly permits taxation of the gross amount. Arguably, a further confirmation of that interpretation is the fact that paragraph 3 of Article 24 (Non-discrimination), which has a direct effect on the deduction of expenses related to a permanent establishment, is not expressed as applicable to fixed bases.

40. On the other hand, the Commentary on Article 14 clearly states that countries should tax only the net amount:

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

41. In addition, the fact that Articles 10 to 12 specify that the source State may levy tax on the “gross” amount of the dividends, interest, etc, might imply that only the net amount should be taxed under Article 14.

42. In practice, it appears that most countries only tax the net amount under Article 14 and the subcommittee considers that there is no policy justification for taxing professional services under Article 14 on a different basis from commercial services under Article 7.

(v) Will the non-discrimination provision of Article 24(3) apply to cases formerly covered by Article 14 because they would now be dealt with by Article 7

43. Another question is whether the migration of the coverage of independent services from Article 14 (with the fixed base test) to Articles 5 and 7 (with the permanent establishment test) means that the non-discrimination obligation in Article 24(3) would apply where it did not previously, thus affecting the balance of taxing rights between source and residence States.

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

44. Article 24(3) provides as follows:

The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

45. The non-discrimination test of Article 24(3) will, for example, affect a State's ability to limit deductibility of costs. This rule disallows a system where e.g. the permanent establishment is subject to more burdensome cost deduction rules than enterprises of the host State. Also, where, e.g., the permanent establishment would be subject to taxation in the host State at a lower tax rate on gross income (no costs deductible), whereas enterprises of that host State would be taxable at the normal domestic tax rate on net income (costs deductible), Article 24(3) could (depending on the parameters chosen for such a taxation rule) be an impediment to States imposing that rule for permanent establishments. The subcommittee notes, however, that it is ultimately the *effect* of the rules that counts. Different rules *as such* applied to permanent establishments and to domestic enterprises are not forbidden.

46. While Article 24(3) strictly only refers to permanent establishments, some commentators consider that the provision implicitly applies in Article 14 cases also. The general view in the subcommittee was that in any case the non-discrimination provision is an important part of the object and purpose of tax treaties of encouraging investment and that the application of the provision in analogous former Article 14 and current Article 5 cases is best viewed as an issue of consistency of application rather than an issue of the balance of source and residence State taxation rights. The subcommittee does not consider it is an issue likely to arise often in practice, in any case.

(vi) Should there be a provision, even if Article 14 is deleted, reflecting in Article 5 the former Article 14(1)(c)?

47. There used to be a provision, Article 14(1)(c), that (as noted by paragraph 7 of the current Commentary):

... provided a further criterion for source country tax when neither of the two conditions specified in subparagraphs (a) and (b) is met. It was provided that if the remuneration for the services performed in the source country exceeds a certain amount (to be determined in bilateral negotiations), the source country may tax, but only if the remuneration is received from a resident of the source country or from a permanent establishment or fixed base of a resident of any other country which is situated in that country.

The view has been advanced that a small number of countries still use that provision in their modern treaty practice, and they would lose this source taxation right if Article 14 was deleted.

48. The subcommittee notes that Article 14(1)(c) was deleted, as indicated by paragraph 8 of the UN Commentary on that Article, because monetary thresholds tended to become meaningless over time and would potentially only limit the import of services, and because it was little used. The subcommittee considers that countries wishing to preserve such a rule in relation to the furnishing of services could still do so if they wanted, even if included under the head of Article 5, rather than under Article 14. Existing treaties with the former 14(1)(c) would, of course, be unaffected by the proposed change.

(vii) Should Article 14 be in fact “enhanced” rather than deleted?

49. One member of the subcommittee suggested not merely keeping Article 14, but also changing it to treat permanent establishments as fixed bases, while specifically excluding paragraphs 4, 7 and 8 from consideration in this context, with the result that more cases would fall for consideration under, and meet the fixed base tests of, Article 14. As the subcommittee considers that enhancements to Article 14 are beyond its current mandate, and because it considers that Article 14 should in any case be deleted, it does not further address the amendment of Article 14 to enhance its operation in this paper.

D Subcommittee Conclusions on Article 14

(i) General conclusions

50. After considering the arguments for and against deletion of Article 14, the subcommittee concluded that retaining the combination of Article 14 and Articles 5 and 7 would continue to cause difficulties, ambiguities and uncertainty in application that benefit neither administrations nor taxpayers. These difficulties include the uncertainties over the personal scope of Article 14, the scope of activities that fall under Article 14, the possible interpretation of a difference between the concepts of permanent establishment and fixed base, difficulties over the taxation of partnerships under Article 14 (especially when of a mixed individual/company character), and in relation to the taxation of large worldwide partnerships of lawyers etc. The subcommittee notes that the OECD for these reasons deleted Article 14 from the OECD Model in 2000, and merged this Article into Articles 5 and 7 of the OECD Model.

51. The subcommittee believes that the UN Model should do the same. It believes that this can be done without raising the threshold for taxation in source countries. The draft wording at Annex 2 of this paper for the various provisions affected by the deletion of Article 14 seeks to achieve this. The structure of those proposed amendments is considered below.

(ii) The structure of suggested changes

52. The integration of Article 14 concepts into Articles 5 and 7 is reflected in the subcommittee’s proposed text of the UN Model, which can be found at Annex 2 of this paper. Structurally, the proposal is as follows:

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

- the existing Article 5(3)(b) (furnishing of services) is proposed to become Article 5(4)(a);
- the content of existing Article 14(1)(b) (stays of 183 days or more) is expressed in the proposed Article 5(4)(b) and Article 7; and
- changes to Article 3 (Definitions) ensure that all situations previously covered by Article 14 would be now covered by Articles 5 and 7.

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

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

(iii) Transition to a Model without Article 14 and retention of Article 14 guidance

55. Without detracting from its view in favour of removing Article 14, the subcommittee recognised that some States may wish, for administrative or other reasons, to retain Article 14 as it was in the 2001 Model, whether as a shorter or longer term measure. The subcommittee also recognised that a consideration of Article 14 will be relevant to existing treaties for some time to come. It has therefore proposed that the existing Article 14, as well as its Commentaries and the 2001 versions of those provisions in other Articles which the subcommittee suggests need consequential amendments, should be preserved, in their 2001 state as an Annex to the next version of the Model. A draft Annex is attached to this paper as Annex 3. To keep that Annex of a manageable size for current purposes, it does not include the 2001 version of the complete Article 14 Commentary, even though that Commentary should be included in the proposed Annex to the next version of the UN Model itself, in the subcommittee’s view.

(iv) Personal scope not addressed

56. The proposed changes do not attempt to resolve the debate on the “personal scope” of Article 14; that is, the issue of whether the current Article 14 only covers individuals (see discussion at paras 9-11 above). This issue is currently unresolved under the UN Model, just as it was not resolved under the OECD Model, before the Article was removed. In view of the conclusions of the subcommittee in favour of removing Article 14, which solves the problem, the subcommittee has taken the question no further.

(v) Rewording of Article 5(2)

57. The current text of Article 5(2) is open to some confusion where it reads “The term ‘permanent establishment’ includes especially...” The term “includes especially” suggests, on one reading, that the paragraph might be deeming each of the items to *automatically* be a permanent establishment. The subcommittee does not believe this is the correct reading.

58. Paragraph 4 of the UN Model Commentary to Article 5 says:

Paragraph 2 ... singles out several examples of what can be regarded, *prima facie*, as being permanent establishments... According to the OECD Commentary, it is assumed that the Contracting States interpret the terms listed “in such a way that such places of business constitute permanent establishments only if they meet the requirements of paragraph 1”.

59. The subcommittee agrees with this statement, and notes that such an approach is widely accepted⁸. Issues such as the geographical and temporal “permanence” of the presence will, for example, still need to be considered. The point was made in the subcommittee’s suggested Commentary changes at Annex 1 to its companion paper (E/C. 18/2007/3 - at para 4 and following of the proposed revised Commentary) but the matter could be clarified further by changes to the provision itself. The subcommittee considers that making such a clarification to the provision itself is justified among several other proposed changes and should not lead to any negative inferences about treaties using the current (“includes especially”) wording.

60. Therefore, the subcommittee proposes a text which better reflects the legal position of the examples, while staying as close as possible to Article 5(2)’s current text: “Subject to the conditions of paragraph 1, the term ‘permanent establishment’ includes: ...”

61. An alternative would be to remove Article 5(2) on the basis that it has no substantial meaning. On this approach, the examples would be better positioned in a separate paragraph of the UN Commentaries to Article 5(1). The subcommittee, however, feel this understates the meaning of Article 5(2), which helpfully suggests what are *prima facie* likely to be permanent establishments, without reaching a definitive view in a particular case – because that requires a reference to paragraph 1 and an application of that paragraph to the facts of the case. The provision may also have evidential value in court or tribunal cases, which could be reduced or even lost by shifting the provision to the Commentary.

(vi) Rewording and renumbering Article 5(3)(a) as Article 5(3)

62. The subcommittee believes that Article 5(3)(a) is not intended to be a deeming provision. This follows from the history of that paragraph: construction activities etc. originate from Article 5(2) of the 1963 OECD Model, where it was one of the examples given (at subparagraph g). In 1977 the construction activities were moved from Article 5(2) to Article 5(3) of the OECD Model, in order to prevent giving support to the erroneous view that the examples in Article 5(2) of the OECD Model would *not* have to meet all the requirements of Article 5(1) of the OECD Model.

63. Indeed, as construction activities are a permanent establishment only if they are performed for 12 months (in the OECD Model), obviously the normal “time” requirement of

⁸ See e.g. Vogel, *Double Taxation Conventions* (Art. 5, m.nr. 47). Various writings have noted this issue of uncertainty. Skaar e.g. writes: “In spite of its own wording, the ‘positive list’ consists mainly of places of business, or, one might say, *prima facie* PE”: A.A. Skaar. *Permanent Establishment; Erosion of a Tax Treaty Principle*. Kluwer 1992, at 113.

Article 5(1) is not relevant in respect of that item. From that, those reading the Article could come to the wrong conclusion that the same approach may be taken to the other items listed in Article 5(2) - that is, that the normal paragraph (1) indicia of a ‘fixed place of business’ need not be shown. To avoid this misunderstanding, the construction permanent establishment provision was moved to a separate provision.

64. The OECD Commentaries (since 2003) accept Article 5(3) as a specific case of Article 5(1) (see paragraphs 4.5, 4.6 and 5.1 of the OECD Commentary on Article 5 OECD Model).⁹ The subcommittee believes this is the correct view as far as the OECD Model is concerned: a construction site etc. is only a permanent establishment if the conditions of Article 5(1) are met (place of business, carry on business, at the disposal of the enterprise), apart from the time requirement which is replaced by the criterion of 12 months in that Model.

65. The UN Model provision, however, is differently worded: “The term ‘permanent establishment’ also encompasses” the specified situations and is less clearly linked to paragraph 1. In any case, the conditions of Article 5(1) are almost automatically met in construction site cases: a building contractor has the factual disposal of the place of business (this is inherent in the building contract with his principal), and carries on his business there.

66. The word *encompasses* (or its synonym *includes*) express this relationship of Article 5(3) to Article 5(1), if the OECD approach is taken in respect of the UN Model. Article 5(3) could thus read: “The term ‘permanent establishment’ also includes a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months.”

67. However, there is an issue here, which is already inherent in the current text of Article 5(3)(a): “supervisory activities in connection therewith” are not necessarily connected with a place of business referred to in Article 5(1). It may be (though in practice this is perhaps unlikely) that these activities are done elsewhere in a place that does not qualify as a “place of business” at the disposal of the supervisory enterprise.

68. One solution might thus be to make that part of the current Article 5(3)(a) a deemed permanent establishment, which detaches the qualification as a permanent establishment from the issue of a place of business.

69. The subcommittee considers, however, that, in the proper maintenance of the source State’s taxing rights, that step is not necessary. Indeed, even if – in an unlikely situation – the supervisory enterprise could be considered not to have at its disposal a place of business at the site of the construction, or elsewhere in the country where these activities are performed, the current Article 5(3)(b) would trigger, subject to the remarks below, this permanent establishment.

70. Therefore, the subcommittee proposes the following text as the new Article 5(3), reflecting current Article 5(3)(a):

⁹ See generally on this, Pijl, “The relationship between Article 5, Paragraphs 1 and 3 of the OECD Model Convention”, *Intertax*, 2005, 189-193.

The term ‘permanent establishment’ also includes a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months.

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

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

72. The furnishing of services often takes place without the physical place of business of Article 5(1), which is Article 5(3)(b)’s reason for existence. The provision should be understood as providing for a “deemed” permanent establishment: if the activities of this provision are met, a permanent establishment exists, even though the terms of Article 5(1) may not be met. This is a different situation to that of a construction permanent establishment, where the terms of Article 5(1) are relevant, subject to a special “time test” replacing the normal paragraph 1 time tests.

73. The subcommittee therefore proposes separating the construction permanent establishment paragraph from the services permanent establishment paragraph to reflect these differences. The proposed text, without altering the current substance of Article 5(3)(b), reads:

4. A permanent establishment shall be deemed to exist where:
 - (a) an enterprise furnishes services through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned; ...

74. Note that the reference to “more than six months” in the current Article is proposed to be changed to the Article 14 terminology, reintroduced to Article 5(4)(b) (“more than 183 days”) to avoid any differences as to how to deal with parts of a month, and to avoid any inference of different tests between the two subparagraphs of Article 5(4).

(viii) Taxation based on duration of stay – proposed Article 5(4)(b)

75. The subcommittee has considered whether Article 5 could be rewritten in a more condensed form. It ultimately decided against attempting that under its current mandate, as such a rewrite was likely to trigger new interpretational questions, issues about existing treaties using the older wording and extensive threshold discussions. Focus on the key issues for decision might also be lost. It has therefore transposed, to the extent possible, the existing paragraphs from Article 14 into the proposed Article 5. This “soft” approach also makes clear the subcommittee’s intention of streamlining the operation of Article 5, by fully covering Article 14 situations, while not altering the balance of taxing rights.

76. The subcommittee considered it unnecessary to provide for an explicit reflection of Article 14(1)(a) (taxation based on existence of a “fixed base”) in Article 5, as that provision is fully covered by Article 5(1). This is because the “permanent establishment” concept fully covers “fixed base” situations in the subcommittee’s view, as noted above.

77. In the view of the subcommittee however, the current Article 14(1)(b) (taxation based on duration of stay, even without a fixed base) must be explicitly mentioned to preserve the current balance of taxing rights in the UN Model, as the current Article 5(3) does not contain a similar “time test”.

78. Whereas current Article 5(3)(a) requires a project of 6 months, and whereas Article 5(3)(b) has specific requirements related to the furnishing of services, the triggering condition of Article 14(1)(b) is merely the presence of a person during 183 days in the working State (compare this requirement to the similar condition in Article 15(2)(a) dealing with dependent personal services). Therefore, the deletion of Article 14 also needs to be accompanied by a change to Article 5, in the absence of which source taxation rights would be reduced. As the OECD Model did not have an equivalent to Article 14(1)(b), the same issue did not arise in removal of Article 14 of the OECD Model.

79. As the 183 day activities test of Article 14 is best classified as a “deemed permanent establishment” when viewed in the context of Article 5 (as under paragraph 5 of that Article¹⁰), and not as a permanent establishment that is a special form of the ones referred to in Article 5(1) and based on general principles (as in the Article 5(2) examples), the subcommittee proposes placing this provision as Article 5(4)(b). The new provision would read:

4. A permanent establishment shall be deemed to exist where: [...]
 - (b) an individual who is a resident of a Contracting State performs services in the other Contracting State and his stay in that other Contracting State is for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned.

80. The combination of Articles 5 and 7 renders it unnecessary to repeat the last words of paragraph 14(1)(b): “in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State”. This idea is already structurally part of the Article 5 and 7 approach.

(ix) Adaptation of the references in Article 5(5) and consequent renumbering of current paragraphs 5 to 8

81. Consequent upon what is currently paragraph 3 being split into paragraphs 3 and 4, paragraphs 4 to 8 of the current Model need to be renumbered as paragraphs 5 to 9.

82. Article 5(1) and (2) are of the same kind, being a definition at paragraph 1 and then examples assisting in the practical application of that definition. The current Article 5(5) reference to paragraph 2 (“Notwithstanding the provisions of paragraphs 1 and 2”) therefore creates the wrong impression that Article 5(2) is detached from Article 5(1) and is somehow a stand-alone test for the existence of a permanent establishment. In addition, if Article 5(3)(b) (and perhaps also Article 5(3)(a)) is indeed intended as a special deemed permanent establishment, it is not clear why Article 5(5) does not make reference to Article 5(3) as well as paragraphs 1 and 2..

¹⁰ See paragraph 22 and following of E/C. 18/2007/3 for the subcommittee’s proposed Commentary on that paragraph.

83. The subcommittee therefore suggests ensuring that the Article reads more logically by bringing the references in conformity with the structure of Article 5. The proposed Article 5(5), after renumbering it as Article 5(6), replacing the reference to paragraph 2 with a reference to paragraph 4, and changing the reference to paragraph 7 with a reference to paragraph 8, would read:

6. Notwithstanding the provisions of paragraphs 1 and 4, where a person - other than an agent of an independent status to whom paragraph 8 applies - is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:

...

- (x) **Ensuring full coverage of professional services – amending the Article 3 definitions of “business” and “enterprise”**

84. The subcommittee’s proposed Article 3(1)(c) reads:

(c) the term “enterprise” applies to the carrying on of any business;

85. The proposed Article 3(1)(h) reads:

(h) the term “business” includes the performance of professional services and of other activities of an independent character.

86. Technically, the proposed inclusion of the existing Article 14(1)(a) (independent personal services through a fixed base) as Article 5(4)(b) is made fully effective by these two proposed additions to Article 3, the General Definitions Article. These changes ensure that the full range of activities that currently come within Article 14, including the rendering of professional services, would now come within Articles 5 and 7.

87. Guidance in achieving this is provided by the OECD Model, which brought Article 14 situations under the scope of Article 5 and Article 7 in its year 2000 revision: see paragraph 4 and paragraph 10.2 of the OECD Commentaries to Article 3 on this point. The OECD changes to the text of Article 3 are the same as are now proposed for the UN Model.

88. Paragraph 4 of the OECD Commentary on Article 3 (dealing with the term “enterprise”) reads as follows:

The question whether an activity is performed within an enterprise or is deemed to constitute in itself an enterprise has always been interpreted according to the provisions of the domestic laws of the Contracting States. No exhaustive definition of the term “enterprise” has therefore been attempted in this Article. However, it is provided that the term “enterprise” applies to the carrying on of any business. Since the term “business” is expressly defined to include the performance of professional services and of other activities of an independent character, this clarifies that the performance of professional services or other activities of an independent character must be considered to constitute an enterprise, regardless of the meaning of that term under domestic law. States which consider that such clarification is unnecessary are free to omit the definition of the term “enterprise” from their bilateral conventions.

89. Paragraph 10.2 of the OECD Commentary on Article 3 (dealing with the term “business”) reads as follows:

The Convention does not contain an exhaustive definition of the term “business”, which, under paragraph 2, should generally have the meaning which it has under the domestic law of the State that applies the Convention. Subparagraph *h*), however, provides expressly that the term includes the performance of professional services and of other activities of an independent character. This provision was added in 2000 at the same time as Article 14, which dealt with Independent Personal Services, was deleted from the Convention. This addition, which ensures that the term “business” includes the performance of the activities which were previously covered by Article 14, was intended to prevent that the term “business” be interpreted in a restricted way so as to exclude the performance of professional services, or other activities of an independent character, in States where the domestic law does not consider that the performance of such services or activities can constitute a business. Contracting States for which this is not the case are free to agree bilaterally to omit the definition.

90. The subcommittee also suggests building upon the OECD Commentary changes to Article 3 by adding part of paragraph 4 of the OECD Commentaries to paragraph 5 of the UN Commentary to Article 3 along the following general lines (recognising that the drafting will, of course, have to be integrated with any other changes to the Commentary):

Since the term ‘business’ is expressly defined to include the performance of professional services and of other activities of an independent character, this clarifies that the performance of professional services or other activities of an independent character must be considered to constitute an enterprise, regardless of the meaning of that term under domestic law. States which consider that such clarification is unnecessary are free to omit the definition of the term ‘enterprise’ from their bilateral conventions.

91. Similarly, the subcommittee suggests a new paragraph after the current paragraph 11 of the Commentary to Article 3 (renumbering the subsequent paragraphs) to explain the new Article 3(1)(g). This proposed paragraph is derived from paragraph 10.2 of the OECD Commentary noted above:

The Convention does not contain an exhaustive definition of the term ‘business’, which, under paragraph 2, should generally have the meaning which it has under the domestic law of the State that applies the Convention. Sub-paragraph *h*), however, provides expressly that the term includes the performance of professional services and of other activities of an independent character. This provision was added in [...] at the same time as Article 14, which dealt with Independent personal services, was deleted from the Convention. This addition, which ensures that the term ‘business’ includes the performance of activities which were previously covered by Article 14, was intended to prevent that the term ‘business’ be interpreted in a restricted way so as to exclude the performance of professional services, or other activities of an independent character, in States where the domestic law does not consider that the performance of such services or activities can constitute a business. Contracting States for which this is not the case are free to agree bilaterally to omit the definition.

92. For the proposed redrafted Article 5(3) and Article 5(4)(a), the changes in Article 3 have no significance. Article 5(3) currently covers the situations that would be covered by

suggested Article 5(3) and Article 5(4)(a) without the extra wording, and that would be the same with the proposed changes.

(xi) Adaptation of other Articles that use the term “fixed base”

93. Annex 2 contains the other UN Model Articles that need to be changed as a consequence of the proposed merger of Article 14 into Articles 5 and 7. The proposed changes are to Articles 6, 10, 11, 12, 13, 15, 17, 21 and 22. They flow on naturally from the other changes proposed, with matters now dealt with by Article 5 that were previously dealt with under Article 14. The proposed change of Article 15’s title from “Dependent Personal Services” to “Income from Employment” is not strictly consequential, but is useful to clarify its operation, with the proposed deletion of Article 14, and follows more ordinary usage. None of these changes involves any change in the balance of taxing rights.

(xii) Renumbering of Articles 15 and following?

94. The subcommittee does not propose the renumbering of Articles 15 and following consequential upon the proposed deletion of Article 14. This avoids further consequential changes to the Articles and Commentaries, although States may prefer to do so in their bilateral treaties.

III. Fees for Technical Services

A The UN and OECD Model Backgrounds

95. Fees for Technical Services would typically fall within the scope of Article 7 (Business Profits) of the OECD Model, under which the exclusive right to tax is allocated to the State of residence unless the services are performed through a permanent establishment that the enterprise maintains in the other State. If this is the case, the latter State may tax the profits attributable to the permanent establishment and the State of residence is obliged to grant relief from double taxation.

96. Article 12 (Royalties) of the OECD Model does not apply to services as it generally deals with payments for the use of, or the right to use, certain forms of intangible property. Whilst the OECD Model definition of royalties also covers payments received as “consideration for information concerning industrial, commercial or scientific experience”, this cannot, in the subcommittee’s view be interpreted as covering Fees for Technical Services.¹¹

97. Whilst the UN Model, contrary to the OECD Model, provides for the source taxation of royalties, it uses a definition of royalties that, although including payments for the use of, or the right to use, industrial, commercial or scientific equipment, is similar to that of the OECD Model and that equally does not include payments for services, in the subcommittee’s view, although paragraph 15 of the UN Commentary to Article 12 at least notes one view that:

¹¹ In taking this view, the subcommittee recognises some difference with the view expressed at paragraph 15 of the Commentary on Article 12 of the UN Model as being held by some countries (paragraph 11.2 of the OECD Commentary on Article 12).

Given the broad definition of “information concerning industrial, commercial or scientific experience”, some countries tend to regard the provision of brain-work and technical services as the provision of “information concerning industrial, commercial or scientific experience” and to regard payment for it as royalties.

98. There are, however, other differences in the UN Model that provide greater source taxation rights with respect to services:

- First, the definition of permanent establishment in Article 5 of the UN Model also encompasses the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve-month period.
- Secondly, the UN Model currently contains Article 14 dealing with “independent personal services – although its proposed deletion is one subject of this paper. According to this Article, income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character may also be taxed in the other Contracting State if (i) the income is attributable to a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities, or (ii) if his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, the other Contracting State may tax the income derived from the activities performed therein.

99. The effect of these two rules is basically that profits from services provided in a country over a period of more than 6 months can be subjected to source taxation.

B Alternative Provisions in Double Tax Conventions

100. Certain double taxation conventions allow for the taxation of Fees for Technical Services by the State from which payment for the services is made as long as the payment is either made by a resident of that State or borne by a permanent establishment situated therein. This result is typically achieved either by extending the scope of Article 12 (Royalties) or by drafting an article similar to Article 12 to cover fees for technical services. An example can be found in Article 13 of the Convention between Portugal and the US. These Articles typically limit the source tax that may be levied to a percentage of the fees (e.g. 10/15%) in a way similar to that which is allowed in the case of royalties.

C Policy Considerations

(i) General

101. Policy considerations with respect to the tax treatment of Fees for Technical Services include considerations regarding (a) the source of the income, (b) the mode of taxation, (c) the distinction between technical services and other services, and (d) the applicable thresholds.

(ii) *Source of the income*

102. A major difficulty with the above alternative provisions that allow source taxation of Fees for Technical Services when the payer of the consideration for these services is a resident of a State (or maintains a permanent establishment that bears the payment) is that these provisions apply even to services that are performed *outside* that State.

103. There is a good tax policy basis for arguing that services performed *in* a State should be taxable in that State. It would indeed be difficult to argue that profits from services performed *in* a State should not be considered to originate from that State. A corollary to this, however, is that a State should not have source taxation rights on income derived from the provision of services performed *outside* that State by a non-resident. In this regard, the analogy with trade in goods can be made: the profits from goods that are merely acquired by a resident of a State and that are not produced in that State are not taxable therein and the same principle should arguably apply in the case of services.

104. Clearly, therefore, any attempt by a country to extend its taxing rights to services performed outside that State is likely to be resisted by other countries, which may well consider that the profits from these services should be sourced where they are performed. Whilst the State of residence of the person paying for these services may be relevant for consumption taxation, it seems less acceptable as a nexus for a tax on profits.

(iii) *Mode of taxation*

105. Another fundamental policy issue relates to the determination of the amount on which tax should be levied. There are several policy reasons why the application of a withholding tax on a payment for services may be considered inappropriate.

106. Expenses incurred to perform a service are recovered through the consideration paid by the client and the application of a withholding tax on a gross basis does not, by definition, take these expenses into account. This will often lead the service provider to “gross-up” the amount charged to the client to include the taxes levied at source by way of withholding tax. The result of such a “gross-up” is that, from an economic point of view, the source State tax is effectively borne by the recipient of the service. As a consequence, a withholding tax levied at source on the gross amount of the payment renders the service more expensive for local enterprises. This greater expense for the consumer will also often result in lower profits in the source State in cases where the expense is allowed as a deduction and a resultant decrease in taxation levied on those profits.

107. In other words, a withholding tax at a fixed rate on payments for services would act as a tariff and would likely be shifted back to the consumer of services in the source State when the contract is signed (both the rate of the tax and the amount of the payment are known at that time). This is more difficult to do with a tax on net profits since the amount of profit and tax thereon is not known and the consumer is therefore reluctant to agree to bear the cost of that tax. A tax on net profits is in the

subcommittee's view less arbitrary and less able to be directly shifted to the consumer than a tax on gross payments. It is, however, more difficult to enforce administratively.

(iv) *Distinction between technical services and other services*

108. The alternative treaty provisions that allow source taxation of payments for Fees for Technical Services are only applicable to payments for services of a technical, managerial and consultancy nature. This can probably be explained by the fact that such provisions were developed as an extension of the royalty definition. The policy logic seems to have been that since Article 12 allowed source taxation of transfers of technology made through intangible property, a similar rule should apply to transfers of technology made through services (e.g. "show-how" treated as "know-how"). This is evident in the provisions negotiated by India with US and UK, which only apply to payments for services related to the transfer of intangible property. The India-US treaty refers, for example, to "technical or consultancy services (including through the provision of services of technical or other personnel) if such services [...] are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or [...] make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design."

109. It is far from clear, however, what is exactly covered by the phrase "services of a technical, managerial and consultancy nature". There has been extensive litigation in India and in other countries on this issue (as well as on the scope of the more limited provision agreed to between India and the US and UK). Cases have also arisen where some countries have tried to stretch the concept of "technical fees" beyond reasonable interpretation, e.g. by trying to include the cost of a building repair as a technical fee.

110. More importantly, it is difficult to find a convincing policy rationale for different treatment of *technical services* as compared to *other services*. Absent good reasons, the non-neutral treatment of one category of services should be avoided. On the assumption that technical services do indeed allow for transfers of technology, one could argue that these transfers are mostly of value in the production of income by residents of the recipient State and should in fact be encouraged rather than penalised through the tax system.

(v) *Thresholds*

111. As already explained, there are sound tax policy reasons to tax profits from services in the State in which these services are performed. There are, however, important administrative and compliance reasons that justify not trying to tax all such profits. For example, it would be difficult to require a consultant who worked in a State for only one day (e.g. meeting a client) to file a tax return, compute the profits from that single day's work and pay tax on these profits.

112. These compliance and administrative reasons are probably the most important justification for rules which allocate exclusively to the residence State the taxing rights as regards services performed in another State that are not attributable to a permanent establishment.

113. If these compliance and administrative reasons are less compelling, a solution is to adopt a provision that extends the definition of permanent establishment in tax conventions based on physical presence and/or other tests. Such a provision would allow taxation of Fees for Technical Services in the source State even in the absence of a fixed place of business in that State through which the services are performed.

114. In this regard, the OECD issued a discussion draft on the tax treaty treatment of services (in general, not only related to technical services) on 8 December 2006¹². The draft (considered in more detail under Chapter IV below) suggests an alternative provision that could be used by countries wishing to increase source taxation rights with respect to services. This provision secures additional source taxation rights on profits from services performed in that State if these are performed over a period of 183 days. This alternative avoids a number of drafting problems that arise from the two provisions (Article 14 and Article 5(3)(b)) included in the current UN Model for that purpose. One such problem is the inclusion of a time test using months as the criterion. Some countries have already drawn attention to the difficulties encountered in the application of this time test. Clearly this type of provision also envisages a treaty which does not include the UN Article 14.

D Conclusion on Fees for Technical Services

115. If source taxation of income derived from technical services performed in a State is considered to be appropriate, this should be done through an extension of the permanent establishment concept so as to make the rules of Article 7 applicable rather than through the inclusion in double taxation conventions of a “technical fees” article or the extension of the definition of royalties. In addition, this preferred approach should deal with all service income rather than just technical services. Consistent tax treatment of services would also be a factor and this is one of the aims of tax treaties.

116. This proposed approach would be in line with the above-mentioned policy considerations in that (i) it would only apply to services performed in the source State, (ii) it would do so on a net basis rather than on the basis of the gross payment (iii) it would apply to all services and not only to technical services, and (iv) it would not apply to services performed over short periods of time.

IV. Treatment of Services Generally

117. The OECD has recently been considering the effectiveness of the current OECD Model in dealing with the taxation of services, where large scale transactions can occur internationally without a “bricks and mortar” presence. In particular, it has considered whether the current permanent establishment rules represent a suitable allocation of taxing rights as between States.

¹² OECD, “The Tax Treaty Treatment of Services: Proposed Commentary Changes”, 8 December 2006.

118. As part of this work, the OECD released for consultation in December 2006 (as noted above¹³) a draft paper on proposed Commentary changes to Article 5. This draft does not propose changes to the permanent establishment rules but proposes including in the Commentary an optional provision that States may wish to include as a new paragraph in Article 5 where they wish to tax services performed on their territory based on a time test. The proposed provision is as follows:

Notwithstanding the provisions of paragraphs 1, 2 and 3, where an enterprise of a Contracting State performs services in the other Contracting State

- a) through an individual who is present in that other State during a period or periods exceeding in the aggregate 183 days in any twelve month period, and more than 50 percent of the gross revenues attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State through that individual, or
- b) during a period or periods exceeding in the aggregate 183 days in any twelve month period, and these services are performed for the same project or for connected projects through one or more individuals who are performing such services in that other State or are present in that other State for the purpose of performing such services,

the activities carried on in that other State in performing these services shall be deemed to be carried on through a permanent establishment that the enterprise has in that other State, unless these services are limited to those mentioned in paragraph 4 which, if performed through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

119. It will be seen that a standard period of 183 days is used. Subparagraph a), which covers individuals, uses a days of presence test, as found in Article 14 of the UN Model. But in order to focus only on individuals who are performing substantial activities in a State (as opposed to visiting for an extended vacation, for example), it contains an extra condition requiring that more than 50 per cent of individual's gross revenues should be attributable to activities in that State.

120. The subcommittee ultimately saw no need to include such a proposal at this stage, although it recognised that there a relevant issue of only seeking to cover substantial relevant activities and in its proposed Article 5(4)(a) it therefore sought to ensure that the period referred to was the period of actual activity, not including periods of vacation for example. Paragraph 5(4)(b) was not similarly altered, as it reflects the current content of Article 14 and to similarly amend it could have been viewed as altering taxing rights.

¹³ At paragraph 114: OECD, "The Tax Treaty Treatment of Services: Proposed Commentary Changes", 8 December 2006.

Annex 1: Current Relevant Articles of the UN Model¹⁴

Article 3

1. For the purposes of this Convention, unless the context otherwise requires:
 - (a) The term “person” includes an individual, a company and any other body of persons;
 - (b) The term “company” means any body corporate or any entity that is treated as a body corporate for tax purposes;
 - (c) The terms “enterprise of a Contracting State” and “enterprise of the other Contracting State” mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;
 - (d) The term “international traffic” means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State;
 - (e) The term “competent authority” means:
 - (i) (In State A):
 - (ii) (In State B):
 - (f) The term “national” means:
 - (i) Any individual possessing the nationality of a Contracting State
 - (ii) Any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State.
2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

Article 5

1. For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

¹⁴ This Annex contains Article 3, 5 and 14, the consideration of which formed the main part of the subcommittee’s work. Annex 2 also contains some suggested consequential changes to other provisions.

2. the term “permanent establishment” includes especially:
 - (a) A place of management;
 - (b) A branch;
 - (c) An office;
 - (d) A factory;
 - (e) A workshop;
 - (f) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
3. The term “permanent establishment” also encompasses:
 - (a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;
 - (b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve-month period.
4. Notwithstanding the preceding provisions of this article, the term “permanent establishment” shall be deemed not to include:
 - (a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
 - (b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;
 - (c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
 - (d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
 - (e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.
 - (f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.
5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 7 applies — is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:
 - (a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or
 - (b) Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.
6. Notwithstanding the preceding provisions of this article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.
7. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial

relations which differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status within the meaning of this paragraph.

8. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

Article 14

1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:

- (a) If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or
- (b) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

2. The term “professional services” includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Annex 2: Relevant Articles of the UN Model – Proposed Amendments

Article 3

1. For the purposes of this Convention, unless the context otherwise requires:
 - (a) The term “person” includes an individual, a company and any other body of persons;
 - (b) The term “company” means any body corporate or any entity that is treated as a body corporate for tax purposes;
 - (c) the term “enterprise” applies to the carrying on of any business;**
 - (d) The terms “enterprise of a Contracting State” and “enterprise of the other Contracting State” mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;
 - (e) The term “international traffic” means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State;
 - (f) The term “competent authority” means:
 - (i) (In State A):
 - (ii) (In State B):
 - (g) The term “national” means:
 - (i) Any individual possessing the nationality of a Contracting State
 - (ii) Any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State.
 - (h) the term “business” includes the performance of professional services and of other activities of an independent character.**
2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

Article 5

1. For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. Subject to the conditions of paragraph 1, the term “permanent establishment” includes especially:

- (a) A place of management;
- (b) A branch;
- (c) An office;
- (d) A factory;
- (e) A workshop;
- (f) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. The term ‘permanent establishment’ also includes a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months.

4. A permanent establishment shall be deemed to exist where:

- (a) an enterprise furnishes services through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned;**
- (b) an individual who is a resident of a Contracting State performs services in the other Contracting State and his stay in that other Contracting State is for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the fiscal year concerned.**

5. Notwithstanding the preceding provisions of this article, the term “permanent establishment” shall be deemed not to include:

- (a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
- (b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;
- (c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- (d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
- (e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
- (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.

6. Notwithstanding the provisions of paragraphs 1 and 2-4, where a person — other than an agent of an independent status to whom paragraph 7 8 applies — is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:

- (a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or
- (b) Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.

7. Notwithstanding the preceding provisions of this article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 8 applies.

8. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a

broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status within the meaning of this paragraph.

9. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

Article 6

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise ~~and to income from immovable property used for the performance of independent personal services.~~

Article 10

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, ~~or performs in that other State independent personal services from a fixed base situated therein,~~ and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment ~~or fixed base~~. In such case the provisions of article 7 ~~or article 14, as the case may be,~~ shall apply.

5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except in so far as such dividends are paid to a resident of that other State or in so far as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment ~~or a fixed base~~ situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

Article 11

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, ~~or performs in that other State independent personal services from a fixed base situated therein~~, and the debt claim in respect of which the interest is paid is effectively connected with (a) such permanent establishment ~~or fixed base~~, or with (b) business activities referred to in (c) of paragraph 1 of article 7. In such cases the provisions of article 7 ~~or article 14, as the case may be~~, shall apply.

5. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment ~~or a fixed base~~ in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment ~~or fixed base~~, then such interest shall be deemed to arise in the State in which the permanent establishment ~~or fixed base~~ is situated.

Article 12

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, ~~or performs in that other State independent personal services from a fixed base situated therein~~, and the right or property in respect of which the royalties are paid is effectively connected with (a) such permanent establishment ~~or fixed base~~, or with (b) business activities referred to in (c) of paragraph 1 of article 7. In such cases the provisions of article 7 ~~or article 14, as the case may be~~, shall apply.

5. Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment ~~or a fixed base~~ in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment ~~or fixed base~~, then such royalties shall be deemed to arise in the State in which the permanent establishment ~~or fixed base~~ is situated.

Article 13

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State ~~or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services~~, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) ~~or of such fixed base~~, may be taxed in that other State.

Article 14: Deleted**Article 15**

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

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

- (a) The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and
- (b) The remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and
- (c) The remuneration is not borne by a permanent establishment ~~or a fixed base~~ which the employer has in the other State.

Article 17

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

2. Where income in respect of personal activities exercised by an entertainer or a sportsperson in his capacity as such accrues not to the entertainer or sportsperson himself but to another

person, that income may, notwithstanding the provisions of articles 7,~~14~~ and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsperson are exercised.

Article 21

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, ~~or performs in that other State independent personal services from a fixed base situated therein~~, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment ~~or fixed base~~. In such case the provisions of article 7 or ~~article 14~~, as the case may be, shall apply.

Article 22

2. Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State ~~or by movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services~~, may be taxed in that other State.

Annex 3: Proposed Annex for those States Preferring to Retain Article 14¹⁵

Article 3

1. For the purposes of this Convention, unless the context otherwise requires:
 - (a) The term “person” includes an individual, a company and any other body of persons;
 - (b) The term “company” means any body corporate or any entity that is treated as a body corporate for tax purposes;
 - (c) The terms “enterprise of a Contracting State” and “enterprise of the other Contracting State” mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;
 - (d) The term “international traffic” means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State;
 - (e) The term “competent authority” means:
 - (i) (In State A):
 - (ii) (In State B):
 - (f) The term “national” means:
 - (i) Any individual possessing the nationality of a Contracting State
 - (ii) Any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State.
2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

Article 5

1. For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
2. The term “permanent establishment” includes especially:
 - (a) A place of management;
 - (b) A branch;
 - (c) An office;
 - (d) A factory;
 - (e) A workshop;
 - (f) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
3. The term “permanent establishment” also encompasses:
 - (a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;
 - (b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve-month period.
4. Notwithstanding the preceding provisions of this article, the term “permanent establishment” shall be deemed not to include:
 - (a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
 - (b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;
 - (c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

¹⁵ As noted at paragraph 55 of this paper, to keep this Annex of a manageable size for current purposes, it does not include the 2001 version of the complete Article 14 Commentary, even though that Commentary should be included in the proposed Annex to the next version of the UN Model itself, in the subcommittee’s view

- (d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
 - (e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.
 - (f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.
5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 7 applies — is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:
- (a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or
 - (b) Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.
6. Notwithstanding the preceding provisions of this article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.
7. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status within the meaning of this paragraph.
8. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

Article 6

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

Article 10

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of article 7 or article 14, as the case may be, shall apply.
5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except in so far as such dividends are paid to a resident of that other State or in so far as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid

or the undistributed profits consist wholly or partly of profits or income arising in such other State.

Article 11

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt claim in respect of which the interest is paid is effectively connected with (a) such permanent establishment or fixed base, or with (b) business activities referred to in (c) of paragraph 1 of article 7. In such cases the provisions of article 7 or article 14, as the case may be, shall apply.

5. Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

Article 12

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with (a) such permanent establishment or fixed base, or with (b) business activities referred to in (c) of paragraph 1 of article 7. In such cases the provisions of article 7 or article 14, as the case may be, shall apply.

5. Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties was incurred, and such royalties are borne by such permanent establishment or fixed base, then such royalties shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

Article 13

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.

Article 14: *retained*

Article 14

INDEPENDENT PERSONAL SERVICES

1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:

- (a) If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or
- (b) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in

the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.

2. The term “professional services” includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Article 15

Title “Dependent Personal Services” retained

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

- (a) The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and
- (b) The remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and
- (c) The remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

Article 17

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

2. Where income in respect of personal activities exercised by an entertainer or a sportsperson in his capacity as such accrues not to the entertainer or sportsperson himself but to another person, that income may, notwithstanding the provisions of articles 7, 14 and 15, be taxed in the Contracting State in which the activities of the entertainer or sportsperson are exercised.

Article 21

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of article 7 or article 14, as the case may be, shall apply.

Article 22

2. Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or by movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, may be taxed in that other State.

Annex 4: A Short History of the “Fixed Base” Concept

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

Article VII(4) of the Mexico Draft read:

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

Article VI(4) of the London Draft read:

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

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

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

Also the 1928 report presented by the General Meeting of Governmental Experts on Double Taxation and Tax Evasion (C.562.M.178.1928.II), Text of Draft Convention Ia, made no difference in Article 5^{16 17}:

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

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

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

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

“Income derived by a resident of a Contracting State in respect of professional services or other independent activities of a similar character shall be taxable only in

¹⁶ Article 7, to which Article 5 refers, deals with dependent personal income: salaries, wages etc.

¹⁷ Nor did the other Models Ib (Article 2) and Ic (Article 3).

that State unless he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities. If he has such a fixed base, such part of that income as is attributable to that base may be taxed in that other State.”

Paragraph 2 of the Commentary (Annex F) to this Article did not explain the need to make a difference, apart from rather vague ‘thoughts’:

“The provisions of Article VI are similar to those customarily adopted for income from industrial or commercial activities. Nevertheless it was thought that the concept of permanent establishment should be reserved for commercial and industrial activities.”

The same remark was made in paragraph 3 of the 1963 OECD Commentaries (and paragraph 4 of the 1977 OECD Commentaries). Unfortunately, the paragraph also contemplated that “it has not been thought appropriate to try to define it”.

The UN Commentaries cite paragraph 4 of the 1977 OECD Model after noting the relevance of that Commentary. (UN Commentary to Article 14, paragraph 10).

As noted in the body of this paper, Article 14 and the concept of fixed base were deleted from the OECD Model in the year 2000 and consequential amendments made, following a report produced earlier that year¹⁸.

¹⁸ OECD, *Issues Related to Article 14 of the Model Tax Convention*, 2000.