

## **Problems with Permanent Establishments**

### **- Problems in Determining Permanent Establishment on the basis of Article 5 (1)**

#### **OECD MC -**

### **1. Introduction and overview**

It is internationally accepted that the right to tax business profits of an entity lies on its State of residence, unless there is a sufficient connection between another State, the State of source, and that enterprise. The main purpose of the concept of permanent establishment (hereinafter *PE*) is to determine the source State's right to tax business profits that can be attributed to a non-resident carrying on its business in another State. Moreover, the PE concept serves to be a solution to guarantee legal certainty for the allocation of taxing rights between the relevant States. The purpose of the thesis is to discuss the common problems in determining the so-called "general rule-PE" in international tax law practice on the basis of the OECD Model Convention (hereinafter *MC*).<sup>1</sup>

### **3. Problems in determining Article 5 (1) OECD MC**

The "general-clause" PE is normally the first step in any course of scrutinising the existence of a PE in a double tax treaty (hereinafter *DTC*), before continuing to consider the impact of the other clauses on a *prima facie* conclusion. Interestingly, the Australian tax authorities in *McDermott*<sup>2</sup> argued that subsequent provisions should be construed having regard to the general definition clause since they elaborate and elucidate (but not "vastly" expand) the concept of substantial business expressed in the general definition provision. Nevertheless, the Australian Full Federal Court rejected such an approach.<sup>3</sup>

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<sup>1</sup> Due to length limits, the thesis does not stand for the comprehensive determination of the provision.

<sup>2</sup> Full Federal Court of Australia, 29 April 2005 *McDermott Industries (Aust) Pty Ltd. v. Commissioner of Taxation* [2005] FCAFC 67.

<sup>3</sup> A Hamad, 'Rationalising the "Permanent Establishment' (2006) 35 *Australian Tax Review* 60-61.

The cumulative requirements for a PE are:

- 1) There must be a *place of business* at the *disposal* of the enterprise;
- 2) The place of business must be *fixed* (geographical and temporal permanence);
- 3) The business of *the enterprise* must be wholly or partly *carried on through* the fixed place of business.<sup>4</sup>

### 3.1 A “place of business”

A “place” is understood as a particular portion of space or an object. Although not defined in the OECD MC itself, the Commentary<sup>5</sup> tends to suggest that the focus of enquiry is on the tangible assets used for carrying on the business.<sup>6</sup> Hence, the “place of business” embraces all physical objects, including the premises and other tangible assets, equipment and accessories used by the taxpayer in whole or in part, that are commercially necessary for being the basis of a taxpayer’s economic activity.<sup>7</sup> For instance, the Italian tax authorities have come to a conclusion that a Swiss company maintaining a piece of railway and a railway station in Italy had a PE under the Italian domestic laws.<sup>8</sup>

Although the lack of necessary connection to a certain part of soil excludes the business activities performed on board ships and aircrafts from being the basis for the creation of a PE, tangible assets itself can be regarded as “places”. The fact may be relevant in cases where such facilities are attached to a certain location, as the case may, for instance, be with floating-restaurants or ship-museums.<sup>9</sup>

Next, the rapidly increasing usage of e-commerce raises a question whether we still should make the distinction between widely accepted physical place of business and

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<sup>4</sup> Emphasis added by the author.

<sup>5</sup> OECD Commentary on Article 5 paragraph 4.

<sup>6</sup> A Hamad, ‘Rationalising the “Permanent Establishment” (2006) 35 *Australian Tax Review* 62.

<sup>7</sup> Arvid A Skaar, *Commentary on Article 5 of the Model Treaty: The Concept of Permanent Establishment* (PE, 25 Supplementary, IBFD, Amsterdam 2005) 13.

<sup>8</sup> R Russo, E Pedrazzini, ‘Permanent Establishments under Italian Tax Law: an overview’ (2007) 47 *European Taxation* 390.

<sup>9</sup> Lasse Lehis, *Tulumaksuseadus. Kommenteeritud väljaanne* (OÜ Casus, Tartu 2000) 101.

intangible location (“virtual places of business”) as the concept of “place of business”. The Commentary makes a clear distinction between tangible computer equipment (e.g. a server) and intangible software and data (e.g. a web site) for the purposes of Article 5 OECD MC.<sup>10</sup> Yet, although a server as such cannot be a PE itself, the place where it is stored, together with the server, may constitute a place of business. Could it be argued that, in case of web sites, the user’s computer could be regarded as a “facility”? According to the Commentary, the existence of premises is not a precondition for the constitution of a PE.<sup>11</sup>

As a consequence of considering a non-physical place, such as web page, to be unsatisfactory the source States are deprived of tax revenue that would have been received before the usage of virtual place of business. The Australian Taxation Office, for instance, has observed that the existence of a “place of business” should be determined on the basis of the functions performed through that place and it is irrelevant whether the place occupies physical space (e.g. office) or electronic space (e.g. web site). The result is different on the basis of Articles 31 and 32 Vienna Convention of the Law of Treaties under which the ordinary meaning of the term “place of business” did not, until very recently (if at all) implied intangibility.<sup>12</sup>

In 2008 the Commentary was supplemented with the treatment of services<sup>13</sup> on the basis of the report that was released as a public discussion draft on December 8, 2006<sup>14</sup>. The main reason for the amendments was that Article 5 in conjunction with Article 7 excluded the possibility for the source States to tax the profits received from the provision of services on their territory. Therefore, to tax profits from services similarly to other business activities, some States expressed the need to change Article 5, so that the

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<sup>10</sup> OECD Commentary on Article 5 paragraph 42.2.

<sup>11</sup> Ibid. 42.1-42.10.

<sup>12</sup> N Tadmor, ‘Clicks vs. Bricks: The Interaction between the OECD PE Concept And Web Sites’ (2001) 22 *Tax Notes International* 1824-25.

<sup>13</sup> OECD Commentary on Article 5 paragraphs 42.11-42.48.

<sup>14</sup> OECD Report, ‘The Tax Treaty Treatment of Services: Proposed Commentary Changes’ 8 December 2006 <<http://www.oecd.org/dataoecd/2/20/37811491.pdf>>, accessed 21 January 2009.

State of source would have the right to tax such income even if it had not been attributed to a PE in that State.<sup>15</sup>

On the one hand, the proposal is logical: several services do not require the existence of a fixed place in order to carry out the business. The most common example is the services provided by a consultant who constantly moves within the territory of the source State.<sup>16</sup> Depending on the subject field, the amounts of income received from the services may be substantial, while, normally, the cost for the provision of services remains low.

On the other hand, although the States who will adopt the alternative provision into their DTCs are to some extent limited<sup>17</sup>, the author is of the opinion that the current wording of the Commentary is too broad and gives the source States too much liberty to deem a PE to exist even when there is a lack of sufficient basis. For instance, one of the basis when a State is allowed to deem a PE to exist is if an individual is present in the other State at least 183 days during any twelve month period and more than 50 per cent of the gross revenue of the enterprise has been derived from the services through that individual in that State.<sup>18</sup> It follows that the days of physical presence of the individual are relevant and not how many days the business is in real carried on.

For instance, assume that an individual stays in his home State R for 180 days and in the source State S for 185 days. In State S he performs services for 10 days for a client who is based in State R or in a third State and 50 per cent of his gross revenue is received from those services. Hence, it follows that:

- A PE is deemed to exist irrespective of the short duration of business activities;
- The number of contracts or clients is irrelevant;
- It is important where the services are performed, not where the services are consumed or used;<sup>19</sup>

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<sup>15</sup> OECD Commentary on Article 5 paragraphs 42.14 and 42.14.

<sup>16</sup> Ibid 42.25.

<sup>17</sup> Ibid 42.23.

<sup>18</sup> Ibid (a).

<sup>19</sup> Brian J Arnold, 'New Services PE Rule in the Canada-U.S. Treaty Protocol', Tax Analysts database, <[www.taxanalysts.com](http://www.taxanalysts.com)>, accessed 17 December 2008.

- The amount of gross revenue is determined on the basis of the domestic laws of the Contracting States, because it has not been specified in the Articles of DTCs;
- In situations other than one-man enterprises, it may be difficult to determine the percentage of the entity's gross revenue derived from the services performed by a particular individual;<sup>20</sup>

In brief, the idea of services PE deserves attention but the current wording may create uncertainty to taxpayers, gives looser rules to tax authorities and can greatly increase the compliance and administrative burden of both the taxpayers and tax authorities. In addition, it is worth rethinking whether the services PE has been introduced to the OECD MC to compensate the deletion of Article 14 of the MC in 2000?

### **3.2 Geographical permanence of the fixed place of business**

To constitute a fixed place a link between the place of business and a specific geographical point shall exist. It is immaterial whether the equipment constituting the place of business is actually fixed to the soil on which it stands. However, there is a requirement that the equipment must be maintained on a particular site.<sup>21</sup> Such an approach crushes the idea that such potential places of business like unmoored ships, aircrafts and floating oil rigs could be considered as PEs since there is a lack of sufficient nexus with a specific geographical point.<sup>22</sup> The question is whether the expression “fixed place” should be understood as envisaging the feasibility of locating, identifying or pointing out a certain place which is stationary and not moving.<sup>23</sup> Surprisingly, in *Fugro Engineers BV v. ACIT*<sup>24</sup> the Indian court has concluded that although the company was

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<sup>20</sup> Ibid.

<sup>21</sup> OECD Commentary on Article 5 paragraph 5.

<sup>22</sup> Klaus Vogel, *Klaus Vogel on Double Tax Conventions* (3rd edition, Kluwer Law International, London 1997) 286.

<sup>23</sup> H Govind, ‘Business Connection and Permanent Establishment’ (2001) 7 *Asia-Pacific Tax Bulletin* 195.

<sup>24</sup> Indian Income Tax Appellate Tribunal. *Fugro Engineers BV v. ACIT* (2008-TIOL-502-ITAT-DEL).

engaged in carrying out activities onboard an Indian ship/vessel belonging to three different clients, a PE existed<sup>25</sup>.

It has been suggested that the narrow interpretation of fixedness has been subject to gradual erosion by being expanded to include movable places which have a relationship or a connection to a geographical area. The justification is that the concept of “fixed place” should be applied on the basis of the nature of the relevant business (e.g. telecommunication services).<sup>26</sup>

Despite to a limited extent, this approach has been recognised by the Commentary when making a reference to the commercial and geographical coherence between the particular location and the activities.<sup>27</sup> Following the example proposed in paragraph 5.2 of the Commentary, it seems that, in case of mobile activities (such as a mine) it is necessary to confirm that (i) the locations are neighbouring and (ii) the same business activities are carried on in those areas.<sup>28</sup> In such a case, both the geographical and commercial coherence are present.

Therefore, although the OECD has recognised the fulfilment of the criterion of being fixed if the nature of the respective activity makes it possible to find a certain relationship or a connection to a geographical area, even if the place itself is movable, it has not provided for guidance on how large a PE can be. Some scholars hold that it is presupposed that normally it cannot be a whole State, even if it has a size of a smaller State (e.g. a big farm).<sup>29</sup>

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<sup>25</sup> Notably, amongst many other observations, the non-OECD Member State India has taken a view that, even if there is no commercial coherence between different places where the business by a non-resident is carried on, a PE is still established. See: OECD Commentary on Article 5, Positions on the Commentary, paragraph 25.

<sup>26</sup> A Hamad, ‘Rationalising the “Permanent Establishment” (2006) 35 *Australian Tax Review* 62.

<sup>27</sup> OECD Commentary on Article 5 paragraphs 5.1-5.4 and 6.

<sup>28</sup> A Caridi, ‘Proposed Changes to the OECD Commentary on Article 5: Part I - the Physical PE Notion’ (2003) 43 *European Taxation* 15.

<sup>29</sup> Dietmar Herbrich, ‘The future of taxing business profits’ in Markus Stefaner, Mario Züger (eds), *Tax Treaty Policy and Development* (39 Series on International Tax Law, Linde Verlag, Vienna 2005) 334.

Whereas the 1963 OECD Commentary excluded the possibility to have a PE in case of mobile activities, the 1977 OECD Commentary gives a more flexible approach by using the wording “normal way /.../ link between” which might allow to disregard the fixed relationship between the place of business and a specific geographical point in paragraph 5 of OECD Commentary on Article 5.<sup>30</sup> Any geographical area which commercially or economically constitutes a unit may be considered as a fixed place of business even if the activities of a taxpayer move around a certain district and without staying in a one certain place for a specified period of time.<sup>31</sup> This view has also been shared by the Dutch Supreme Court where it has stated that the mobility of a fixed place of business (a circus tent) did not prevent it from being treated as a PE.<sup>32</sup> An opposite view has been taken in the “German Milkman” case where the Court rejected the tax authorities’ opinion that the entire area, represented by the streets the dairy dealer regularly covered, be treated as a single place of business.<sup>33</sup>

An awkward approach has been taken by the Estonian tax authorities: if a non-resident carries on its business through several branches within the Estonian territory, only one geographic place and, accordingly, one PE is considered to exist in Estonia. It is remarkable that such an interpretation is not affected by the fact whether the distinct branches are engaged in different fields of business.<sup>34</sup>

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<sup>30</sup> Hans Pijl, ‘The Concept of Permanent Establishment and the Proposed Changes to the OECD Commentary with Special Reference to Dutch Case Law’ (2002) 56 *Bulletin for International Fiscal Documentation* 555.

<sup>31</sup> Arvid A Skaar, *Commentary on Article 5 of the Model Treaty: The Concept of Permanent Establishment* (PE, 25 Supplementary, IBFD, Amsterdam 2005) 19.

<sup>32</sup> Hans Pijl, ‘The Concept of Permanent Establishment and the Proposed Changes to the OECD Commentary with Special Reference to Dutch Case Law’ (2002) 56 *Bulletin for International Fiscal Documentation* 555.

<sup>33</sup> A Caridi, ‘Proposed Changes to the OECD Commentary on Article 5: Part I - the Physical PE Notion’ (2003) 43 *European Taxation* 17-18.

<sup>34</sup> Tiiu Albin, Helen Pahapill, ‘Is there a Permanent Establishment in Estonia?’ in Arvid A. Skaar, Jacques Sasseville (eds), *Is There a Permanent Establishment?* (IFA Cahiers de Droit Fiscal International, 2009) 207.

### 3.3 Temporal permanence of the fixed place of business

Similarly to the geographical connection criterion, the duration test does not provide for a certain threshold for the place to be fixed. The word “permanence” does not refer to the existence of a place as such, but to the usage of the site for carrying on the business.<sup>35</sup>

To make the distinction between “temporary” and “permanent” the intention of the non-resident should be taken into account. If a taxpayer plans to exercise its operating activities through the fixed place of business for an indefinite period of time, a PE is set up even if *de facto* the intentions are not realised.<sup>36</sup> If the purpose of the taxpayer was to use a place of business for a short period, but for objective reasons the usage has become constant, a PE is established retroactively.<sup>37</sup>

One could consider whether the intention of the taxpayer or the nature of the activity is more important. In Dutch case law, although influential, the intention criterion has not been decisive but the latter criterion has been considered.<sup>38</sup> On the other hand, the Commentary suggests that, as long as the place of business was not set up for purely temporary purposes, a very short period of time could be sufficient owing to a special nature of the business or due to incidental circumstances.<sup>39</sup> For instance, the Canadian Tax Appeal Board has held that despite the brief existence of the taxpayer’s place of business (used to carry out the construction of a pavilion) a PE existed, because it was set up for the duration of the enterprise.<sup>40</sup>

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<sup>35</sup> Aare Kurist, ‘Püsiva tegevuskoha mõiste rahvusvahelistes maksulepingutes ja Eesti tulumaksuseaduses. (1998/1999) *Juridica* 450-453.

<sup>36</sup> Arvid A Skaar, *Commentary on Article 5 of the Model Treaty: The Concept of Permanent Establishment* (PE, 25 Supplementary, IBFD, Amsterdam 2005) 34.

<sup>37</sup> Aare Kurist, ‘Püsiva tegevuskoha mõiste rahvusvahelistes maksulepingutes ja Eesti tulumaksuseaduses. (1998/1999) *Juridica* 450-453.

<sup>38</sup> Hans Pijl, ‘The Concept of Permanent Establishment and the Proposed Changes to the OECD Commentary with Special Reference to Dutch Case Law’ (2002) 56 *Bulletin for International Fiscal Documentation* 557.

<sup>39</sup> OECD Commentary on Article 5 paragraph 6.3.

<sup>40</sup> R G Tremblay, ‘Permanent Establishments in Canada’ (1992) 2 *Journal of International Taxation* 309.

It should be examined what could be considered as being *sufficient*<sup>41</sup> to argue that the permanency element exists. It is not odd that courts have to analyse which time-slot is sufficient for PE purposes. For instance, Dutch courts, depending on the facts and circumstances of the cases, have come to different conclusions, varying from approximately four months to four years to be sufficient, and from few days to several months to be insufficient. Yet, a six-month period is regarded satisfactory for Dutch general practice purposes.<sup>42</sup> Contrary, the US Internal Revenue Service has held that if a foreign horse enters in subsequent US races without the information of the frequency of such entries, an entry would be considered as a PE.<sup>43</sup>

If the nature of the business activity is such that it is realised at one certain location for a short period but frequently over the years, the time requirement may be complied with even if each time, separately, does not fulfil the criteria to be permanent. In such cases, the definite regularity, continuity and minimum time period for each season must be examined to make a conclusion.<sup>44</sup> The same is true with activities involving temporary interruptions, e.g. because of the unsuitable weather conditions, strikes, political, financial, etc, reasons.

Hence, the continuous character is strongly related to the permanent nature of an activity. This issue whether isolated activities could be regarded as continuous activities has been discussed in the US court cases *Consolidated Premium Iron Ores Ltd* and *Inez De Amadio*. Contrary to the Court's opinion<sup>45</sup>, the Estonian tax authorities are of the opinion that isolated activities can be the basis for a PE. The latter finds that as long as the activity of an undertaking constitutes a coherent whole, the time spent for the provision

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<sup>41</sup> Emphasis added by the author.

<sup>42</sup> Hans Pijl, 'The Concept of Permanent Establishment and the Proposed Changes to the OECD Commentary with Special Reference to Dutch Case Law' (2002) 56 *Bulletin for International Fiscal Documentation* 557.

<sup>43</sup> J Nitikman, 'The Meaning of "Permanent Establishment" In the 1981 U.S. Model Income Tax Treaty: Part I' (1989) 15 *International Tax Journal* 163.

<sup>44</sup> Arvid A Skaar, *Commentary on Article 5 of the Model Treaty: The Concept of Permanent Establishment* (PE, 25 Supplementary, IBFD, Amsterdam 2005) 36.

<sup>45</sup> J Nitikman, 'The Meaning of "Permanent Establishment" In the 1981 U.S. Model Income Tax Treaty: Part I' (1989) 15 *International Tax Journal* 166.

of closely related business operations is aggregated even if they take place in different geographical locations.<sup>46</sup>

The problem of the Estonian aggregation-approach questions if a non-resident finishes its activities in Estonia, is a PE automatically liquidated or can it exist until the non-resident formally announces about the cessation. Due to the unique Estonian income tax system<sup>47</sup> the question carries a practical importance: the liquidation triggers the taxation of profits of the PE, while the maintenance of a PE makes it possible to defer the PE's tax liability.

Last but not least, the question is whether there should be connection between the time requirement and the amount of deals to distinguish permanent activities from temporary activities. It might not even be reasonable to specify it since the activities of taxpayers may be too different by nature. The criteria, for instance, for taxpayers selling bread and those selling jet planes cannot logically be the same. In this example, normally, the former has several deals per year, whereas for the latter the profit from one deal is presumably bigger than the one of the baker during 10 years.

### **3.4 Disposition of the fixed place of business**

The disposition element stems from the phrase "business of an enterprise" which evidently indicates that the business has to be at the disposal of the enterprise. Also, the OECD Commentary makes it clear that the mere existence of a fixed place of business is insufficient to create a PE, but the taxpayer must have the place at its disposal. The term "disposition" means that the taxpayer has the power or liberty to control the place and, hence, the right to determine the conditions according to its needs.

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<sup>46</sup> Tiiu Albin, Helen Pahapill, 'Is there a Permanent Establishment in Estonia?' in Arvid A. Skaar, Jacques Sasseville (eds), *Is There a Permanent Establishment?* (IFA Cahiers de Droit Fiscal International, IFA, 2009) 271.

<sup>47</sup> According to Articles 49-52 ITA the tax liability of Estonian legal person is deferred till the profit distribution or until it makes other taxable payments, e.g. payments unrelated to business. Article 53 ITA sets forth the similar way of taxation of PEs: income tax liability is deferred until the property is taken out of a PE.

The disposition criterion is solved on the basis of specific DTCs concluded between the States since some States have adopted a wider understanding than others. An example of a narrow interpretation can be found in Germany-Austria DTC under which the simple availability of a key or an office desk is enough.<sup>48</sup>

The second question is whether a legal right over the property (i.e. formal right to use acquired by law, contract or other lawful formalised agreement and whether in the form of ownership, commercial or residential lease, deposit, pledge or other relationship) is required. The OECD Commentary explicitly confirms that there is no need for that and even illegal presence may constitute a PE.<sup>49</sup> Also, an implicit authorisation (i.e. factual right to use) is not a prerequisite. On the other hand, the simple presence is not always sufficient, as illustrated by a number of examples in the OECD Commentary<sup>50</sup>

If implicit legal right and illegal disposition is accepted, the disposition clause is to some extent limited or even without relevance in practice. For instance, a person who has illegally occupied a place can never have a complete right to determine the criteria for the use of such a location, since the competent authorities can always restrict the taxpayer's freedom to use it.<sup>51</sup>

The mere control over a place is not sufficient to satisfy the disposition requirement. The material presence of the non-resident is also necessary. The Supreme Court of Canada has held that where there was no person in the office with capacity to contract on behalf of the non-resident and the conduct and control were performed from outside Canada, there was no PE in Canada, in spite of the fact that the taxpayer had an office available in Canada.<sup>52</sup>

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<sup>48</sup> Dietmar Herbrich, 'The Future of Taxing Business Profits' in Markus Stefaner, Mario Züger (eds), *Tax Treaty Policy and Development* (39 Series on International Tax Law, Linde Verlag, Vienna 2005) 336.

<sup>49</sup> OECD Commentary on Article 5 paragraph 4.1.

<sup>50</sup> Ibid 4.2-4.5.

<sup>51</sup> A Caridi, 'Proposed Changes to the OECD Commentary on Article 5: Part I - the Physical PE Notion' (2003) 43 *European Taxation* 9.

<sup>52</sup> R G Tremblay, 'Permanent Establishments in Canada' (1992) 2 *Journal of International Taxation* 308.

### 3.5 Carry on business of the enterprise through the fixed place

The next requirement encompasses three issues: (i) whose business (is carried on), (ii) which connection (can be found between the fixed place and the business) and (iii) should the business be active.

It is clear that the business must be of the non-resident and not that of its employees or other third parties. Does it also mean that subcontracting is automatically ruled out? The OECD Commentary has discussed the issue under the construction-clause PE and state that the time spent by the subcontractor on the (building) site is attributable to the main contractor.<sup>53</sup> The same may be applied in case of general-rule PE. The Austrian Ministry of Finance, however, has not shared this view since it is the business activity of the subcontractor which is exercised in the fixed place and not that of the main contractor.<sup>54</sup>

Still, should it make any difference whether the enterprise complies with its obligations by making use of its facilities and employees or that of third enterprises? A solution can be found from another point: the responsibility assumed by the main contractor, i.e. every function that falls within the scope of his contractual responsibility should be considered as his activities.<sup>55</sup> Although there is no explicit requirement of responsibility in the PE-provision, the author is of the opinion that even if all of the activities are subcontracted by the main contractor to other enterprises, while maintaining the responsibility over the fixed place of business, a PE for the former is created.

Another key may be found from the OECD report on the attribution of profits to a PE<sup>56</sup>: if there are no functions performed by the main contractor's PE, no assets can be used or risks attributed to the PE. Consequently, even if a PE existed for the main contractor, it

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<sup>53</sup> OECD Commentary on Article 5 paragraph 19.

<sup>54</sup> Dietmar Herbrich, 'The Future of Taxing Business Profits' in Markus Stefaner, Mario Züger (eds), *Tax Treaty Policy and Development* (39 Series on International Tax Law, Linde Verlag, Vienna 2005) 338.

<sup>55</sup> Ibid.

<sup>56</sup> OECD Report, 'The Attribution of Profits to Permanent Establishments' 17 July 2008, <<http://www.oecd.org/dataoecd/20/36/41031455.pdf>>, accessed 21 January 2009.

would be without practical importance, since no income of the company would be attributed to the PE and, thus, taxable in the state of the PE.

Next, the word “through” instructs that the business must be exercised by using the place. Therefore, if a certain connection between the place and the activity is present, the criterion is fulfilled. This view is not changed by the fact that the business is not carried on “in” the premises of the enterprise, so long as these premises are the “focal point” for the business, i.e. activities are attributable to the PE.<sup>57</sup>

Thirdly, the wording of “carry on” strongly suggests continuity and regularity. Thus, only income derived from trade or business can be the basis for the existence of a PE. This is also clear for the purposes of Article 7 OECD MC which stands for the allocation of taxing rights over (active) business income. Other income generating activities or investments (dividends, interests and royalties) fall under other Articles of the OECD MC and cannot be the primary reason for setting up a PE.

An interesting contradiction between the “old” (Mexico/London MCs) and the “new” (UN/OECD) model conventions is that the formers expressly necessitated the place to have a productive nature, whereas in the latter such an approach has not been taken. The OECD has reasoned such a view with an assumption that each part of an enterprise contributes to the productivity as a whole.<sup>58</sup> Accordingly, the new concept of a place of business may create a PE even if the activities have mainly or nothing but expenditures.<sup>59</sup> The Mexico and London MCs, on the other hand, followed the idea that establishments which were not directly engaged in actual productive operations (such as research laboratories), but were used simply for the purposes of certain general or particular services having no precise link with the profits generated by the concern should not create the State of such an establishment taxing rights. The concern was that levying income tax on imputed profits in case of such entities would easily lead to arbitrary or

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<sup>57</sup> J Nitikman, ‘The Meaning of “Permanent Establishment” In the 1981 U.S. Model Income Tax Treaty: Part I’ (1989) 15 *International Tax Journal* 164.

<sup>58</sup> OECD Commentary on Article 5 paragraph 3.

<sup>59</sup> A Hamad, ‘Rationalising the “Permanent Establishment” (2006) 35 *Australian Tax Review* 66.

extraterritorial taxation.<sup>60</sup> Yet, the OECD and UN MCs have approached the problem by including the “negative list” of PE’s (Article 5 (4)).

#### 4. Conclusion

The main idea of the thesis was to introduce various approaches applied by States. Although relevant guidance on the determination of PE is provided by MCs and their commentaries, the flexibility to interpret the term creates a number of disagreements that lead to double-(non-)taxation of the business income of a company acting cross-border.

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<sup>60</sup> London and Mexico Model Tax Conventions, Commentary and Text. Official No.: C.88.M.1946.II.A. (1946) League of Nations, Fiscal Committee, Geneva 14.