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Permanent Establishment through Related Persons

A Study on the Treatment of Related Persons under Article 5 of the OECD Model Tax Convention

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Abstract
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Globalization, changed business practices and the developments in information technology have put pressure on the PE concept. This thesis deals with related persons and the PE concept, and the increasing tension between them.

The main objective of the thesis is to analyze and define the scope of the PE concept, when applied to related persons. To meet this objective, the thesis is focused on three research questions. Initially, a theoretical foundation regarding the PE concept is established. It is concluded that the PE concept's underlying principles are the notions of source, equity and basic neutrality.

The first research question deals with the scope of the "related company clause" in Article 5(7) of the OECD MTC. To answer this, the history and underlying principles and theories of the related person PE are analyzed. It is concluded that the related person PE should be understood as including two distinct taxpayers and that the "related company clause" has no substantive scope.

The second research question deals with the application of the PE concept to situations with related persons. It is established that the central question is whose business is being conducted. It is argued that this is a substance-over-form assessment and that guidance should be had from the dependency test in the agency clause, i.e. legal control and economic relationship.

The third research question concerns what function the PE concept has, and should have, when it comes to preventing tax avoidance. It is argued that applying substance-over-form, not inherent to a specific PE condition, should be limited to preventing abuse. To determine if a situation is abusive, one should compare the outcome with the PE concept's underlying principles. If the result is unintended and contrary to the underlying principles, it is an abuse of the PE concept, provided that this is achieved intentionally by the taxpayer.

Keywords: PE, permanent establishment, taxation, international taxation, tax treaty, OECD MTC, Article 5, related person, related company, related enterprise, BEPS

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Preface

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Material after November 30 2017 has not been observed. On November 23 2017, the OECD approved of the previously released draft update to the MTC. It was not possible to adapt the study at that point and, consequently, only the draft is mentioned.

Uppsala, February 20 2018

Linus Jacobsson

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1 Introduction

1.1 General Overview of the Topic

Today it is fairly common for companies of all sizes to conduct their business in several countries. Some large multinational companies can be said to conduct their business globally, leaving the notion of a country or region as the area of operation behind. To be able to pursue business abroad efficiently, companies often organize themselves with branches or subsidiaries, or both, in other countries. This leads to tax claims from two or more jurisdictions, which can lead to international juridical double taxation, hereafter referred to as double taxation. To avoid this, states conclude double taxation agreements, hereafter, tax treaties or treaties, which divide taxing rights between the contracting states. The main method used to divide taxing rights on active business income is the use of the legal concept "permanent establishment", hereafter, PE. In the OECD[1] Model Tax Convention on Income and on Capital, hereafter, the OECD MTC, which is the most common basis for tax treaties, the rules concerning PEs can be found in Article 5. Simply put, the PE is a threshold that the business must pass in order to be taxed in the state of establishment and not only in the state of residence.

The topic of the study is the application of the PE concept to related persons in a tax treaty context. The topic can be illustrated with a metaphor of boxes. A company can be seen as a box. In fact, when one draws a picture of a group's organization or a transaction, the different companies involved are usually drawn as boxes. From a tax law perspective these companies are, as a starting point, treated as separate units. However, if we switch to an economic perspective, the multinational enterprise, consisting of several companies, can be perceived as a single unit (one big box). The reason for this is that the parent company, and ultimately its shareholders, is mainly interested in how the group is doing as a whole. Thus, we have a situation where we see the same situation differently depending on which perspective we choose.

[1] The Organisation for Economic Co-operation and Development.

Both of these views are valid in their respective contexts, but perhaps not suitable outside of those contexts. Having competing views on the same situation can lead to problems with the application of the PE concept. The problem dealt with in this study concerns tax law and occurs when two boxes, in different countries, seem to overlap. This overlap legally belongs to one company but could economically be considered to belong to the other company. Thus, the problem can be described as whether economic substance or legal form should prevail.

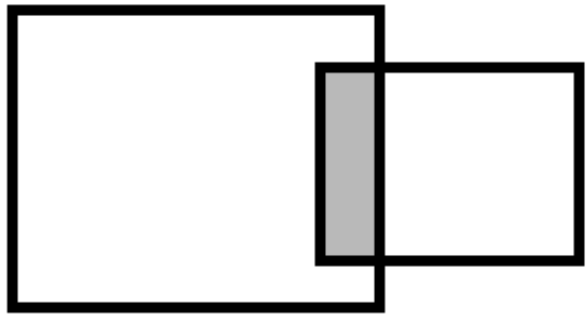

Figure 1. Depicting the overlap of two corporate entities, in different countries, belonging to the same group.

This problem is not unique to the PE concept or international taxation. If we confine ourselves to domestic tax law, these different views are often mitigated by different methods to equalize profits between group companies, e.g. consolidation or group contribution.[2] If we add the circumstance that the companies are in different countries, however, profit and loss equalization is generally not possible with these

[2] See Wiman, B, "Equalizing the Income Tax Burden in a Group of Companies", *International Studies in Taxation: Law and Economics – Liber Amicorum Leif Mutén.*

rules. In general, countries are not prepared to apply the economic view in cross-border situations if that could result in a loss of revenue.

By contrast, in cross-border situations countries may be interested in taxing the income originating from the overlap depicted above. It is here that the PE concept becomes interesting. The question can be formulated as: In which box should the content of the overlap be placed? If it belongs to the foreign company and can be considered to be a PE, it can be taxed in the state of establishment. When a PE exists in these situations it could be seen as a box within the box, belonging to another company.

What is the general problem? The problem is that tax law in general does not recognize that what happens in one corporate entity can be considered to belong to another corporate entity. As Sheppard puts it, the "OECD needs to get away from the idea that group members or controlled affiliates of whatever stripe ever act independently of one another".[3] In other words, we are in a way trapped within our preconceptions derived from tax law. To break free we need a specific provision, which, in the case of this study, is the PE concept. It is not easy, however, to apply the PE concept to these situations. One reason is that the discourse concerning the PE, specifically the discourse concerning the fixed place of business rule, is mostly focused on branches, not other companies. Any discussion regarding the related person PE mostly deals with the agency clause, which is fairly easy for tax payers to avoid.[4] PEs according to the fixed place of business rule, on the other hand, is sparsely discussed. This is highlighted in the BEPS project, which focuses mainly on the agency clause when it comes to the PE concept.[5]

In the past decade or so, tax agencies' interest in these situations has increased. They often argue from an economic point of view, i.e. *substance-over-form*. One might suspect that they are trying to increase revenue and prevent tax planning as these arguments are mostly brought forward in cases where profit shifting is somehow achieved.

[3] Sheppard, L, "Revenge of the Source Countries?", *Tax Notes International*, March 28 2005, p. 1138.

[4] At least the traditional, pre-BEPS version. Whether the new version will be generally accepted and solve this remains to be seen.

[5] See the next section for a discussion about the BEPS project. "BEPS" stands for Base Erosion and Profit Shifting.

Thus, the problem is about definitions and boundaries in situations where we have competing views and contexts, but it is also about tax competition and how to divide taxing rights between countries. This is a classic problem in law as every time a line is drawn and a concept is defined, there will be difficult cases close to the line that share characteristics with both sides. In fact, we cannot be completely certain where the line is drawn, that it is a line, or that it even exists. Indeed, the line drawn in law dividing the boxes disappears if we adopt an economic point of view.

Furthermore, there are other problems with the current concept, both general and specific to related companies. A general problem is that the concept is old, one might even say dated, and does not correspond to the present business reality.[6] The PE concept is based on physical presences, which do not necessarily correspond to today's e-commerce and information era.[7] This can cause problems with the application of the concept to business operations that do not rely on physical presence to conduct their business abroad.[8] Furthermore, business today is a global affair, with MNEs operating all over the globe. This is not a new phenomenon.[9] However, the development of IT since the middle of the 1990s has driven globalization even further, which has further blurred the already fuzzy concept of source and put pressure on the PE concept.

In short, the general topic of this study can be described as the interaction between the PE concept and substance-over-form in situations where the involved persons are related. This topic also plays a big part in the BEPS project, which is described in the following section.

[6] It is necessary to stress that the fact that the concept is old is not just a weakness but also its strength. The PE concept is well known and established, which provides legal certainty and foreseeability.

[7] See for instance the descriptions of Actions 1 and 7 in OECD, *Action Plan on Base Erosion and Profit Shifting*.

[8] See Pinto, D, *E-Commerce and Source-Based Income Taxation*, p. 59-60. See also OECD, *Addressing Base Erosion and Profit Shifting*, p. 27-28 and Gazzo, M, "Permanent Establishment through Related Corporations", *Bulletin for International Fiscal Documentation*, no. 6 2003, p. 263.

[9] The difficulties in establishing the source of income were described in 1923 by "the four economists" in two examples concerning an orange farm and a tea plantation, League of Nations, *Report on Double Taxation*, p. 22-24, (1923).

1.2 The BEPS Project

In 2012 the G20 and OECD launched the BEPS project. In essence, the BEPS project is intended to counter certain tax planning practices and restore a perceived intended taxation. The BEPS project has relevance for this study in several ways. First, the PE concept is explicitly dealt with, and amended, under Action 7.[10] Second, several other concepts such as transfer pricing, attribution of profits and the prevention of treaty abuse have some impact on the PE concept. Finally, the BEPS project did not just appear out of nowhere; it is an expression of the current debate on international taxation. This debate has been present both in media and among politicians. To some extent, large multinational corporations are perceived as not paying the taxes that they "should" be paying, which, to be fair, in many cases is true. The present debate will of course influence any amendments of the PE concept, but it may also influence the application of the current rules. Tax agencies and courts are not immune to the political climate, and their decisions will likely, at least to some extent, be influenced by the BEPS project even before its recommendations are implemented.

This leads to the conclusion that the BEPS project is important for this study as it will likely have, and to some extent already has had, a significant impact on the PE concept. The BEPS project also serves as a background to the current political climate concerning international taxation and as such may help explain recent developments of the PE concept. In the following, the BEPS project is described in general, focusing on the aspects deemed important for this study. This serves as a more specific, but still general, overview of the topic of this study. The details of the BEPS project are not discussed here but rather throughout the study where they are relevant.

This section is structured as follows. First, a brief overview of the BEPS project is presented. After that, the focus is shifted to the parts specifically related to the PE concept. Finally, the political climate, especially in relation to the PE concept and BEPS, is discussed.

In February 2013, the OECD released a report titled "Addressing Base Erosion and Profit Shifting".[11] This report deals with BEPS on a

[10] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*.
[11] OECD, *Addressing Base Erosion and Profit Shifting*.

general level. The main questions dealt with in the report are about empirical data to analyze BEPS, business models, key tax principles and the identification of the "key pressure areas". A good summary of, what I consider to be, the main point in the report is: "there is a more fundamental policy issue: the international common principles drawn from national experiences to share tax jurisdiction may not have kept pace with the changing business environment."[12] After concluding this, the OECD identifies "key pressure areas". These "key pressure areas" are the basis for the next report. For the PE concept, the main pressure area is the "jurisdiction to tax", but both "effective anti-avoidance measures" and "counter harmful regimes" have relevance as well.

The next report is the "BEPS Action Plan",[13] which contains a more specific description of problems related to the key pressure areas. In the Action Plan, 15 actions are presented to be dealt with in the context of the BEPS project. The actions are divided into four different categories: (i) establishing international coherence of corporate income taxation, (ii) restoring the full effects and benefits of international standards, (iii) ensuring transparency while promoting increased certainty and predictability and (iv) the need for a swift implementation of measures. In addition to this, Action 1 concerning the tax challenges of the digital economy seems to be its own fifth category as well as connected to the other actions.[14]

The most relevant category for the PE concept is the second one, restoring the full effects and benefits of international standards. This category contains Action 7, which is titled "Prevent the artificial avoidance of PE status". Additionally, the prevention of treaty abuse (Action 6) and transfer pricing (Actions 8-10), both relevant for the PE concept, are included in this category. The focus of Action 7 is commissionaire arrangements and artificial fragmentation to avoid a PE.

The general idea of the second category is that, while many of the international standards are sound, increased globalization has made it possible to shift income between countries.[15] Applied to the PE con-

[12] OECD, *Addressing Base Erosion and Profit Shifting*, p. 5, 27-28 and 35-36.
[13] OECD, *Action Plan on Base Erosion and Profit Shifting.*
[14] OECD, *Action Plan on Base Erosion and Profit Shifting*, p. 14.
[15] OECD, *Action Plan on Base Erosion and Profit Shifting*, p. 18-19.

cept, this means that the existence of the concept is not challenged but rather that it should be tweaked to stop what are considered to be artificial structures.

When studying Action 7 it is clear that the identified artificial structures to a large extent relate to multinational enterprises. This is especially interesting in this study as Action 7 mainly, one could even say almost exclusively, deals with what could be labeled "related person PE" problems. However, the suggested changes are general in nature and will affect other, "non-artificial", situations as well.

In essence, the OECD has four main changes in mind in the context of Action 7. The *first* one is an addition to the agency clause to include situations where the principal is "economically bound" and not only, as is the case now, situations where the principal is legally bound.[16] This is intended to target "commissionaire arrangements" as well as similar strategies.[17] This is mainly a related person PE problem as it can be assumed that the arrangement between independent parties does not include profit shifting. Shifting profits between independent parties basically means that one party is giving a gift to the other, which is unlikely between independent parties.

The *second* proposal also deals with the agency clause, but this time with the second part, namely, the dependency assessment. The change makes an agent working almost exclusively for "closely related" enterprises automatically considered dependent.[18]

The *third* proposal deals with the exceptions for preparatory and auxiliary activities found in Article 5(4) of the OECD MTC. The suggested change is to add the condition that the listed activities must be of a preparatory or auxiliary nature,[19] essentially turning the provision from a list of exceptions into a list of examples. This change is not immediately connected to related persons but rather motivated by new business practices and the digital economy.

[16] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 16.
[17] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 15.
[18] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 16-17.
[19] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 28-29.

The *fourth*, and final, proposal is actually two separate ones but with a similar theme of fragmentation among related persons. The first situation is under the exceptions in Article 5(4) and is intended to prevent a practice of dividing activities between several related persons so that each person is considered to conduct exempted activities.[20] The solution is simply to aggregate the activities provided that they are complementary and part of a cohesive business operation.

The other situation concerns the construction clause and the practice of dividing contracts between related companies in order to bypass the twelve-month threshold and, thus, avoid having a PE.[21] This situation also targets the related person situation. The solution, however, is not found in Article 5 but rather as an example in the commentary to the suggested Principal Purpose Test[22] as well as in the commentary to the construction clause.

Having discussed the proposal regarding the PE concept, we now turn to the impact of the current political climate. To begin with, one can conclude that at the moment, the argument to prevent various tax-planning schemes and abusive practices is particularly strong. One could argue, somewhat correctly, that there is always a strong case to be made for preventing abuse. The difference or perhaps rather what is special right now is that the will to co-operate and compromise in order to reach broadly accepted solutions is unusually strong. This has created a situation where both the OECD and EU are "competing" to provide solutions to prevent tax avoidance.

In order to capitalize on the present consensus regarding tax avoidance, the BEPS project has been progressing at a rapid pace, and a key factor of its success will be whether it can be completed while the political climate is still focused on the questions the project raised. It is necessary, however, to keep in mind that we do not yet know how successful the implementation of the proposals in Action 7 will be. Indeed, there is good reason to question how successful the implementation will be. For instance, the United States has not signed

[20] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 39.
[21] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 42.
[22] This can be found in OECD, *BEPS Action 6 Final Report: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, p. 64.

the multilateral instrument, Sweden has signed but will not implement Action 7, Germany includes only one proposal, and so does the United Kingdom.[23] Thus, a fast and uniform implementation of Action 7 worldwide seems to be out of the question. In fact, it seems difficult to achieve this even within the OECD member states.

What are the consequences for the PE concept? Well, first of all, BEPS-like measures are already being implemented in some jurisdictions. Additionally, some countries are accepting the proposals, which means that some treaties will change with the multilateral instrument. However, many treaties will not. This leads to fragmentation and complexity as there will be parallel systems when it comes to the PE concept. Despite this, one can assume that the currently common narrative that portrays the multinational as the "villain" is affecting tax agencies and judges when applying the PE concept in specific cases. This in turn affects taxpayers, who may change their tax planning strategies. Because of this it is not unlikely that changes to the PE concept are taking place even before the BEPS project is implemented.

Given this development, it is important to critically examine the BEPS project and not get carried away by the present narrative when studying the PE concept. Preventing abuse often leads to solutions that do not respect the internal coherence and principles of a legal concept such as the PE. One must also strike a balance between the objective of preventing tax avoidance and that of respecting taxpayers' rights. Thus, it is important to critically examine the suggestions and changes produced in this political climate. In particular, it is important to examine whether changes to prevent abuse also affects non-abusive situations.

[23] http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf, accessed 2017-10-04.

1.3 Key Issues of This Study

1.3.1 Permanent Establishments, MNEs and the Notion of Source

One of the main issues with the PE concept and related persons is how the taxing rights on income are divided according to the OECD MTC. An initial question is what type of rule the PE concept represents. This might seem like a pointless question, but depending on how one views a concept, its meaning can be interpreted in different ways. The PE concept can be seen as a source taxation rule, giving the state of establishment *a right to tax*. The PE concept can also be said to limit the state of establishment's right to tax, and to represent residence-based taxation. Schön argues that the PE concept is a mix of source and residence.[24] On the one hand, it acts as a threshold for limited tax liability. On the other hand, it should be treated as a separate enterprise with the possibility to allocate income even from third states to the PE. He concludes that the PE concept is justified "as an extension of unlimited tax liability to non-incorporated business units" and that it is predominantly an expression for residence-based taxation.

The PE concept is primarily based on the notion of separate companies, which means that the source of income is decided on a company level. In essence this means that, as a starting point, the different companies in a group are treated as separate units and do not constitute PEs of each other. Naturally, this is to some extent a fiction. A group will in many cases see itself as one unit and the different companies within it are usually working for the common good. One reason for this approach is that when the concept was shaped, the different companies in a group probably were separate units. Before the current information and transportation era, each unit in the group had to be fairly self-sufficient. It was not possible to share services within the group over great distances, have video-conferences or access shared information through common software systems.

[24] Schön, W, "International Tax Coordination for a Second-Best World (Part I)", *World Tax Journal*, no. 1 2009, p. 104-105. Also see Reimer, E, *Klaus Vogel on Double Taxation Conventions*, 4th ed., Article 5 marg.no. 2-3.

The development of information technology has led to the concept of source becoming even more blurred.[25] The following example can demonstrate this.

> A MNE develops and sells products. All development takes place in country A. The group's parent company provides centralized management services and is situated in country B. The MNE has a resale unit in country C. The majority of the customers are residents in countries D and E. On top of this, the MNE has a marketing unit in country F and a group bank in country G which finances the development of products.

Where is the source of income in this example? All of the different parts contribute to the group's profit, which derives from selling its products. The present solution is to use transfer pricing rules to prevent income from being shifted between jurisdictions. In the example above, the type of establishment, i.e. branch or subsidiary, has deliberately been left out. In the next section we will see that transfer pricing alone is not enough to salvage the eroded notion of source.

1.3.2 Neutrality between Branches and Subsidiaries – Substance or Form?

Neutrality is an important objective in tax law. The notion of neutrality is broad and encompasses various theories and principles.[26] To simplify a bit, neutrality in corporate taxation can be characterized as the notion that tax law should not influence business decisions.[27] One aspect of neutrality that is interesting in this section is the neutrality between establishing a subsidiary or a branch. Initially, it might be fruitful to discuss non-fiscal reasons for the choice of form with which to conduct business in a foreign country. Skaar mentions two main reasons to choose a branch: "lack of experience in a foreign market" and mobile industries that know they will be active only for a

[25] Schön, W, "International Tax Coordination for a Second-Best World (Part I)", *World Tax Journal*, no. 1 2009, p. 68.
[26] In fact, neutrality can hardly be described as *one* principle. For further discussion about neutrality see section 2.3.3.
[27] Romby, A, *Underskott i aktiebolag – En skatterättslig studie av förlust- och resultatutjämning i ljuset av svensk rätt och EU-rätten*, p. 29.

limited time.[28] A reason to choose a subsidiary can be to limit the risk from the establishment. In a completely neutral system only similar business reasons would influence the decision to establish a branch or a subsidiary. As we will see below, the current system is not neutral, and fiscal considerations can affect that decision.[29] In addition to fiscal reasons there may be other differences between establishing a branch or a subsidiary, such as accounting and general administrative compliance.

In the context of a tax treaty, one aspect of neutrality is achieved if the related person PE assessment is made the same way as for branches and unrelated companies.[30] However, this aspect of neutrality is trapped within the boundary of the PE definition. For instance, the fixed place of business PE is developed with branches in mind and, thus, might not produce "neutral" results concerning related persons. The PE is a threshold for taxation in the state of establishment, and as such it is at least connected to the idea of the source of income. Vogel argues that a common understanding of source does not exist. Instead, any chosen definition "is not a basis from which to proceed, it is a part of the problem".[31] Furthermore, countries have different interests and opinions about the PE concept, which shows that it is difficult to reach a common view on the source taxation threshold.[32] One example of this is whether neutrality should be achieved according to capital-import neutrality or capital-export neutrality.

One of the neutrality problems with the current PE concept is that two identical establishments, disregarding legal form, can lead to dif-

[28] Skaar, A, *Permanent Establishment*, p. 8-9.

[29] A typical modern fiscal system will never be completely neutral. Taxes will always distort the economy to some degree. The question is how much distortion should be accepted and whether other considerations are more important than neutrality.

[30] This is the position of the OECD, with the exception of a parent company as the subsidiary's place of management, para. 40-41 of the commentary to Article 5 of the OECD MTC. Also see Skaar, A, *Permanent Establishment*, p. 541-542. It can be noted that the OECD seems to have distanced itself a bit from this notion with the proposed inclusion of a specific rule for related persons in the agency clause.

[31] Vogel, K, "Worldwide vs. source taxation of income (Part I)", *Intertax*, no. 8/9 1988, p. 229.

[32] Skaar, A, *Permanent Establishment*, p. 571-572.

ferent taxation. The example in the previous section can illustrate this. In the example, the MNE has a research and development unit in country A and a marketing unit in country F. If both of these units are subsidiaries both A and F can tax the domestic subsidiary. The other countries, however, may only tax these companies directly provided that a PE exists in their respective jurisdictions. By contrast, if the establishments in A and F are branches, countries A and F might not be able to tax these operations while C can now tax them. The reason is that marketing and research may constitute preparatory or auxiliary activities according to Article 5(4) in the OECD MTC.[33]

This example shows that there may be different results, from a fiscal point of view, between establishing a branch or a subsidiary. This difference originates from the different criteria in the OECD MTC's definitions of residence and PE. It could be questioned from a neutrality perspective whether legal form is sufficient to allow different treatment of otherwise identical establishments. Furthermore, dividends, interest and royalties may be taxed differently whether they are connected to a PE or not. This discrepancy can be, and has been, used for tax planning. The traditional view of the related person PE is that it can only be constituted through the agency clause. Consequently, a foreign enterprise can establish a subsidiary acting on its behalf, but not in a way that fulfills the agency clause. By limiting the risk the subsidiary assumes, the profit can be kept low with the surplus being shifted abroad to the parent.

However, the traditional view of the related person PE has been challenged and has perhaps already changed. Countries may attempt to classify the subsidiaries as PEs, through the use of the substance-over-form approach, in order to be able to tax their income. The rationale for this can be that the state of establishment considers that the income has its source within its jurisdiction.

Against this background, this issue can be summarized as whether branches and separate legal entities should be treated the same way or not, and whether and when a substance-over-form approach should be adopted. The use of the PE for tax planning and as an anti-avoidance tool is further elaborated in the next section.

[33] Para. 23 of the commentary to Article 5 of the OECD MTC. Also see Skaar, A, *Permanent Establishment*, p. 307-310.

1.3.3 Tax Planning and BEPS

As shown in the previous section, the PE concept can be used to shift income between countries. Base Erosion and Profit Shifting has lately drawn the attention of the OECD. BEPS had also been discussed by policy makers and in the media, which probably influenced the OECD to take a greater interest in this issue. In February 2013, the OECD released a report with the title "Addressing Base Erosion and Profit Shifting",[34] hereafter the "BEPS report", and in July 2013 it released "Action Plan on Base Erosion and Profit Shifting",[35] hereafter the "BEPS Action Plan". In the BEPS report it is concluded that the existing studies do not provide conclusive evidence on whether BEPS, is really a serious problem.[36] However, it is certainly perceived as a serious threat to tax revenue.[37] For the purpose of this study, a perceived threat is enough as it may put a strain on the PE concept when countries try to fight BEPS. When it comes to the PE concept, the problem can be described as an artificial separation of income and the income-generating activities.[38] Three main PE issues are identified: e-commerce, commissionaire arrangements and artificial fragmentation of activities.[39] In the context of the related person PE, all three of these issues have relevance, although e-commerce would probably be an issue combined with one of the other two.

The identified shortcomings of the PE concept are not a new issue. In 1991, Skaar noted that creative interpretations of the PE concept were being used to prevent tax avoidance and predicted that it would be more common in the future.[40] This is the very core of the problems with the PE concept. A concept that does not produce a perceived "correct" result is stretched and twisted to achieve the wanted result. This creates legal uncertainty for both taxpayers and tax agencies. To come to terms with this, it is likely that the PE concept needs to be amended, or at least clarified. This study attempts to do that regarding the related person PE.

[34] OECD, *Addressing Base Erosion and Profit Shifting*.
[35] OECD, *Action Plan on Base Erosion and Profit Shifting*.
[36] OECD, *Addressing Base Erosion and Profit Shifting*, p. 15-21.
[37] OECD, *Addressing Base Erosion and Profit Shifting*, p. 13.
[38] OECD, *Action Plan on Base Erosion and Profit Shifting*, p. 10.
[39] OECD, *Action Plan on Base Erosion and Profit Shifting*, p. 14 and 19.
[40] Skaar, A, *Permanent Establishment*, p. 554.

1.4 General Objective and Research Questions of This Study

1.4.1 General Objective of the Study

The general objective of the study is to analyze and define the substantive scope of the PE concept,[41] as applied to related persons. The objective should be understood in light of the description of the topic in the preceding sections.

The term *related person* is broadly defined in the study to include individuals, subsidiaries, group companies, common ownership not constituting a group and any other situation where persons can be said to be related because of ownership. The common denominator is that a person can use its influence derived from ownership, direct, indirect or through shareholder agreements, to exercise control over another person. Thus, for the purpose of this study, related persons should be understood as any relationship where one person has control over another person due to ownership, which exceeds the normal situation between independent parties. The reason for the focus on ownership is that it is these situations that most commonly cause disputes. This is likely because ownership means having a financial stake in another enterprise. Thus, one can imagine the shifting of profits between persons if one exercises control over the other because of ownership. The same situation is unlikely where common ownership does not exist. Furthermore, the OECD MTC is focused on ownership.[42]

This means that certain situations that may include similar control fall outside the scope of the study. Other such situations could include control in a creditor-debtor relationship or in a buyer-seller relationship. These situations, and others, are not studied, but the general reasoning in the study may be applicable in such situations as well, although this must be assessed on a case-by-case basis.

A secondary objective, not connected with the main objective, is to provide Swedish material on the PE concept. This may be interesting for the international reader as case law from Sweden is usually not available in English. It is not the intention to fully explore and define a

[41] See section 1.6.2 for a discussion about what I mean by the "PE concept".
[42] See section 3.5.3.1.

"Swedish PE concept" but rather to use examples from Sweden as part of meeting the main objective.

In order to fulfill the main objective, the study deals with three different research questions: (1) What is the scope of the specific *related company clause* in Articles 5(7) and 5(8) in the OECD and UN MTCs respectively? (section 1.4.2.1), (2) How should the PE concept be applied to related persons? (section 1.4.2.2) and (3) Can, and should, the PE concept be used to prevent tax avoidance? (section 1.4.2.3). In the following section, these research questions are elaborated further.

1.4.2 Research Questions

1.4.2.1 The First Research Question

The first research question of the study concerns the scope of the related company clause found in Article 5(7) of the OECD MTC and Article 5(8) of the UN MTC. The related company clause is the only provision in the PE concept that directly deals with the question regarding the related person PE. According to this provision, the fact that a company "controls or is controlled by a company which is a resident of the other Contracting state […] shall not of itself constitute either company a permanent establishment of the other." There is a duality to this provision as it seems to reject "form", i.e. a subsidiary is not a PE because of the formal relationship between parent and subsidiary. By contrast, the traditional application of the PE concept, specifically the fixed place of business rule, in related person situations has to some extent embraced "form", i.e. this is a subsidiary and, thus, *cannot* be a PE of its parent. This contradiction must be studied and preferably eliminated in order to meet the general objective of this study.

To achieve this, the scope of this provision must be defined. To do so, this question is divided into two subordinate questions or aspects of the related company clause and the related person PE.

The first subordinate question examines the historical context and the underlying principles of the related company clause. This is necessary because the present provision can only be fully understood in the light of its historical context and underlying principles. Furthermore, this is important in understanding the discrepancy presented above.

The historical context might shed some light on why this contradiction exists.

The second subordinate question is to interpret and define the scope of the related company clause. The result of the first subordinate question will serve as a background and is used to reach an answer to this question. There are, in principle, two general ways to interpret the related company clause. The first interpretation basically removes any substantial scope and treats the provision as only referring back to the other paragraphs in Article 5.[43] With this view, the function of the related company clause is merely to prevent a related company from automatically being classified as a PE. The second possible interpretation recognizes that the related company clause has a substantive scope, which actually influences the application of the other paragraphs in Article 5.

The result of the first research question is necessary in order to answer the second research question. Without a defined scope of the related company clause, it is not possible to determine how the other provisions in the PE concept should be applied to related persons. Additionally, it is necessary to address the substance-over-form contradiction before proceeding.

1.4.2.2 The Second Research Question

The second research question deals with the application of the PE concept to related persons. The OECD MTC contains three different provisions to determine whether a PE exists: the fixed place of business rule (Article 5(1)), the construction PE clause (Article 5(3)) and the agency clause (Article 5(5-6)). In addition, the UN MTC also includes the service PE (Article 5(3b)) and the insurance PE (Article 5(6)). The objective of the second research question is to determine how a selection of these provisions should be applied to related persons. As a starting point, the general scope of these provisions must be identified.[44] However, given the study's general objective, the focus is on the application of the PE concept to related persons. This focus

[43] For an example of this view see Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 384.

[44] This is in line with the OECD's view that the PE concept should be applied neutrally between branches and related persons, para. 41 of the commentary to Article 5 of the OECD MTC.

is achieved by identifying conditions and situations that are unique or significant to related persons.

The first thing to note is that the PE concept deals with the situation of a foreign enterprise conducting its own business in the state of establishment. If we apply this to a situation with two related companies, the company in the state of establishment must conduct the business of the foreign company for a PE to exist. Thus, the most important question from a principle point of view when it comes to related persons is whose business is being conducted. An aspect of this is the control a person can exercise over another related person. The emphasis on control is necessary because control is the most relevant characteristic that differs between related and unrelated persons. At a certain degree of actual control, *not possible control*,[45] it can be argued, from a general standpoint, that the business of the controlled person is actually just an extension of the controlling person's business. If this reasoning is correct, the result is that the controlled person is a PE, or rather its facilities, under the fixed place of business rule, of the controlling person, provided that all the other prerequisites are fulfilled. Consequently, the role control plays within the PE concept is examined by identifying the breakpoint between control that affects the PE assessment and control that does not.

1.4.2.3 The Third Research Question

The third research question concerns what function the PE concept has, and should have, when it comes to preventing tax avoidance. The PE concept could be used to prevent tax avoidance either with a wide interpretation or by applying a separate concept, such as substance-over-form, to the PE conditions or the facts.

For instance, in certain situations, a country might consider that the organization chosen by a multinational group does not reflect the economic reality and is being used as a way to avoid taxation.[46] Such business structures can be set up so that one or more PE conditions

[45] A parent company can be said to have the possibility of complete control over a wholly owned subsidiary. Thus, to take such control into consideration in the PE assessment seems to be in direct conflict with the wording of the related company clause.

[46] As described in section 1.3.2.

are not fulfilled, or by using whatever protection the related company clause provides. The solution, from the country's perspective, might be to make a wide interpretation, for instance interpreting the agency clause to only require an economic binding of the principal. Another option could be to use substance-over-form to determine which company is conducting the business.[47] Consequently, the possibility of using a tax treaty, in particular the PE concept, to prevent tax avoidance must be examined. This is currently being explored by the OECD. Action 6 in the BEPS Action Plan calls for "treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances".[48] However, such a general approach, i.e. a GAAR, falls outside of the study's scope. Indeed, the focus in this study is on the PE concept itself and not on other concepts.

Compared to the two previous research questions, this question is present throughout the study. This is because the current development of the related person PE is rooted in tax planning and tax avoidance. To some extent, this question is present even when not explicitly discussed as a background to the problems studied. This is changed in the final chapter, where this question serves as a tool to evaluate the related person PE.

1.4.2.4 The Link between the Three Research Questions

The idea is that these three research questions will follow one another and use the result of the previous questions as a foundation to build upon. The first research question should provide a general understanding of the PE concept, relevant principles and theories and the related person PE. It is necessary to have this understanding before the specific rules can be studied.

The second research question is based upon the general understanding but focuses on specific rules and conditions in the PE concept. The results of the first research question are not only the starting point but are also used to interpret, clarify and evaluate specific parts of the PE concept.

[47] See the second research question in section 1.4.2.2.
[48] OECD, *Action Plan on Base Erosion and Profit Shifting*, p. 19.

The third research question is a tool to both evaluate the results of the previous questions and help define the boundaries of the PE concept. To some extent it can be said that this question puts a limit on how far one can extend the PE concept in the related person PE situation. Furthermore, it looms in the background as it can be said to be the driving force behind the development that prompted this study.

The study moves from the general (the first question) to the specific (the second question) to an overall evaluation (the third question). However, it is not possible to "contain" a question to a specific chapter as the questions are all intertwined. Consequently, all three questions can be found throughout the study and not only in their allotted chapters.

1.5 Delimitations

1.5.1 The PE Concept

The PE concept can be said to include a number of different rules. For instance, the OECD MTC contains the fixed place of business rule, the construction clause and the agency clause. Additionally, it contains suggestions on two versions of a service PE in the commentary. The UN MTC contains the same rules as the OECD MTC with the addition of an insurance PE and a service PE, which are included in the treaty.

In addition to these different rules, some countries include other provisions in their tax treaties under the PE heading. These rules often concern the extraction of natural resources.[49]

Which of these rules can be said to be part of the PE concept? To some extent all of them can be said to be a part of it, although the rules concerning natural resources would be lumped together as a special type of rule. To study all of these rules, however, would be too large of a task. A selection of rules to study needs to be made.

When selecting which rules to study, it is useful to start with the most common rules, as they will have the most relevance in practice. It is then natural to begin with the rules in the OECD and UN MTCs.

[49] For example, see Article 5(4) in the tax treaty between Sweden and India, December 25 1997, and Article 5(3) in the U.S. MTC.

The fixed place of business rule, construction clause and agency clause are, with some differences, included in both.

Both the fixed place of business rule and agency clause are general in nature and apply to all types of business. Both rules are included in most, if not all, treaties. Furthermore, the fixed place of business rule in conjunction with the agency clause is particularly interesting when it comes to related persons. Because of this, it is necessary to study these rules to meet the objective of the study.

On the other side of the spectrum we have insurance PEs and the rules concerning extraction of natural resources. Both of these rules are quite specific and narrow. They are also not as common in actual tax treaties. Additionally, neither of the rules has attracted any special attention regarding related persons. Furthermore, the rules regarding extraction of natural resources are not based on a model, and it is difficult to see them as one rule. Rather, they represent several rules intended to regulate similar situations. Based on this, it seems prudent to exclude these rules from the study.

This leaves us with the service PE and the construction clause. Starting with the service PE, it is not included in the OECD MTC but can be found in the commentary and in the UN MTC. The service PE has some relevance when it comes to the related person PE situation as it is fairly common for MNEs to perform services within the group. To my knowledge, no comprehensive study of the service PE has been done. Taking this into account, the study of the service PE seems too extensive a task to include.

Regarding the construction PE, it is a part of both MTCs, although with different time thresholds. There are similarities between the fixed place of business PE and the construction PE in the sense that both are based on a, relatively fixed, place of business. As such, the fundamental question for both of these rules in a related person PE situation is who is conducting the business from the assessed place of business. Because of this, the construction PE is not studied separately, but rather indirectly through the fixed place of business rule.

1.5.2 Attribution of Profits to PEs

The question of how to attribute profits to a PE is closely connected to the objective of the study. This is because the allocation of profits can be said to be the consequence, or the desired outcome, of a relat-

ed person constituting a PE. Nevertheless, this study does not deal with the actual process of attributing profits to a PE.

Instead, attribution of profits is only discussed in general to serve as a background and highlight the relevance of the study's objective. The reason for this is that even though these questions are connected, whether a PE exists is a separate question that precedes the attribution process. In other words, the question of whether a related person constitutes a PE concerns who the taxpayer is. By contrast, the attribution of profits to a PE concerns what income the taxation is based on. Thus, it is not necessary to examine the attribution of profits in order to achieve the objective of the study. Furthermore, the attribution of profits is a vast and complex issue on its own, and it would not be possible to deal with both questions in a satisfactory way.

1.5.3 Transfer Pricing

It has been argued that there is no need to treat a related person as a PE.[50] Instead, the situation could be solved with transfer pricing adjustments between the two related persons. Indeed, the transfer pricing regulation's objective can be said to achieve a correct allocation of income between two related persons. However, this may not be true in all situations.

For instance, in a tax treaty with a force of attraction provision, the question of whether a related person is a PE is still relevant and cannot be solved with transfer pricing.[51] Another example is an agency PE where the agent is resident in a third country without a fixed place of business in the state of establishment. Another example that transfer pricing does not solve is a situation with a treaty including a service

[50] This is discussed by Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 212; also see Baker, P and Collier, R, *The attribution of profits to permanent establishments*, p. 33. For a Swedish example see Nylén, H, "Dotterbolag som beroende representant", *Skattenytt*, no. 5 1996, p. 289.

[51] Force of attraction provisions are not part of the OECD MTC. By contrast, the UN MTC contains limited force of attraction on similar goods and business activities as sold or carried out in the PE, Article 7(1). MTCs are, as the name implies, just models and states can choose to include a force of attraction provision even though it is not recommended by the OECD. See for instance Article 7(3) of the Double Taxation Convention between India and the United Kingdom, October 25 1993.

PE provision and a foreign person providing services to a domestic related person.

Additionally, if this argument were true, one could basically remove the agency clause as an unrelated agent per definition would receive arm's-length remuneration and it would make no difference whether the agent constituted a PE or not. Finally, the PE concept divides taxation rights between *countries* while transfer pricing divides income between *enterprises*. These enterprises may or may not be taxable in the perceived state of source. Thus, the notion that the related person PE question can be solved by transfer pricing must be rejected.

Furthermore, in the situations covered by the study, the question of whether a PE exists is a question concerning who the taxpayer is. Thus, in principle, the PE question and transfer pricing are two different questions.[52] Based on all of the above, transfer pricing is not dealt with in the study.

1.5.4 Domestic Source Rules

Many countries use the PE concept in their national legislation to determine whether a business activity conducted by a foreign enterprise should be taxed or not. Sweden, for instance, has modeled its domestic PE after the OECD MTC.[53] The study focuses on a tax treaty perspective with an international PE concept manifested in the OECD and UN MTCs. Thus, even though national concepts can be similar, the study does not attempt to define the scope of any national concepts. Instead, domestic case law dealing with provisions modeled after the OECD or UN MTCs is used as an additional source to define the PE concept.[54]

[52] The OECD seems to be of the same opinion, see *The Attribution of Profits to Permanent Establishments*, 2010 version, Part 1 para. 230.

[53] Swedish Income Tax Act, chap. 2 sec. 29. The Swedish definition lacks the corresponding provisions in Articles 5(3), 5(4) and 5(7). These deviations are made to avoid limiting Sweden's right to tax in accordance with existing treaties (5(3) and 5(4)) and because the OECD phrasing is deemed unnecessary (5(4) and 5(7)), Prop. 1986/87:30, p. 42-43.

[54] For a similar approach see Helminen, M, *The Dividend Concept in International Tax Law – Dividend Payments Between Corporate Entities*, p. 9.

1.6 Method

1.6.1 Introduction and Method in General

The method used in this study is the traditional legal method. This method can be described as analyzing a specific legal problem using the various sources of law. This is done by compiling and systematizing different sources of law into a coherent whole. It is not possible to specify the general method more than this and it is not really needed as the method itself does not stand as a guarantee of the results, as can be the case in natural sciences. One cannot separate the method from the result. This means that the general method is often of less interest in studies of law.

Despite this, a discussion of method in a more limited sense can improve the reader's understanding of the study and author.[55] This can be specific methodological questions or the author's view on law in general and the specific area of law studied. Those aspects of method are further discussed below.

When analyzing a legal problem it is natural to include policy considerations in situations with several possible interpretations. This is because there is an inherent claim in law to provide proper and just solutions. If there are two different interpretations, equally valid, with different outcomes, one would of course not argue for a solution with a negative outcome. However, policy discussions are not limited to uncertain cases in this study. A general policy discussion is conducted where the result of the study is analyzed with principles of taxation in mind. The principles mainly used to evaluate the general result of the study are neutrality, legal certainty and complexity, and the interest to prevent tax avoidance.[56] To some extent the interests to prevent tax avoidance includes an aspect of fairness, both between taxpayers and between countries. The reason that these principles are chosen is that they are fundamental in law and also especially relevant to the topic of the study.[57] Thus, the method of the study consists of the traditional

[55] Berglund, M, *Avräkningsmetoden*, p. 37.
[56] For a discussion about the criteria for good tax law see Lodin, S-O, "Några kvalitetskrav på en god skattelagstiftning", *Skattenytt*, no. 9 2007, p. 477-490.
[57] For a discussion of these and other principles, see chapter 2.

legal method, what the law is, and policy considerations, what the law ought to be.

As law is based on recognized sources, one of the most important methodological questions is how to value and compare different sources of law. In international tax law this becomes especially important as sources come from different countries and international organizations. Additionally, it is not always clear if an international source is law, soft law or something else. Thus, it is not as clear how to handle the various sources of law as it would be in a purely domestic system. The relevant sources of law in this study are mainly tax treaties, OECD and UN MTCs with commentaries, case law and literature.

In addition to the discussion of method in this section, method is also discussed when it is needed throughout the study. The idea is that general questions concerning method are discussed here, whereas more specific questions are discussed in the context where the question arises.

The following sections present a more detailed view on the methodology used in the study. First, the specific nature of the PE concept is discussed (section 1.6.2). Second, the interpretation of tax treaties is analyzed (section 1.6.3). Third, how the two major MTCs, the OECD and UN, are dealt with in the study is discussed (section 1.6.4). Fourth, the selection of materials is discussed (section 1.6.5). Finally, a brief description of the Swedish administrative court system is provided (section 1.6.6).

1.6.2 Permanent Establishment – A Multiple and Fragmented Concept

The PE exists in numerous forms. It can be found in tax treaties, MTCs and domestic legislation. Strictly speaking, every single PE provision found in tax treaties is a distinct legal provision of its own. Differences in wording, treaty negotiations, language, mutual agreements and state practice (both administrative and case law) mean that it is not possible, nor meaningful, to study the PE as one distinct rule of law. Instead, the PE could be viewed as a concept that provides a general understanding of and background to the different PE provisions mentioned above. This is the view taken in this study. In practice, the difference between this approach and a more traditional one is small.

However, in my mind it is an important distinction to make, and I think the difference lies in how one approaches the PE, which to some degree will influence the results. One such difference with this view is that the reasoning is more important than the outcome of a court case. Treating the PE as a concept gives rise to a few additional methodological questions, which are discussed below.

First, because of the PE's fragmented nature it is necessary to establish a starting point[58] from which to study the PE concept. The starting point in this study is the OECD MTC. The reason for this is that it is the most influential and most widely used basis for tax treaties. Another reason is that the UN MTC is to a large extent based on the OECD's work when it comes to PEs. In most respects, the UN and OECD PEs are similar. Most of the commentary to Article 5 in the UN MTC is actually copied from its OECD counterpart. Thus, it is natural to use the OECD model as a starting point.

Second, what is the PE concept? This might seem like a strange question given the objective of the study. Certainly, the substantive scope of the PE is an important part of the concept but it is not the entire concept, nor is it what the question aims at. In addition to the substantive scope, the PE also encompasses theories and principles. The interesting question is where these principles originate from, and what they mean. There are, in general, two ways to answer this question. The answer depends on how the PE concept is envisioned.

The PE can be seen as strongly connected to the historic and traditional understanding of the concept, specifically with the fixed place of business PE. With this view, the fixed place of business rule is a clear reflection of the principle, i.e. the text in Article 5(1) of the OECD MTC and the principle are similar, and the core of the concept. An example can illustrate this view. The requirement of a fixed nexus has been softened through changes in the commentary and state practice. If the historic and traditional understanding of the fixed place of business rule is the true bearer of meaning, this evolution has changed the PE concept. This view seems to be the most common as

[58] "Starting point" should, in this context, be understood in its literal meaning. It is a place from which to start the study, not a benchmark for the concept. Granted, the OECD MTC with commentary is the most important material in the study and will naturally influence the results more than other materials.

authors often comment that similar changes have led to the concept changing. This view can also be noticed by the use of the word "deemed" or "PE fiction" in front of PE provisions other than the fixed place of business rule. This indicates that, for example, an agency PE is not a "real" PE, which means that the actual PE principle is the fixed place of business PE.

Another way to understand this is that the PE concept is represented not only by the treaty text, in a literal sense, and especially not only by the fixed place of business PE. With this view, the fixed place of business rule is only one manifestation of the concept, not the concept itself. Thus, the PE is rather a general principle and its conditions may not always reflect the principle correctly. The meaning of the "PE principle" is, with this view, a requirement of economic allegiance, represented by a physical connection, in order for a country to tax a foreign enterprise.

If we consider the previous example, changes to the fixed nexus requirement are not necessarily erosion or evolution of the concept. Indeed, as the world changes, the interpretations or the text itself may need to change in order to preserve the principle that is the core of the PE. With this view, a change in interpretation or treaty text could just as well preserve the concept, in an ever-changing world, instead of transforming it. The notion of the PE as a general principle is the one favored in this study.

Naturally, this approach has its limits. With regards to legal certainty and security, one cannot apply an idea to solve a specific problem. A textual interpretation must still be used to determine the current scope of the PE. In my opinion, however, the distinction between the two approaches is important. In a situation where the text is ambiguous or in *de lege ferenda* reasoning, the idea that *is* the PE can be used as guidance.

1.6.3 Interpretation of MTCs and Tax Treaties

1.6.3.1 Introduction

When dealing with a concept found in tax treaties, one must apply an international approach. Tax treaties are part of public international law and cannot be understood from a purely domestic perspective. The

Vienna Convention[59] contains rules of interpretation and applies to treaties concluded between states. The rules on interpretation in the Vienna Convention constitute customary international law and are used as a basis for interpreting tax treaties.[60] Tax treaties have a long history and are based on extensive background materials, i.e. the OECD and UN MTCs with commentaries; it is sometimes said that their interpretation constitutes a separate methodology, although based on the Vienna Convention. By contrast, the standard method of interpreting tax treaties is not fully applicable to the PE as a concept. This is because the interpretation of a specific tax treaty aims to identify the meaning of the included PE provision. The PE concept, however, cannot be said to have an *exactly* defined scope, as is the case with principles in general. Thus, the concept must be studied in a much more general way than a specific PE provision in a treaty. Naturally, a general study of the PE concept can be used to better interpret the various specific provisions. What is stated above, however, does not imply that the standard method can be completely disregarded. In general, the same method must be used; otherwise, the results may not reflect the actual use of PEs in tax treaties.

The interpretation of tax treaties is a topic that is thoroughly examined. This study does not present a detailed examination of all the complex issues connected to the interpretation process largely because this has already been done by other authors.[61] Another reason is that, as mentioned above, I believe that the method to interpret a treaty is not fully applicable to this study. Indeed, one can question, and I do,

[59] Vienna Convention on the Law of Treaties, May 23 1969.

[60] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed., Introduction marg.no. 68.

[61] See for instance Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed; Engelen, F, *Interpretation of Tax Treaties under International Law* and Kleist, D, *Methods for Elimination of Double Taxation under Double Tax Treaties – with Particular Reference to the Application of Double Tax Treaties in Sweden*. Also see Bjuvberg, J, "Rättskällevärdet av OECD:s modellavtal – synen på förhållandet mellan modellavtalet och Wienkonventionen i litteraturen", *Svensk Skattetidning*, no. 2 2015, p. 111-130; Bjuvberg, J, "Betydelsen av OECD:s modellavtal vid tolkning av skatteavtal – några typfall", *Svensk Skattetidning*, no. 5 2015, p. 427-443 and Cejie, K, *Utflyttningsbeskattning av kapitalökningar*, p. 79-98.

whether a special method of tax treaty interpretation exists at all.[62] Instead, the general principles of interpretation are presented with commentaries indicating where this study deviates from them. First, the Vienna Convention is discussed (section 1.6.3.2). This is followed by specific tax treaty rules and the standing of MTCs with commentaries (section 1.6.3.3).

1.6.3.2 The Vienna Convention

The rules for interpreting treaties are located in Articles 31-33. Article 31(1) states that "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." This implies that an objective interpretation of the treaty text is the starting point.[63] Furthermore, the context and the treaty's object and purpose should be taken into account. According to Article 31(2), the context is quite limited. Context is understood as preambles and annexes to the treaty; agreements between the treaty-concluding states and instruments agreed upon, both in connection with the conclusion of the treaty. In addition, any subsequent agreements or practices regarding the application or interpretation of the treaty should be considered, as stated in Article 31(3). Finally, Article 31(4) states that if the parties intended a special meaning, that meaning shall prevail.

If the interpretation according to Article 31 is ambiguous or leads to absurd results, other sources, such as preparatory works of the treaty and circumstances of the treaty's conclusion, may be used, as stated in Article 32. Article 32 also allows the use of supplementary material to confirm the interpretation made with Article 31. Finally, Article 33 deals with treaties authenticated in more than one language.

[62] Arnold, B, "The Interpretation of Tax Treaties: Myth and Reality", *Bulletin for International Taxation*, no. 1 2010, p. 14; Berglund, M, "Några anteckningar om skatteavtalstolkning – med anledning av ett rättsfall om dödsboinkomst", *Skattenytt*, no. 7-8 2016, p. 569-573 and Samuelsson, J, *Tolkningslärans gåta – En studie i avtalsrätt*, p. 154-156.

[63] Ault, H, "The Role of the OECD Commentaries in the Interpretation of Tax Treaties", *Intertax*, no. 4 1994, p. 145 and Dahlberg, M, *Svensk skatteavtalspolitik och utländska basbolag*, p. 68.

1.6.3.3 Tax Treaties and MTCs with Commentaries

In this section, the interpretation of treaties is discussed in a tax treaty context, specifically in relation to this study and the PE concept. This means that the specific legal sources and provisions relevant to this study are discussed. Furthermore, the method used in this study is highlighted.

The interpretation of a tax treaty starts with the wording of the treaty. This is a standard method in any field of law, whether domestic or international. The problem with this is that an ordinary meaning can be hard to establish from the treaty text alone. In order to have functioning tax treaties, definitions of key terms are included in the treaty. Indeed, Article 5 is a definition of the term "permanent establishment". However, the article uses undefined terms, for instance "fixed". Nevertheless, Article 3 provides useful definitions to interpret the PE concept, most notably, Article 3(1a-c), where the terms "person", "company" and "enterprise" are defined. Another important provision is Article 3(2), which contains a reference to domestic law if a term is not defined in the treaty, either expressly or by the context. Reimer argues that this recourse should only be made when all efforts to make an autonomous interpretation have failed.[64] In this study, with no specific domestic law, this approach is the only possible one.

The OECD and UN MTCs contain a number of guidelines for interpretation, apart from the actual treaty texts, in their respective commentaries. The question is how these commentaries influence the treaty interpretation in the Vienna Convention. There are two ways to include this material in Article 31. First, the commentary can be seen as stating the ordinary meaning.[65] This is a convincing argument, especially regarding PEs, which to a large extent are discussed by practitioners and scholars with the commentary as a background. Second, it could be argued that when two countries conclude a tax treaty, which follows the wording of a MTC, it is the parties' intention to follow the meaning expressed in the MTC's commentary. Thus, the commentary

[64] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 1 marg.no. 82.
[65] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed., Introduction marg.no. 80.

constitutes a special meaning according to Article 31(4).[66] Naturally, both of these approaches are restricted to situations where the MTC is followed. If a tax treaty deviates from the model it can be assumed that this was done for a reason, i.e. to reach a different result.[67] In conclusion, interpretation of tax treaties will usually be made by taking the relevant MTC with commentary into consideration.

The method for interpretation in this study is to start with the wording. The PE concept, however, does not have *one* distinct text to interpret. Instead, it exists in numerous forms. This makes it necessary to apply a slightly different approach. As the PE is viewed as a concept rather than as a distinct legal provision, it is necessary to apply a wider approach to interpretation than the method used when interpreting a tax treaty. Apart from the text, commentaries, case law and literature are always used to interpret the concept. Furthermore, sources from various countries are used throughout the study in contrast to interpreting a specific treaty where the use of foreign sources is usually more limited. The limit of this is, of course, the wording of the PE provisions, most clearly manifested in the OECD and UN MTCs.

Another difference in method is how to value the various sources of law. For instance, commentaries to MTCs are traditionally treated as possible, although not necessarily the correct, interpretations. By contrast, in a general study such as this one, MTCs are of greater importance, and in that context it can be argued that commentaries actually reflect the *right* interpretation of the model.[68] This means that when a statement in the commentary is clear and not in conflict with the model or with other parts of the commentary, that statement reflects the correct way to understand the *OECD MTC*. This, however, does not necessarily mean that it is the correct understanding of the *PE concept*. Even though the OECD MTC is a distinct representation of the PE concept, this does not imply the complete identity of the

[66] Ault, H, "The Role of the OECD Commentaries in the Interpretation of Tax Treaties", *Intertax*, no. 4 1994, p. 146; Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed., Introduction marg.no. 80 and Dahlberg, M, *Svensk skatteavtalspolitik och utländska basbolag*, p. 93.

[67] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 1 marg.no. 74.

[68] Recommendation of the OECD Council Concerning the Model Tax Convention on Income and on Capital, October 23 1997, I 2-3.

two. This difference should not be overstated, though. It has been noted that the OECD commentary plays a significant role in treaty interpretation,[69] much greater than it would be if it really were treated like literature. Thus, the difference in the commentary's role in interpretation between the PE as a concept and a specific provision may in practice be minor.

Finally, the use of case law in this study is described. As the study is not aimed at defining a distinct provision in a specific jurisdiction, the role of case law is somewhat different than it would be if that were the case. For starters, this means that if a Supreme Court of a country has ruled on a question, ultimately binding lower courts and the tax agency to follow that ruling, this does not mean that the meaning of the *PE concept* is settled. For instance, a decision from the Swedish Supreme Administrative Court does not bind courts and tax agencies in other countries. The value of such a case in this study, i.e. for the PE concepts, depends on the strength of the court's reasoning and on what is stated in case law from other countries as well as in literature. This means that case law is one legal source among others, even though a Supreme Court ruling is of course always persuasive, and may not always correctly reflect the PE concept. In practice, case law is often used as an example of a possible line of reasoning. This means that case law is valued in a similar way that literature is, namely, on the strength of the reasoning.

1.6.4 The OECD and UN Model Tax Conventions

The two main MTCs are from the OECD and the UN. As mentioned above, the OECD MTC is the starting point in this study.[70] The PE definitions are similar in both MTCs, and Article 5 in the UN MTC is to a large extent based on the OECD version. For simplicity, the UN MTC is only referred to where it differs from what is stated in the OECD MTC. Thus, most sections of the study cover *both* the OECD and UN MTCs, even though the OECD version is the only one explicitly referred to. Conversely, the UN view is exclusively discussed when it is expressly stated that a passage deals with the UN MTC.

[69] Sasseville, J, and Skaar, A, *Is there a permanent establishment?*, p. 21.
[70] See section 1.6.2.

These passages mainly deal with situations where the UN MTC differs from the OECD's MTC.

At the time of writing (fall 2017), there is a draft of a new OECD MTC. The new model is in line with the changes proposed under Action 7 within the BEPS project.[71] Additionally, there are a few changes to the commentary that seem to originate from the 2012 report regarding the interpretation of Article 5.[72] The proposed new Article 5 with commentary is labeled as proposals, and all references to the OECD MTC are to the 2014 version.

1.6.5 Selection of Material

In the field of international taxation there are interesting materials from all over the globe. It is not possible to give each country the same attention. Indeed, it is not practically possible to conduct a study encompassing all the existing material regarding the PE, such as case law and literature. The reason for this is threefold. First, the amount of existing material is too vast to include everything. Second, this study is conducted from Sweden and there are limitations on what material I have access to.

Third, only material in English and the three Scandinavian languages Swedish, Norwegian and Danish is used. This is because of my own language limitations. In general, I have excluded material in languages I cannot read myself. In essence, this means that I do not rely on case law I cannot read myself by referencing literature.[73] I do, however, use translations of case law when they are available.

Despite these limitations, a selection of which material to include and discuss has to be made. This selection is based on the quality of the material. A court case without a reasoned discussion about some aspect of the PE is in general of less interest than a well-reasoned case. This is especially true in this study, where the PE is studied as a concept. The consequence of this is that it is not possible to draw any

[71] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*.
[72] OECD, *OECD Model Tax Convention: Revised Proposals concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, 2012.
[73] There are a few exceptions to this where I have deemed it necessary to use other authors' descriptions of cases.

precise conclusions regarding the PE concept in a specific jurisdiction.[74]

1.6.6 The Swedish Perspective

As mentioned previously, a secondary objective is to present Swedish case law as this is not readily available to an international audience. I had wanted to include all Swedish cases, but some are just not interesting enough to warrant inclusion. Additionally, I have not included any cases from the County Courts. A brief description of the Swedish administrative court system is presented below.

After the tax agency has made a decision, the tax payer can request that the agency conduct a mandatory review of its decision. If the taxpayer is still not satisfied with the decision, he can appeal the decision to the County Court (*Förvaltningsrätten*). Either side can then appeal to the Administrative Court of Appeals (*Kammarrätten*). Finally, to have a case tried by the Supreme Administrative Court (*Högsta Förvaltningsdomstolen*), a leave of appeal is required. Few cases concerning the definition of the PE concept have been tried by the Supreme Administrative Court.

In addition to the procedure described above, a taxpayer can apply for an advance ruling, e.g. on what the tax consequences will be in a planned but not yet executed scenario, from the Board of Advance Rulings (*Skatterättsnämnden*). This Board is not a court but rather an administrative body made up of experts in tax law from various institutions such as the universities and the tax agency. The Board's decision is binding for the tax agency.

The Board of Advance Rulings only deals with questions of law and not questions of fact. An application can be rejected if the circumstances of a case are not sufficiently described or the question of law is deemed to be clear. The Board of Advance Rulings' decision can be appealed directly to the Supreme Administrative Court without the need for a leave to appeal.

[74] See for instance Skaar, who focused on three jurisdictions but included materials from many more with the caveat that those other jurisdictions did not constitute a "complete representation". Furthermore he argued that the study is relevant in general and not only for the three countries focused on. Skaar, A, *Permanent Establishment*, p. 2 and 7.

1.7 Previous Research

The PE is a fundamental concept and has been part of tax treaties almost from the beginning. Despite its long history, not much was written about it at an early stage, at least from an international perspective. In the last 30 years, however, the PE concept has been the topic of several extensive studies and numerous articles. This section deals with the already existing research concerning the PE. First, the most important literature is presented. Second, notable articles are discussed and, finally, material from international organizations, such as the OECD, League of Nations and International Fiscal Association, is mentioned. As I previously noted, only material presented in English or the Scandinavian languages is used.

The first notable study of the PE concept was conducted by Arvid Skaar and was published in 1991.[75] This study is extensive and covers the entire PE concept as it was understood at that time.[76]

Other notable studies have been done by John Huston and Lee Williams,[77] Arthur Pleijsier,[78] Martin B. Tittle,[79] Jean Schaffner,[80] Ekkehart Reimer,[81] Anders Nørgaard Laursen[82] and Amar Mehta.[83] Klaus Vogel's commentary[84] on tax treaties also deserves to be mentioned. All of these studies primarily analyze the PE concept in general. A few of the authors give certain aspects special attention. Skaar focused on the mobile petroleum business. Huston and Williams analyzed the PE from a tax planning perspective. Pleijsier studied the

[75] Skaar, A, *Permanent Establishment*.
[76] Later additions, such as service PE and e-commerce, are not explicitly covered. However, some of the general reasoning could still be applied to these additions.
[77] Huston, J and Williams, L, *Permanent Establishments*. An updated version of this study was published in 2014, Williams, R, *Fundamentals of Permanent Establishments*.
[78] Pleijsier, A, *The Agency Permanent Establishment*.
[79] Tittle, M, *Permanent Establishment in the United States*.
[80] Schaffner, J, *How Fixed Is a Permanent Establishment?*.
[81] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M and Reimer, E, *Klaus Vogel on Double Taxation Conventions*, 4th ed.
[82] Nørgaard Laursen, A, *Fast driftsted*.
[83] Mehta, A, *Permanent Establishment in International Taxation*.
[84] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed.

agency PE. Tittle studied the PE from a United States point of view. Schaffner focused on the geographical link required for a PE to be considered fixed.

There are also some studies that deal with PE-related issues other than the definition. Radhakishan Rawal,[85] Michael Kobetsky[86] and Andreas Waltrich[87] write about taxation and the allocation of profits to PEs. A topic that has received quite a bit of attention in the past 20 years is the taxation of e-commerce. Dale Pinto[88] and Richard Doernberg and Luc Hinnekens[89] have studied this. A similar study was done by Eric Kemmeren[90]. Kemmeren's study is focused on a model for source-based, or rather "origin-based", income taxation.

Nowadays there are numerous articles about the PE concept to choose from, and they cover most aspects of the PE. I will mention only a few articles that have a certain importance for this study, and articles deemed to be of general importance. Le Gall,[91] Gazzo,[92] Milet,[93] and Taylor, Davies and McCart[94] have written about the related person PE. There are several articles about how to divide taxing rights in principle. A few notable examples are written by Vogel[95] and

[85] Rawal, R, *The Taxation of Permanent Establishments*.
[86] Kobetsky, M, *International Taxation of Permanent Establishments*.
[87] Waltrich, A, *Cross-Border Taxation of Permanent Establishments – An International Comparison*.
[88] Pinto, D, *E-Commerce and Source-Based Income Taxation*.
[89] Doernberg, R and Hinnekens, L, *Electronic Commerce and International Taxation*.
[90] Kemmeren, E, *Principle of Origin in Tax Conventions*.
[91] Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 179-214.
[92] Gazzo, M, "Permanent Establishments through Related Corporations", *Bulletin for International Fiscal Documentation*, no. 6 2003, 257-264.
[93] Milet, M, "Permanent Establishments Through Related Corporations Under the OECD Model Treaty", *Canadian Tax Journal*, no. 2 2007, p. 289-330.
[94] Taylor, W B, Davies, V L, McCart, J, "Policy Forum: A Subsidiary as a Permanent Establishment of Its Parent", *Canadian Tax Journal*, no. 2 2007, p. 333-345.
[95] Vogel, K, "Worldwide vs. Source Taxation of Income (Part I-III)", *Intertax*, no. 8/9 1988, p. 216-229 (Part I), no. 10 1988, p. 310-320 (Part II), no. 11 1988, p. 393-402 (Part III).

Schön[96]. Fleming, Peroni and Shay have also written several articles on this topic.[97]

There are quite a few reports and studies on the PE concept by international organizations. These range from the work of the League of Nations in the 1920s to reports completed very recently. Here, a selection of these texts is presented. The League of Nations published reports in 1923[98] and 1925[99] that deal with double taxation and the source of income in general. The International Fiscal Association has had the PE definition as a general topic for three conferences.[100] The OECD has released several reports and discussion papers on the PE, the most recent one in 2012.[101] Furthermore, the OECD published the BEPS report[102] and the BEPS Action Plan[103] in 2013. After this, the Final Report on Action 7[104] was published in 2015. In addition, a report on the attribution of profits was released in 2017 to show what impact the proposals under BEPS Action 7 would have.[105]

In conclusion, the PE has been the object of several extensive studies and numerous articles. To my knowledge, however, no study exists on the application of the PE concept to related persons. It is mentioned by other authors to some extent but mostly in the context of the agency clause. Thus, the present study seems to fill a void by examining the PE concept regarding related persons.

96 Schön, W, "International Tax Coordination for a Second-Best World (Part I-III)", *World Tax Journal*, no. 1 2009, p. 67-114 (Part I), no. 1 2010, p. 65-94 (Part II), no. 3 2010, p. 227-261 (Part III).

97 For example, Fleming, C, Peroni, R and Shay, S, "Perspectives on the Worldwide vs. Territorial Taxation Debate", *Tax Notes International*, January 4 2010, p. 75-105.

98 League of Nations, *Report on Double Taxation*, (1923).

99 League of Nations, *Double Taxation and Tax Evasion*, (1925).

100 IFA, *Cahiers de droit fiscal international*, Vol. 34a (1957), Vol. 52 (1967) and Vol. 94a (2009).

101 OECD, *OECD Model Tax Convention: Revised Proposals concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, 2012.

102 OECD, *Addressing Base Erosion and Profit Shifting.*

103 OECD, *Action Plan on Base Erosion and Profit Shifting.*

104 OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status.*

105 OECD, *Discussion Draft on Additional Guidance on the Attribution of Profits to Permanent Establishments.*

1.8 Terminology

In this section, the terminology used in the study is discussed. Initially, it should be mentioned that more technical terms connected to specific parts of the study are discussed in those sections. Thus, only general terms are dealt with in this section.

Throughout the study, the term *state of residence* refers to the country from which a company originates, i.e. not the PE state. *State of establishment* refers to the country where the possible PE is located. The reason for not using the term "state of source" is that the *real* source of income is difficult to decide. Additionally, the term "state of source" includes a value judgment that implies a right for that state to tax. Thus, "state of establishment" is a more accurate description than "state of source".

All general references to PEs are to the PE as a concept. When the term is used for a specific provision in a tax treaty it is expressly stated.

The term *tax treaty*, or *treaty*, is used both as a general term, referring to no specific tax treaty, and a specific term, referring to a specific tax treaty.

The term *related person* is used as a general description of a situation where two or more parties are related. The term "person" corresponds to the definition in Article 3(1)a of the OECD MTC, i.e. both individuals and companies are encompassed by the term.

Perhaps a more common term would have been "related company" or "related enterprise". The reason these terms are not generally used is that the study also deals with individuals not necessarily conducting business.

Nevertheless, a common situation in the study is when the involved parties are related companies. This means that "related company" is sometimes used in examples where the involved parties are companies. Regarding what is intended by "related", see the previous description in section 1.4.1.

1.9 Outline

1.9.1 In General

The general idea behind the outline is to present the study in a coherent and comprehensible way. To achieve this, the chapters are arranged in the order they are intended to be read. The study starts with the PE, and its underlying theories, in general. After that, the study is focused on specific PE provisions. Finally, general conclusions and suggestions, based on the previous sections, are presented.

The outline of this study can be divided into three parts. Part one consists of chapters 1-3 and is focused on principles and theories relevant to the PE concept. Furthermore, it includes the related person PE in general, i.e. the first research question. These chapters establish a background and a general understanding of the PE concept, which the second and third part will build on.

Chapters 4-6 make up the second part of the study. This part is more specific and deals with the different kinds of PEs in detail. The second part mainly deals with the second research question.

Part three consists of chapter 7 and evaluates the results in the second part and also discusses the third research question, i.e. whether the PE concept can, and should, be used in order to prevent tax avoidance. This part also includes general conclusions and a summary of the study.

In the following section, a more detailed overview of the chapters is presented.

1.9.2 Overview of Chapters

Chapter 1 contains an introduction to the topic and the study. The research questions are described and delimitations are presented. Furthermore, method and terminology specific to the study are discussed. The objective of this chapter is to introduce the topic and describe how it is approached.

Chapter 2 deals with the PE concept in general. The PE's function and objective are discussed. In order to discuss function and objective, various theories on how to divide taxing rights are touched upon. The objective of this chapter is to provide a background to the PE

concept, present my view of the concept and describe how function, purpose and theories affect the following chapters.

Chapter 3 covers the first research question, i.e. the scope of Article 5(7) in the OECD MTC and Article 5(8) in the UN MTC. These are the only provisions, within the PE concept, that directly deal with related companies. The history of these articles is analyzed. From the analysis, three different ways to treat related companies are discussed. The question of whether the articles have any substantial scope or only refer back to the other paragraphs in Article 5 is discussed. The objective of this chapter is to analyze the scope of Articles 5(7) and 5(8), as well as to analyze the related person PE in principle.

Chapter 4 is devoted to the fixed place of business PE and the second research question. This chapter will deal with the prerequisites in the fixed place of business test, both in general and specifically regarding the application between related persons. A central issue is how to decide whose business is being conducted in situations of related companies with merging business interests and how this affects the application of the PE concept.[106] The objective in this chapter is to define the scope of the fixed place of business PE between related persons.

Chapter 5 deals with the agency PE and the second research question. The agency PE is discussed in general as well as in detail concerning its application to related persons. A few selected situations, such as commissionaire agents, are given special attention. The objective of this chapter is to define the scope of the agency PE between related persons.

Chapter 6 covers the exception for certain activities, sometimes called the "negative list", found in Article 5(4). These exceptions are discussed both in general and with specific focus on situations with related persons.

Chapter 7 consists of a summary of the results in previous chapters and general conclusions. The chapter is based on the results in the previous chapters and is focused on evaluating the result of the previous chapters. Additionally, the third research question, i.e. the PE concept as an anti-avoidance tool, is discussed. The main objective of this discussion is to sort and evaluate the various lines of reasoning regarding the related company PE situation identified in the previous

[106] See section 1.4.2.2.

chapters with the addition of the anti-avoidance argument. The conclusions in this chapter will be of a general nature. Based on the findings in previous chapters, a *de lege ferenda* discussion about the future of the PE is presented. The objective of this chapter is to provide an overview of the most important findings in the study and to present general suggestions on how to proceed with the PE concept and related persons.

2 Permanent Establishment – A Background

2.1 Introduction

The PE concept has a long history and is connected to various theories and principles. These theories co-exist with the PE concept but are not always compatible with each other, or with the PE concept. Depending on which theory is given preference, the view of the PE concept might change. This leads to the question of what the PE's function and objective really are. It is necessary to establish the PE concept's function and objective in order to evaluate the relevance of fiscal principles and theories. For instance, a theory that hampers the function or leads to results contrary to the objective might have its relevance for the PE concept questioned.

When interpreting a specific provision, or a set of provisions, principles can generally be connected to the provision in three different ways.[107] Principles can be manifested directly in a specific provision or indirectly through preparatory works, case law and the structure and context of the specific legislation. In addition to this, principles can be generally applicable in a certain field of law, for instance, the principle of legality in tax and criminal law. Finally, principles can exist without a specific connection to the specific provision or the context it exists in.

Naturally, the stronger the connection is between a provision and a principle, the more important the principle becomes when interpreting said provision. In the absence of a connection one could argue that the principle should not be used for interpretation,[108] and rather be limited to policy discussions. Based on this, one important objective of this chapter is to analyze the connection between the various

[107] For a discussion about principles see Påhlsson, R, *Likhet inför skattelag*, p. 31-33, with further references.
[108] Burmeister, J, *Verklig innebörd*, p. 51.

principles and the PE concept as this will determine the principles' further usefulness in the study.

This chapter serves to provide a general background to the PE concept. This background, together with the more specific background in chapter 3, is a starting point for the analysis in the following chapters. The chapter is outlined as follows. First, the function and purpose of the concept are analyzed (section 2.2). Second, the various principles on how to divide taxation rights on active business income are discussed (section 2.3). Third, the concept of "substance-over-form" is discussed (section 2.4). Finally, the chapter is summarized and general conclusions are presented (section 2.5).

2.2 Function and Objective of the Permanent Establishment

Permanent establishments are part of a tax treaty context as well as a domestic law context. These contexts are a bit different, although both deal with international taxation and whether foreign subjects can be taxed. As previously mentioned, this study is focused on the tax treaty context. Given this focus, it can be assumed that the PE concept is designed to fulfill the objective of the treaty. Thus, the function and objective of the PE are connected with the overall objective of the treaty. The main objective of the OECD MTC is to provide common solutions to solve double taxation.[109] The objective of a tax treaty is, according to the OECD, to promote cross-border exchange and movement by eliminating double taxation.[110] An additional objective is to prevent tax avoidance and evasion.[111] In addition to this, the UN expressly states that a tax treaty's objectives are to prevent discrimination, provide legal certainty and "furtherance of the development aims of developing countries".[112] In summary, it can be said that the main objective of a tax treaty is to enable economic cross-border exchange by eliminating double taxation and providing legal certainty.

[109] Para. 2-3 of the commentary to the Introduction of the OECD MTC.
[110] Para. 7 of the commentary to Article 1 of the OECD MTC.
[111] Para. 7 of the commentary to Article 1 of the OECD MTC.
[112] Para. 6 of the commentary to the Introduction of the UN MTC.

The objective of preventing tax avoidance and evasion can be divided into two parts: preventing tax avoidance in general and preventing misuse of the treaty. Only the first can be regarded as an actual objective.[113] The second is merely a treaty-internal principle to make the treaty's objectives achievable. It is rather self-explanatory that in order to reach the objective of a treaty, or any form of legislation, misuse of the treaty must somehow be prevented.

Given the structure of the MTCs, it could be argued that a secondary objective is to achieve an equitable and "correct" allocation of taxation rights between countries. This is connected with the main objective of eliminating double taxation. Double taxation is eliminated either by granting one of the countries exclusive taxation rights or by having the state of residence grant relief by the exemption or credit method. An exclusive right to tax an income can be seen as a statement on which country the income is most closely connected to. The PE illustrates this allocation of taxation rights as it allows the state of establishment to tax. Given the structure of the MTCs, with a general right of taxation for the state of residence paired with an obligation to eliminate double taxation, any right for the state of establishment to tax can be regarded as a statement on what is an equitable allocation. Thus, the PE has a role to play in fulfilling the treaty's objective. We will now take a closer look at what exactly that role is, i.e. the function and objective of the PE concept.

By studying Article 5, in conjunction with Article 7, it becomes clear that the PE concept divides taxation rights between the treaty-concluding states. Consequently, the PE is an instrument to eliminate double taxation in order to fulfill the main objective of a tax treaty. In situations where a PE does not exist, Articles 5 and 7 eliminate double taxation by giving the state of residence the exclusive right to tax. To eliminate double taxation if a PE exists, recourse to either Article 23A or B is necessary. From this it is clear that the PE does not, in itself, always achieve the elimination of double taxation and that its function

[113] This objective is most clearly manifested in Article 23A(4) of the OECD MTC, which deals with double non-taxation, and Article 26 of the OECD MTC, which deals with exchange of information between states to ensure that domestic tax law is upheld. To some extent, Articles 7 and 9 also express this as attribution of profits and transfer pricing can be seen as safeguards against profit shifting. Also see Dahlberg, M, *Internationell beskattning*, p. 250.

rather is to divide taxation rights as a first step to eliminate double taxation. This is also the OECD view, and it is stated in the commentary that the PE concept's main function is to determine a state's right to tax a foreign enterprise.[114] As stated above, it must be assumed that this has not been designed arbitrarily but rather as a conscious decision on how to divide taxation rights. This leads us to consider the secondary objectives of the PE concept.

Two secondary objectives can be identified, namely, to divide taxation rights in a "correct", or equitable, way and to take into account neutrality considerations. What constitutes an equitable allocation of taxation rights is difficult to define. Various theories and principles have been used as arguments for how the allocation should be made. This is not further discussed here, but we will return to it further on.[115] Finally, the PE concept seems to strive to achieve a neutral treatment of different establishments. The most relevant example for this study is the notion that related companies and branches should be subject to the same PE assessment.[116] Both of these objectives are subject to issues with tax avoidance. Tax avoidance may cause an unfair shift in taxation, an incorrect allocation of taxation rights or a non-neutral application of the PE concept.

In addition to these three objectives, one could argue for a fourth one, which is that the PE concept should be practical and simple.[117] As the absence of a PE means no taxation in the state of establishment on income covered by Article 7, it does not burden the taxpayer or the tax agency with compliance and administration. This objective can be described as the question of at what height the "PE threshold" should be placed. This question must be seen in relation to the other objectives as, for example, what is equitable is not always a practical solution.

[114] Para. 1 of the commentary to Article 5 of the OECD MTC. The UN expresses the same view of the PE's function, para. 2 of the commentary to Article 5 of the UN MTC. Also see Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 1 marg.no. 35-38; Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed., Article 5 marg.no. 4 and Skaar, A, *Permanent Establishment*, p. 9.

[115] See section 2.3.

[116] Article 5(7) of the OECD MTC and para. 41 of the commentary to Article 5 of the OECD MTC.

[117] Cf. para. 42.11-42.12 of the commentary to Article 5 of the OECD MTC.

In summary, it can be concluded that the function of the PE concept is to divide taxation rights between the treaty-concluding states with the objective of eliminating double taxation. This allocation strives to be equitable between the states and neutral between different types of establishments, i.e. the PE concept's objectives. However, the question is how, and whether, this influences the interpretation of the PE definitions and problems relevant to this study. Initially, it can be noted that the function is rather straight-forward and, viewed on its own, does not seem to express a principle standpoint. Rather, it is just a description of how the PE concept is constructed. Conversely, the objectives are not as easy to define and apply. The notions of equity and neutrality are elusive and encompass ideas that cannot always be reconciled. The usefulness of these objectives must be evaluated in two situations. First, policy considerations such as equity and neutrality are naturally relevant in *de lege ferenda* reasoning. Second, regarding the actual scope of the PE concept, the objectives do not have much weight.[118] However, they may be useful in situations where several interpretations seem equally possible. In such situations, the interpretation best reflecting the PE's objectives could be given preference. The topic of the study is an uncertain one in general, which could mean that the objective carries a bit more weight than usual.

Regarding the related person PE, one can see that the traditional interpretation of the PE concept is questioned. This is done from the perspective of equity and correct allocation of taxing rights. To some extent it is also questioned from a neutrality perspective as it has been, and still is, possible to achieve a different allocation of taxing rights depending on whether the establishment is a branch or a related person. To some extent this questioning is at odds with the main objective of eliminating double taxation as differences in interpretation, based on what is equitable and correct, may result in double taxation. This also creates more complexity and less legal certainty for both taxpayers and tax agencies. Additionally, one could argue that related persons have previously been treated differently than other PE situations, i.e. as not neutral. The use of substance-over-form can be seen as an attempt to achieve an equitable, correct or neutral application of the PE concept.

[118] See section 1.6.3 concerning the interpretation of tax treaties.

In conclusion, there are presently different ideas about what the PE concept's secondary objectives mean in practice. It is important to re-establish a common understanding of this in order for the PE concept to perform its function better in the related person PE situation.

2.3 Dividing Taxation Rights in Principle

2.3.1 Introduction

As was concluded in the previous section, the function of the PE is to divide taxation rights between treaty-concluding states. In addition to this, it was concluded that this should be done in an equitable and neutral way. In this section, different theories on how to divide taxation rights are discussed. It must be pointed out here that there is no consensus among scholars regarding most of the theories discussed in this section. Furthermore, some theories may be either detrimental or beneficial for a specific country, and as the PE concept is most often implemented through bilateral treaties, what is best in general may not be the best for the involved countries or even possible to agree upon. The above is an indication that the question is too complex to confine within the boundaries of a single theory. Consequently, each aspect discussed in the following must be analyzed in order to establish its relevance, in whole or in part, to the PE concept. It seems likely that a compromise must be made between different theories and practical aspects when analyzing how to divide taxation rights between countries in the context of the PE concept.

The section is outlined as follows. First, the source of income is discussed (section 2.3.2). Second, four different neutrality theories are described and analyzed (section 2.3.3). Third, equity considerations on how to divide taxation rights are touched upon (2.3.4). Fourth, countries' means to enforce taxation on foreign income and its implications on how to divide taxation rights are discussed (2.3.5). Fifth, we turn to the application of the PE concept regarding legal certainty and foreseeability (section 2.3.6). Finally, a summary with general conclusions is presented (section 2.3.7).

2.3.2 The Impact of the Source of Income

Whether one sees the PE concept as a source rule (domestic perspective), as a limitation to source taxation (tax treaty perspective) or as a mix of both source and residence, it is clear that the PE has a connection to the source of income. Furthermore, despite the difficulty in defining where income has its source, the notion of source may still be relevant to the PE concept since the PE concept can be seen as a legal definition of source. This legal definition may not always coincide with the true economic source of income. This, however, does not pose any serious issues as it has rightly been argued that the notion of source is too ambiguous to base taxation on.[119] Based on this, one can argue that it would not be practically possible to design the PE concept to always be in accordance with the source of income. By contrast, it is difficult to envision the PE concept completely disconnected from the source of income, e.g. the existence of a PE without any income connected to it. Thus, for this study, the relevant question regarding the source of income is how it should be understood in the context of the PE concept.

The common denominator in the PE concept seems to be some sort of activity. The fixed place of business PE requires a business activity carried out through the fixed place of business. The construction PE requires activities connected to a building site, construction or installation project. The agency PE requires the conclusion of contracts. Even newer additions, such as service and insurance PE, are based on activities. This seems to be in line with Vogel's definition of source. He defines source as the place where an investment is made and economic activities are carried on.[120] Given the PE concept's structure, it can be concluded that source, in this context, must be understood as requiring some sort of activity. The exact nature of the activity can vary. For instance, fully automated equipment can constitute a PE.[121] Thus, activities are not limited to tasks performed by employees. This

[119] Schön, W, "International Tax Coordination for a Second-Best World (Part I)", *World Tax Journal*, no. 1 2009, p. 68 and Vogel, K, "Worldwide vs. source taxation of income (Part I)", *Intertax*, no. 8-9 1988, p. 218.
[120] Vogel, K, "Worldwide vs. source taxation of income (Part III)", *Intertax*, no. 11 1988, p. 399. For a similar view, see Skaar, A, *Permanent Establishment*, p. 23-24.
[121] Para. 10 of the commentary to Article 5 of the OECD MTC.

means that the notion of source within the PE concept is based on business activities performed in the state of establishment. If we add the various conditions in the different PE rules, it can be said, simplifying somewhat, be said that the notion of source under the PE concept is concerned with activities performed during a sufficient time.

When it comes to related persons it becomes clear from this notion of source that the related person must conduct the business of the foreign enterprise in order to consider that enterprise to have income with its source in the state of establishment. The same notion is expressed in the related company clause, where it is clear that investment alone is not sufficient to constitute a PE. This means that the question of whose business is being conducted is fundamental when discussing the related person PE. If this question is not discussed, the source of income may be separated from the PE concept, which would be strange to say the least.

2.3.3 Neutrality Aspects

2.3.3.1 Introduction

Neutrality in tax law is a wide and somewhat blurred concept.[122] A basic starting point is that business decisions should not be affected by tax law.[123] In this study this is called the *basic neutrality notion*. In an international context this usually means that cross-border situations should neither be promoted nor hindered by tax law, i.e. the option to invest abroad or domestically should not be influenced by tax law.[124] This ideal neutrality is not always achievable in practice.[125] The idea

[122] Romby, A, *Underskott i aktiebolag – En skatterättslig studie av förlust- och resultatutjämning i ljuset av svensk rätt och EU-rätten*, p. 30.

[123] Musgrave, P, *United States Taxation of Foreign Investment Income*, p. 109; Schön, W, "International Tax Coordination for a Second-Best World (Part I)", *World Tax Journal*, no. 1 2009, p. 78; Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 313; Lewander, A, *Den skatterättsliga gränsdragningen mellan ränta och utdelning – Klassificering på gränsen mellan skatterätten och redovisningsrätten*, p. 88 and IBFD Tax Glossary.

[124] Musgrave, P, *United States Taxation of Foreign Investment Income*, p. 109.

[125] Skaar, A, *Permanent Establishment*, p. 28; Schön, W, "International Tax Coordination for a Second-Best World (Part I)", *World Tax Journal*, no. 1 2009, p. 78 and Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 310.

behind neutrality is that it promotes efficient resource allocation. If taxpayers are free to organize their business without considering tax law it can be assumed that they will act in a way that is economically efficient.

A basic example might illustrate this. An enterprise has the option to invest in country A or B. The pretax return in A is 10, and in B it is 8. From an economic point of view the best investment is in country A. Now assume that the tax is 50 percent in A and 25 percent in B. If we take taxes into account, an investment in A will yield 5 after tax, whereas an investment in B will yield 6. Factoring in taxes, the economically inferior option is now the best investment after tax. In this situation, capital would not be allocated in the most efficient way.[126]

In addition to efficient resource allocation, fiscal neutrality can be said to encompass an element of equity. Neutral taxation implies a certain level of equal treatment of taxpayers. Equal treatment of taxpayers in similar situations is a fundamental aspect of equity. What is equitable is a difficult, and often subjective, question to answer. Indeed, the international setting makes the question of what is equitable even more difficult to answer. This is because there are two possible objects of reference, i.e. taxpayers in the state of establishment or those in the state of residence. Furthermore, equity is complicated by a second layer, namely, equitable allocation of taxing rights between countries. This means that the question of equity in the context of the PE concept and neutrality must account for taxpayers in both countries as well as equity between the countries themselves.

Given the discussion above, it is no surprise that there is no consensus on how fiscal neutrality should be understood. It becomes especially complicated in an international setting. Should neutrality be achieved in the state of establishment or the state of residence, and should tax systems be neutral between countries or taxpayers? Different tax systems, with varying tax rates, make it difficult to achieve neu-

[126] Vogel argues that a "no tax" scenario should not be used as a starting point for neutrality. Instead, the starting point should be no interference by states on investment decisions. Vogel considers the ratio between taxes and benefits, which he labels *administrative net output*, to be vital in a neutrality analysis. With this view, tax systems should not dictate the choice of investing in low-tax/low-benefit or high-tax/high-benefit jurisdictions. Vogel's neutrality concept is discussed further in section 2.3.3.4. Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 313-314.

trality from both countries' points of view.[127] Furthermore, fiscal neutrality has been debated since the 1960s without reaching a consensus on how it should be understood. From this perspective it could be argued that neutrality is an inadequate starting point from which to divide taxation rights between countries.

In the following sections, four different theories on neutrality are discussed. In general, three different questions are dealt with in each section. These questions concern the meaning of the specific neutrality theory, how the theory fits in with the PE concept and implications for the related person PE. The focus is on economic efficiency and not equity. The reason for this is that it becomes too complex to discuss equity and economic efficiency at the same time. Instead, equity is discussed in section 2.3.4.

This section is structured as follows. First, the concept of capital-export neutrality is discussed (section 2.3.3.2). Second, capital-import neutrality is examined (section 2.3.3.3). Third, inter-nations neutrality is dealt with (section 2.3.3.4). Fourth, capital-ownership neutrality is described (section 2.3.3.5). Finally, general conclusions concerning neutrality and the PE concept are presented (section 2.3.3.6).

2.3.3.2 Capital-Export Neutrality

Capital-export neutrality seems to have first been defined by Richard Musgrave.[128] This view of neutrality can be said to focus on the investor's state of residence.[129] Consequently, capital-export neutrality means that an investor is taxed the same way for both foreign and domestic investments. This requires a worldwide income tax, without deferral, paired with a full tax credit. In this system, the investor is

[127] Ståhl, K, *Aktiebeskattning och fria kapitalrörelser*, p. 111.

[128] Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 311.

[129] This focus, however, is a compromise between the objectives of achieving neutrality in a national or international context. Peggy Musgrave argues that, from a national perspective, capital-export neutrality is not neutral. Instead, again from a national perspective, foreign investments should be treated differently depending on the investor and country invested in. According to her, from a national perspective, there is in general no interest in promoting foreign investment, rather the opposite. Musgrave, P, *United States Taxation of Foreign Investment Income*, p. 99 and 105.

taxed according to the tax rate in the state of residence regardless of the tax rate in the state of establishment.

One advantage with capital-export neutrality is that it fulfills the basic neutrality notion. The investor is taxed the same way on both foreign and domestic business operations. This means that there is no tax incentive to invest in a low-tax jurisdiction.[130] Thus, the main benefit of capital-export neutrality is that it promotes a worldwide efficient allocation of capital in the sense that reasons other than taxation dictate investment decisions. However, because neutrality is based on residence, companies might choose residence based on tax reasons. This means that capital-export neutrality is not neutral when it comes to the decision on where to incorporate a business or locate the effective management.[131] As no deferral is allowed, this would only be a factor for the parent company in a group context.

Capital-export neutrality can, apart from the efficiency argument, be strengthened by other fiscal principles and arguments. Most commonly, capital-export neutrality is connected with the ability-to-pay principle.[132] A worldwide income tax is consistent with capital-export neutrality. Furthermore, a tax subject's ability to pay is best assessed in the state of residence, at least if it is assumed that only the state of residence uses a worldwide income tax. Presently, this assumption seems to hold. However, the extent to which the principle can be used has been questioned. Dahlberg argues that, due to the vague nature of the ability-to-pay principle, it should be applied with caution when determining whether or not an income should be taxed.[133] Schön questions the value of the ability-to-pay principle in an international setting as, in the current system, it is inherently biased towards the state of residence. Such bias, he continues, makes the principle of little use when

[130] Fleming, C, Peroni, R, Shay, S, "Perspectives on the Worldwide vs. Territorial Taxation Debate", *Tax Notes International*, January 4 2010, p. 105. Cf. Vogel's argument about administrative net output, note 126 and section 2.3.3.4.

[131] Musgrave, P, *United States Taxation of Foreign Investment Income*, p. 111 and Schön, W, "International Tax Coordination for a Second-Best World (Part I)", *World Tax Journal*, no. 1 2009, p. 80.

[132] Fleming, C, Peroni, R, Shay, S, "Fairness in International Taxation: The Ability-To-Pay Case for Taxing Worldwide Income", *Florida Tax Review*, no. 4 2001, p. 311-313.

[133] Dahlberg, M, *Ränta eller kapitalvinst*, p. 53-54.

it comes to dividing taxation rights between two or more countries.[134] It could be of some use, however, as a background to a common understanding of the tax base.[135] Having similar tax bases is necessary in order to achieve capital-export neutrality through the tax credit.[136]

Sometimes it is argued that taxation in the state of establishment is a reality and that countries are not likely to refrain from such taxation.[137] This is most likely true, but what does it imply? According to this argument, capital-import neutrality is more in line with how states tax foreign investments in practice. Although this is stated more in favor of capital-import neutrality than against capital-export neutrality, it deserves to be addressed here. First, it must be established that capital-export neutrality does not preclude the state of establishment from taxing investments made in its territory. Indeed, the requirement to grant a full tax credit clearly indicates that capital-export neutrality recognizes the state of establishment's right to tax.[138] Second, most countries tax their residents on their worldwide income and on income sourced within their territory earned by non-residents. Thus, even considering that territorial tax systems are not unheard of, it can hardly be considered such an established practice that it can be used as an argument against capital-export neutrality. One could just as well argue that the way modern tax systems are structured slightly favors capital-export neutrality. In a general tax policy discussion, however, the current state practice does not give preference to either system. Nevertheless, from a practical point of view, it could be argued that the current international regime supports a *light* version of capital-

[134] Schön, W, "International Tax Coordination for a Second-Best World (Part I)", *World Tax Journal*, no. 1 2009, p. 72-73.
[135] Schön, W, "International Tax Coordination for a Second-Best World (Part I)", *World Tax Journal*, no. 1 2009, p. 73.
[136] Musgrave, P, *United States Taxation of Foreign Investment Income*, p. 113 and Berglund, M, *Avräkningsmetoden*, p. 93.
[137] Pinto, D, "The Need to Reconceptualize the Permanent Establishment Threshold", *Bulletin for International Fiscal Documentation*, no. 7 2006, p. 271; Avi-Yonah, R, *International Tax as International Law*, p. 28 and Vogel, K, "Worldwide vs. source taxation of income (Part I)", *Intertax*, no. 8/9 1988, p. 217.
[138] Granted, it is unlikely that countries would go from an ordinary to a full tax credit. Nevertheless, with a full tax credit, the state of establishment's primary right to tax is fully recognized. The same is true for the ordinary tax credit.

export neutrality, and in the interest of continuity, capital-import neutrality seems less probable.

The main idea behind capital-export neutrality, as well as its strengths and weaknesses, has been outlined above. One might, however, question some of the assumptions made in connection with capital-export neutrality. Peggy Musgrave argues that capital-export neutrality is the preferred solution in a situation where taxes are not shifted and directly reduce the profits of companies.[139] She recognizes that there is a lack of empirical evidence on whether this assumption holds true.[140] Horst states that for capital-export neutrality to be the optimal solution, the supply of capital needs to be fixed in the involved countries, which he finds unlikely.[141]

Before we turn from capital-export neutrality in principle towards its implications for the PE concept, a short recapitulation of the principle's strengths and weaknesses is in order. The main strength of capital-export neutrality is that the basic neutrality notion is fulfilled, which, at the very least, does not promote investment decisions being dictated by tax considerations. The principle's weaknesses are that it is not neutral when it comes to the decisions regarding residence and that it is based on assumptions that haven't been proven and to some extent seem unlikely. Furthermore, at present, countries are unlikely to implement and accept a full tax credit. After this short summary, we shift our focus to capital-export neutrality and the PE concept.

To begin with, capital-export neutrality affects some aspects of the PE. The most relevant for this study is the lack of deferral, which has the consequence that foreign subsidiaries should be taxed in their parent company's state of residence. Thus, in principle, subsidiaries should always be treated as PEs in a system based on capital-export neutrality. This is not in line with the PE concept, specifically Article 5(7) in the OECD MTC, which explicitly forbids this approach. The treatment of branches, however, seems to be in accordance with capital-export neutrality. The PE concept, in conjunction with Article 7, only limits the state of establishment's right to tax. Consequently, the state of residence is free to tax the branch's income whether it has the

[139] Musgrave, P, *United States Taxation of Foreign Investment Income*, p. 112-113.
[140] Musgrave, P, *United States Taxation of Foreign Investment Income*, p. 115.
[141] Horst, T, "A Note on the Optimal Taxation of International Investment Income", *The Quarterly Journal of Economics*, no. 4 1980, p. 796-797.

status of PE or not. The OECD MTC as a whole, however, does not fulfill capital-export neutrality as both exemption and credit are supported. This means that capital-export neutrality *may* be fulfilled, in a limited sense, in some situations, e.g. where an enterprise has the option, for business reasons, to establish a branch in a select few countries with lower tax rates than the state of residence and where the applicable treaties use the credit method. In the case of subsidiaries, exemption treaties or higher tax rates in the possible states of establishment, capital-export neutrality is not fulfilled. Thus, it can be concluded that the current PE concept is not designed according to capital-export neutrality.[142] This makes the principle somewhat less relevant while interpreting the current PE concept. In *de lege ferenda* reasoning, however, it can still be useful, especially when it comes to the treatment of related persons.

2.3.3.3 Capital-Import Neutrality

Capital-import neutrality is, to some extent, the opposite of capital-export neutrality discussed in the previous section. This view of neutrality uses the state of establishment as a starting point. Consequently, a business activity should be taxed the same way regardless of whether it is owned by foreign or domestic investors. This is achieved by applying the exemption method in the state of residence. This means that a business activity should be taxed only in the state of establishment for the taxation to be considered neutral.

The main argument in favor of capital-import neutrality is that businesses established in the same market can compete under the same tax conditions.[143] This, however, presupposes that the tax system in the state of establishment is neutral between foreign and domestic investments. For instance, in a country with a preferential tax regime for foreign companies it could be argued that neutrality has already been breached and that capital-import neutrality does nothing to remedy that situation. Another argument against this is that in the current globalized world, a company might not establish itself in a country to access just that country's market. Instead, it has been suggested that MNEs in particular establish themselves in places that are suited for

[142] Skaar, A, *Permanent Establishment*, p. 31.
[143] Skaar, A, *Permanent Establishment*, p. 27.

their worldwide business.[144] The same argument can be made for e-commerce and other activities that use information technology to conduct business. Thus, it can be concluded that while competition neutrality is a valid argument, developments in technology and globalization have made it situational as one cannot assume that the location of the establishment completely coincides with the market the business intends to compete in. Furthermore, it has been suggested that the argument of competition neutrality is no longer within the boundaries of fiscal neutrality as a means to efficient resource allocation.[145] Based on what is stated above, the competition neutrality argument does not seem like a convincing basis for policy in general. There are, however, other arguments put forward in favor of capital-import neutrality. The most prominent one is the benefit theory.

The benefit theory implies that a tax subject should be taxed in accordance with the benefits received from the government. A company established in a state may, for instance, receive benefits from the infrastructure, legal system and the educational system. Because the company receives tax-funded benefits, it can be argued that it should be taxed in the state of establishment. The main problem with the benefit theory is that in practice it is close to impossible to calculate and value the benefits each taxpayer receives. Nevertheless, as a general starting point, the notion that companies that use tax-funded resources should help fund them is still valid. It should be noted that it has been recognized that the state of residence may provide benefits as well.[146] Against this background a more moderate approach to the benefit theory seems justified. Thus, the benefit theory can be used as an argument for taxation in the state of establishment, albeit cautiously. However, it may not be used as an argument for exclusive taxation in the state of establishment. The reason for this is that it is not possible to calculate benefits and the decreased connection between source and establishment.

[144] Schön, W, "International Tax Coordination for a Second-Best World (Part I)", *World Tax Journal*, no. 1 2009, p. 81.
[145] Musgrave, P, *United States Taxation of Foreign Investment Income*, p. 119.
[146] Musgrave, P, *United States Taxation of Foreign Investment Income*, p. 116; Schön, W, "International Tax Coordination for a Second-Best World (Part I)", *World Tax Journal*, no. 1 2009, p. 75 and Skaar, A, *Permanent Establishment*, p. 25.

An example can illustrate this. An enterprise from the United States decides to expand its business to the European market. The enterprise establishes a PE in a European country through which it sells software throughout Europe. All software is sold through downloads from the enterprise's servers located in the state of establishment. A central benefit for this business model is the protection provided by legal systems against illegal downloading and copying. Another crucial element, which may be tax funded, is the required infrastructure to download products, e.g. the quality of the customer's internet connections. These benefits are received, if at all, regardless of where the PE is established. Thus, it is not possible to argue for *exclusive* taxation in the state of establishment with reference to the benefit theory. Currently, in this example, the state of establishment, would act as "state of residence" for the PE and attract the income from all sales in Europe despite crucial benefits being provided by other states. As illustrated by the example, due to ongoing globalization, the benefit theory has lost much of its value as an argument in international taxation.

In conclusion, the previous discussion shows that the benefit theory cannot be used as an argument for capital-import neutrality. Indeed, the moderate interpretation of the benefit theory, i.e. that the benefit theory supports taxation in the state of establishment, is more likely to be fulfilled in a system based on capital-export neutrality. Granting any state the exclusive right to taxation in situations where two or more countries have tax claims cannot be said to be in line with the benefit theory because of the uncertainty about where benefits are received.

One argument against capital-import neutrality is that the basic neutrality notion is not fulfilled. A system with taxation only in the state of establishment is open to tax influence on location decisions. This can lead to business structures set up in low-tax jurisdictions for primary tax reasons. Thus, capital-import neutrality would have to be complemented with effective domestic anti-abuse rules to prevent aggressive tax planning.

Capital-import neutrality, like capital-export neutrality, is based on certain assumptions. Peggy Musgrave argues that if taxes are shifted to the extent of the tax rate in the state of establishment, an exemption system in the state of residence is preferable.[147] Furthermore, capital-

[147] Musgrave, P, *United States Taxation of Foreign Investment Income*, p. 114.

import neutrality is preferable if the demand of capital is fixed.[148] These assumptions are situational and to some extent unrealistic. This makes it difficult to apply the theory as a basis for general tax policy. A case-by-case approach to situations where capital-import neutrality is optimal does not seem like a practically possible solution. Thus, based on the above, capital-import neutrality does not seem to be a convincing argument for how foreign income should be taxed.

As outlined above, capital-import neutrality favors exclusive taxation in the state of establishment. Turning to the PE, it can be noted that the concept is not constructed to achieve exclusive taxation in the state of establishment when it comes to branches. Indeed, given the MTC's structure, the state of residence has exclusive right to tax branches that do not constitute PEs. By contrast, a subsidiary is taxed only in the state of establishment unless it constitutes a PE of its foreign parent.[149] This means that, when it comes to related persons, the PE concept is fairly in line with capital-import neutrality. However, by assessing the PE as a whole it can be concluded that the PE concept does not fulfill capital-import neutrality.[150] Neither does the MTC as there is no preference between exemption or credit. Nevertheless, the PE concept of source, i.e. activities of a certain magnitude with a sufficient duration, and the benefit theory support primary taxation in the state of establishment. As such, the benefit theory is relevant when studying the PE concept, whereas capital-import neutrality is less so.

Consequently, it cannot be said that the PE concept or the MTC give preference to a specific neutrality interpretation. Thus, as with capital-export neutrality, the relevance of capital-import neutrality as a tool to interpret and develop the PE concept can be questioned.

2.3.3.4 Inter-Nations Neutrality

As discussed above, the basic neutrality notion is that taxes should not affect business decisions. This means that this notion of neutrality is perceived as if taxes did not exist. In an international context this is difficult to achieve because of differences in national tax systems. Vo-

[148] Horst, T, "A Note on the Optimal Taxation of International Investment Income", *The Quarterly Journal of Economics*, no. 4 1980, p. 796.
[149] This is under the assumption that the subsidiary does not have any foreign income.
[150] Skaar, A, *Permanent Establishment*, p. 31.

gel argues that this difficulty has led scholars to disregard neutrality in more than one state, i.e. capital-export and capital-import neutrality.[151] To some extent, the two preceding sections express just that. Furthermore, Vogel concludes that neutrality in an international setting must consider the combined effects of the involved countries' tax laws on investment decisions. Consequently, he argues for an approach that focuses on neutrality between countries, which he labels "inter-nations neutrality".

Vogel defines inter-nations neutrality as a situation where "a taxpayer who conducts an enterprise in another country – or market – and thus utilizes the other country's facilities (public goods) can be sure of being taxed no more than anyone else who, under the same circumstances, uses these facilities to the same extent."[152] This definition is based on two main arguments.

The first argument is that while different tax systems' combined effects are not neutral, countries should accept this and not alter the situation in another jurisdiction with tax law.[153] Thus, international neutrality in this context seems to be a notion of non-intervention in other jurisdictions. The second argument is that neutrality between countries cannot focus solely on taxes. Instead, both taxes and benefits provided by states should be included in the neutrality assessment.[154] The reasoning behind this is that if taxes and economic reasons are equal in two countries, there is a preference to invest in the country that provides the most benefits. Vogel labels this relationship between benefits and taxes as the *administrative net output*. Following the previously mentioned neutrality definition, this means that inter-nations neutrality is achieved when countries do not distort the ad-

[151] Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 313.
[152] Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 314.
[153] Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 313. Vogel has based this reasoning on Ture's neutrality definition. Ture defines international neutrality as a situation where countries do not use taxes to change relative prices in other jurisdictions.
[154] Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 313.

ministrative net output of other jurisdictions.[155] According to Vogel, this will result in efficient resource allocation as it can be assumed that investments are channeled to countries with high administrative net output, provided all other factors are equal.[156] In order to achieve inter-nations neutrality, a territorial approach to taxation must be applied.[157]

As inter-nations neutrality and capital-import neutrality are achieved in similar ways, i.e. exclusive taxation in the state of establishment, their strengths and weaknesses are similar. This has been discussed in the previous section and is not repeated here. However, there is one interesting aspect that differentiates inter-nations neutrality from capital-export and capital-import neutrality. This is the focus on other aspects, loosely labeled benefits, in the neutrality assessment. This is an important innovation in this neutrality notion as the sole focus on taxes in an efficiency analysis is quite shallow. To achieve complete neutrality, either export or import, one has to remove distortions from all types of legislation, not only taxes. For example, labor and environmental law can distort investment decisions as well. If one is to strive for neutrality one cannot stop with taxes.

Another aspect deserves to be discussed in this section as well. The difference between inter-nations neutrality and capital-import neutrality lies in the definition of neutrality and, thus, more in the arguments than in the result. Inter-nations neutrality is strongly connected to the benefit theory, even more so than capital-import neutrality, as the efficiency argument is connected to the administrative net output. As argued previously, the benefit theory does not, in general, support exclusive taxation in any state.[158] If an establishment receives benefits in the investor's state of residence while not being taxed there, the administrative net output in that state might be distorted. Granted, if it is

[155] Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 314.

[156] In this part of the analysis, Vogel disregards any differences in administrative net output between countries. The reason for this is that it favors countries with an efficient administration and, thus, overall efficiency. Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 314.

[157] Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 314.

[158] See section 2.3.3.3.

assumed that the benefits received are almost exclusively from the state of establishment, it can be seen as an acceptable solution. The present business reality with globalization and digital economy, however, does not support that assumption. Thus, it can be questioned whether inter-nations neutrality is achieved with taxation exclusively in the state of establishment.

Finally, inter-nations neutrality in relation to the PE concept is discussed. Initially, it can be noted that Vogel does not consider all establishments or activities to be relevant in an inter-nations neutrality discussion. He requires the establishment or activity to be of a certain magnitude, which coincides with the PE concept.[159] Thus, there is a connection between inter-nations neutrality and the PE concept. This connection, however, reinforces the PE concept, depending on how one views the concept, as something outside the discussion on what neutrality is. If the PE is seen as a concept separated from neutrality, it functions as a threshold for when neutrality arguments are valid. In other words, it is assumed that if no PE exists there are not enough benefits received to warrant neutrality considerations. On the other hand, if it is seen as a concept integrated with neutrality, it constitutes an important part of the neutrality definition. In this context, the integrated approach requires the PE concept to adapt to new business models so that a PE is recognized where substantial benefits are received. Vogel seems to perceive the PE in a separate, or traditional, way and excludes sales from inter-nations neutrality. An integrated approach would rather focus on whether or not substantial benefits are received. Regardless of how one views the PE concept, a strong connection between the PE concept and benefits received must be upheld to achieve inter-nations neutrality. In practice, it is impossible to establish this connection. Thus, the separate approach, where the PE is excluded from the neutrality definition, seems like a more realistic option. Nevertheless, if one advocates for full inter-nations neutrality, the PE concept should be interpreted and amended in light of the benefit theory.

When it comes to the related person PE, one could say that inter-nations neutrality "resolves" this question. This is because a system based on territorial taxation is focused on activities and not on taxpay-

[159] Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 314.

ers. Thus, for the most part, taxation would be upheld in the state of establishment where activities are carried out, regardless of who those activities belong to.

As previously concluded when discussing capital-export neutrality and capital-import neutrality, the PE concept does not consistently result in a specific neutrality approach being fulfilled. This holds true in the case of inter-nations neutrality as well.[160]

2.3.3.5 Capital-Ownership Neutrality

A more recent neutrality theory is capital-ownership neutrality. Capital-ownership neutrality means that taxes should distort ownership patterns as little as possible.[161] If this is achieved, it can be assumed that assets will be controlled by the most productive owners.[162] The reasoning behind this is that it promotes efficient resource allocation by making sure that the most productive owner owns a particular asset. Welfare is maximized if businesses are owned by those that can produce the best result, which will lead to efficient companies. As such, this neutrality notion is focused on the ownership of capital and not the capital itself.[163]

In order to achieve this, potential owners cannot be taxed differently on the same investment. The best way to achieve this is to adopt an exemption system, i.e. exclusive taxation in the state of establishment.[164] Thus, capital-ownership neutrality produces the same result as capital-import neutrality. However, capital-ownership neutrality seems to be more connected to the economic aspects of neutrality and less on equity. Nevertheless, the advantages and disadvantages with capital-ownership neutrality and capital-import neutrality are similar. Specifically, capital-ownership neutrality is open to tax planning when it

[160] Skaar, A, *Permanent Establishment*, p. 29-31.
[161] Desai, M, and Hines Jr., J, "Evaluating International Tax Reform", *National Tax Journal,* no. 3 2003, p. 494.
[162] Desai, M, "Taxing Multinationals: Securing Jobs or the New Protectionism", *Tax Notes International*, July 6 2009, p. 66.
[163] Desai, M, and Hines Jr., J, "Old Rules and New Realities: Corporate Tax Policy in a Global Setting", *National Tax Journal*, no. 4 2004, p. 956.
[164] Capital-ownership neutrality can also be achieved with worldwide residence-based taxation paired with a full tax credit, i.e. capital-export neutrality. However, the likelihood that any country would adopt a full tax credit does seem slim.

comes to the decision on where to locate an establishment, provided said establishment is somewhat mobile. It is recognized that this can lead to excessive investments in countries with low taxation.[165] This means that there is a tradeoff between efficiency in the location of the investment and the location of the investor inherent in capital-ownership neutrality.

One difference, however, is that capital-import neutrality can be reached, in a limited sense, between two countries if we assume that the state of residence exempts the income from the state of establishment. By contrast, capital-ownership neutrality does not seem to be possible in such limited situations. Potentially, the most productive owner can be resident anywhere on the globe. Thus, capital-ownership neutrality requires a worldwide adoption of exemption. Naturally, this high degree of coordination makes this particular notion of neutrality rather unrealistic at the moment.

Regarding the PE concept in relation to capital-ownership neutrality, it can, once again, be concluded that they do not match, as not all activities performed in the state of establishment are taxed. In this context, the PE concept could be seen as a simplification to avoid taxation and the administrative burden of minor establishments. However, the PE concept would not play a role in the discussion on how to divide taxation from a principle point of view. When it comes to the related person PE it can be concluded that a subsidiary and branch should be treated the same way in the state of establishment and would not be taxed in the owner's state of residence. Thus, the importance of this question would be reduced.

2.3.3.6 Conclusion

During the discussion of the different neutrality theories in previous sections we have seen that while there are some merits to all theories, they also contain weaknesses. These weaknesses range from unrealistic assumptions to not fulfilling the basic neutrality notion. Additionally, they require a high degree of harmonization of both tax treaties and domestic law. Because of this it seems questionable to base interna-

[165] Desai, M, and Hines Jr., J, "Evaluating International Tax Reform", *National Tax Journal,* no. 3 2003, p. 495.

tional tax policy exclusively on one of these theories.[166] Furthermore, the PE concept outdates these theories and, as such, is not designed to achieve any specific neutrality theory. Indeed, the current PE concept fulfills different neutrality notions depending on the situation.[167] Thus, it seems clear that the international neutrality theories that have been presented here have little impact on the interpretation of the PE concept. This raises the question of whether neutrality matters at all when defining the PE.

The answer to that question is yes, neutrality has a role to play in international taxation. I do, however, believe that it is necessary to go back to the basic neutrality notion. In this study this means that subsidiaries and branches should, as a starting point, be treated the same way for tax purposes.[168] This holds true unless it can be established that a subsidiary is different enough from a branch to warrant different treatment.[169] This conclusion might lead one to consider capital-export neutrality as the preferred theory as it best fulfills the basic neutrality notion. This is not the intention. Neutrality is considered within the context of tax treaties, not between countries. Thus, the role of neutrality in this study can be described as follows: Related persons and branches should be subject to the same PE assessment unless factual, legal or practical considerations warrant different treatment. In essence, the basic neutrality notion should be the source of guidance unless a convincing argument for departing from it can be presented. For practical purposes, one could argue that the PE concept is such a departure.

[166] Fleming, C, Peroni, R, Shay, S, "Perspectives on the Worldwide vs. Territorial Taxation Debate", *Tax Notes International*, January 4 2010, p. 79; Horst, T, "A Note on the Optimal Taxation of International Investment Income", *The Quarterly Journal of Economics*, no. 4 1980, p. 797; Schön, W, "International Tax Coordination for a Second-Best World (Part I)", *World Tax Journal*, no. 1 2009, p. 94 and Graetz, M, "Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies", *New York University Tax Law Review*, no. 3 00/01, p. 275.

[167] Skaar, A, *Permanent Establishment*, p. 31.

[168] See Skaar, A, *Permanent Establishment*, p. 541-542 and Vogel, K, "Worldwide vs. source taxation of income (Part II)", *Intertax*, no. 10 1988, p. 310.

[169] For a similar reasoning see Schön, W, "International Tax Coordination for a Second-Best World (Part I)", *World Tax Journal*, no. 1 2009, p. 95.

However, as the discussion in the previous sections showed, neutrality in tax law is not only an argument for economic efficiency but also equity. The aspect of equity is discussed in the following section.

2.3.4 Equity Considerations

There is no single definition for equity, in an international tax law context, that fits in all situations.[170] This is the case for most discussions concerning equity. Before one can discuss equity one must acknowledge that what is equitable is situational and subjective. For the purpose of this discussion, it is not possible to produce a definition of equity that can be generally applied in international taxation. What can be done, however, is to enhance certain aspects of equity relevant to the PE concept and international taxation in general.

Much like the neutrality discussion above, where equity is an inherent part of the discussion, equity may have different implications for a tax system depending on perspective. From a taxpayer perspective, one can view equity either from the state of establishment or state of residence and possibly reach different results. It has been argued that equity, in the state of residence, implies either treating foreign taxes as costs (national equity) or granting a tax credit (international equity).[171] From this perspective, equity is envisioned as equal treatment between taxpayers in the state of residence. As an enterprise in a PE situation is actually a taxpayer in both states, it can be argued that equity requires equal treatment with taxpayers in the state of establishment.[172] This means that there are equity arguments in favor of taxation in both the state of residence and the state of establishment.

Another aspect of equity between taxpayers is the question of whether or not richer persons should contribute more to the common good. This can be labeled vertical equity.[173] Avi-Yonah argues that

[170] Vogel describes equity as a creative interpretation that is also situational. Vogel, K, "Worldwide vs. source taxation of income (Part III)", *Intertax*, no. 11 1988, p. 393.

[171] Musgrave, P, *United States Taxation of Foreign Investment Income*, p. 128.

[172] Vogel, K, "Worldwide vs. source taxation of income (Part III)", *Intertax*, no. 11 1988, p. 398.

[173] Mill, J S, *Principles of Political Economy with Some of Their Applications to Social Philosophy*, Book V Chapter II, v. 2.7. Mill expresses this as: "Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice."

there has been a shift in who is burdened by taxation, with increased taxation of labor through consumption and payroll taxes.[174] As capital is more mobile than labor, this shift may be a reaction to secure a more stable tax base. From the perspective of equity it could be argued that capital is mainly owned by richer persons and that this shift has increased inequalities with a greater division in the distribution of wealth.[175] To some extent this argument can be applied to the related person PE situation as well. Large multinational enterprises have the means and opportunity to relocate establishments in order to take advantage of lower taxation. Smaller businesses may not have the same ability to relocate establishments. Thus, an exemption system in the state of residence will to some extent allow some taxpayers to reduce their taxation, whereas other taxpayers cannot. One cannot ignore the tension and feeling of inequality this creates among countries as well as among taxpayers, and the BEPS project can be seen as a reaction to this phenomenon.

In conclusion, equity between taxpayers is a complex issue, which becomes even more complex in an international setting. It does not seem possible to achieve a solution that is completely equitable to all involved parties, and therefore a compromise may be the best option.

These positions are valid when we proceed to another perspective of equity, namely, equity between states, as it is difficult to draw a meaningful line between equity among taxpayers and countries.[176] The arguments may be different, but equity between taxpayers and countries is ultimately connected as the allocation between countries is likely to affect taxpayer equity. Thus, taxpayer equity and inter-nations equity should be considered together.

Turning to inter-nations equity, Vogel argues that it is best achieved by exclusive taxation in the state of establishment. As with his arguments regarding neutrality, this is strongly based on the assumption that the state of establishment provides "most or all of the

[174] Avi-Yonah, R, "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State", *Harvard Law Review*, May 2000, p. 1616-1625.
[175] Avi-Yonah, R, "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State", *Harvard Law Review*, May 2000, p. 1624-1625.
[176] Berglund, M, *Avräkningsmetoden*, p. 89.

benefits".[177] As has been argued in previous sections, the benefit theory does not support exclusive taxation in any state because of the difficulty in establishing the impact of the benefits for income generation. Peggy Musgrave points to the problem that corporate income taxes are generally not designed according to the benefit theory and, thus, "there is no clear case for any particular allocation formula" based on benefits.[178] However, the benefit theory and equity in general certainly support some level of taxation in the state of establishment. As a rule of thumb, one should be cautious in deciding what is equitable in the same way one turns a lamp on or off. There are good equity-based arguments for taxing a PE in both the state of establishment and the state of residence. Inter-nations equity is not only concerned with which country has the best claim to tax an income. It should also include the countries' interest in upholding equity between taxpayers within its domestic system.

Considering equity both between taxpayers and countries, we can conclude that exclusive taxation in the state of establishment achieves equal treatment between taxpayers in that state.[179] However, equal treatment between taxpayers in the state of residence is not achieved. Neither is inter-nations equity guaranteed as, even though the state of establishment has the primary right to tax, the state of residence is not allowed to maintain its domestic equity.

With a credit system, equity from a taxpayer perspective is somewhat upheld in the state of residence but not in the state of establishment. Inter-nations equity is, yet again, not fully achieved as the state of establishment cannot guarantee its domestic equity. However, disregarding equity between taxpayers, the allocation of taxing rights seems equitable with a credit system. The primary right to taxation lies with the state of establishment, according to the benefit theory, with a residual right to taxation for the state of residence. A full credit system would be more equitable, but it is unlikely that countries would implement such a system.

[177] Vogel, K, "Worldwide vs. source taxation of income (Part III)", *Intertax*, no. 11 1988, p. 398.
[178] Musgrave, P, *United States Taxation of Foreign Investment Income*, p. 131-132.
[179] Provided that the state of establishment's domestic tax law treats foreign and domestic business operations the same way, e.g. not having a preferential tax regime to attract foreign investments.

Given the discussion above it seems clear that the benefit theory is not suited in practice as the one and only basis for equity. The notion of what is equitable in the situation of international taxation is too complex to be solved by the benefit theory alone. Without implying that this study holds the key to equity, the discussion above can be distilled into two general statements. The first is that the state of establishment has the main right to taxation according to the benefit theory. The second is that the state of establishment has a right to any residual taxation in order to maintain its domestic equity.

What is the PE concept's function in all this? Well, the PE concept is a tool for dividing taxing rights. The PE is a threshold for taxation in the state of establishment and, as such, divides taxation rights between countries. Thus, the PE concept's role in an equity discussion is to decide when equity arguments are valid. If a PE does not exist, there is no taxation right in the state of establishment and, consequently, no issues regarding equal treatment or how to divide the revenue. The existence and use of the PE concept compared to source state taxation can, in this context, be motivated because a minor establishment means less connection to the state of establishment which, in turn, means that the use of benefits may not warrant taxation. For this reason, and for practical ones, the PE concept has a role to play in the equitable distribution of taxing rights. This means that equity is relevant when discussing the design of the PE concept *de lege ferenda*. In general, one could argue that substantial activities generating substantial income should, for equity reasons, constitute a PE. With an increased global service economy, one could certainly question from an equity perspective why service PE is not included in the OECD MTC. Similarly, the rapid expansion of the digital economy is something that to some extent breaches the notion of equity put forward above.

When it comes to the related person PE, one can say that the traditional interpretation of the fixed place of business PE, paired with weaknesses in the agency clause and the list of exceptions, has caused situations where the notion of equity is not fulfilled. This mainly affects the state of establishment, but from a wider perspective it affects taxpayer equity in general as some enterprises pay less taxes than they *should* from an equity perspective. Having said all this, when interpreting the PE concept, equity is of little relevance as it is already considered and *agreed upon* when entering into a tax treaty.

2.3.5 Enforceability Aspects

An important aspect of international tax law is the ability to collect taxes from foreign taxpayers. If a country has a right to tax, for instance because of the existence of a PE, but does not have an ability to enforce its tax claims, such rights to tax can be said to be pointless. In a lot of situations this will not be a problem as the PE has assets located in the state of establishment. In other situations this is not the case. Take for instance a subsidiary whose main business is the manufacturing of car components for its parent company. In addition to this, the subsidiary habitually concludes contracts in the name of another group company. Consequently, the subsidiary constitutes an agency PE. However, this PE owns no assets as it is mainly one employee that, a few times a year, negotiates and concludes contracts. If the foreign group company refuses to pay taxes because it does not agree that it has a PE, the only way for the tax agency to collect this tax claim is to get assistance from the group company's state of residence or to enforce the tax claim from another taxpayer, i.e. the subsidiary.

Assistance with collecting taxes is dealt with in Article 27 of the OECD MTC. However, this provision is not always included. Furthermore it can be costly and complicated to get this assistance. Thus, it is advisable to not extend the PE concept too far from an enforceability perspective.

2.3.6 Foreseeability and Legal Certainty

A legal concept such as the PE can be based on principles, practical considerations or a mix of both. The PE provisions would be designed differently depending on whether principles or practical considerations are given preference. For instance, a PE concept based strictly on the true economic source of income would have to be drafted in a general way. Naturally, such a provision would make it more difficult for companies to determine whether an establishment amounts to a PE or not. Thus, a conflict can be said to exist between fiscal principles on how to divide taxation rights and the general principle of legal certainty and foreseeability.

As has been argued above, the PE is not designed to achieve taxation according to any specific notion of neutrality or the economic source of income. This suggests that practical considerations have

played a big part in the concept's design. Indeed, looking at Article 5 reveals a number of objective conditions, i.e. without a fixed place there can be no PE according to the fixed place of business rule. Objective conditions will naturally increase foreseeability for the tax payer. Furthermore, the PE concept's age and stability help to provide foreseeability. Against this background, it can be said that the PE concept provides a reasonable degree of foreseeability. However, when it comes to the question of how taxation rights should be divided, the question is how to strike a balance between foreseeability and the principles discussed in this section. It is not possible to give an exact answer to this question. What can be said is that striving for a pure principle-based solution is not advisable. Instead, principles should provide guidance on how the concept should be applied or amended, but the need for a practical solution is paramount.

Turning to the related person PE and foreseeability, one could argue that presently it is rather difficult to discern when a related company constitutes a PE, especially according to the fixed place of business rule. However, one could also argue that it is rather easy. To some extent both opinions are right. Initially, it must be said that the vast majority of situations with related persons are unproblematic and the discussion of whether or not they constitute PEs is nonexistent. What is difficult is when the question of related person PEs is relevant. So far this question has been quite rare, but it is likely that its relevance will increase in the future.

The reason for this is twofold. First of all, the traditional interpretation of the PE concept has been rather strict when it comes to related person PEs. Second, the arguments for a related person PE are often connected to economic substance, which is a complicated assessment. The change in how the related person PE is perceived paired with substance arguments, often in order to prevent tax avoidance, has created a situation where it is difficult to apply the PE concept in a related person PE situation. If we add the proposed changes in the BEPS project, it is likely that this difficulty will persist, perhaps even increase, for the foreseeable future. Thus, increasing foreseeability is an important aspect of this study.

2.3.7 Conclusion Regarding How to Divide Taxation Rights and the Permanent Establishment

Having examined different aspects of how to divide taxation rights between countries, a few conclusions have been drawn. It was concluded that the PE concept is a legal definition of source. This definition is based on activities performed in the state of establishment. When it comes to neutrality it was concluded that the PE concept is not developed to fulfill any of the discussed neutrality notions. Neutrality is still relevant but in the form of the basic neutrality notion, i.e. that taxes should affect taxpayers' decisions as little as possible. It was also concluded that equity considerations warrant primary taxation in the state of establishment. However, the state of residence has an interest in upholding taxpayer equity and has a residual right to tax.

A general conclusion is that the PE concept is not fundamentally based on a specific principle or theory discussed. Instead, the PE concept seems to be a compromise between several principles. The strongest influences seem to be from the basic neutrality notion, the notion of source, equity and practical considerations. Thus, when interpreting the PE concept, principles should be used with caution. This suggests that the PE concept should be approached on its own terms, i.e. primarily the wording of Article 5, instead of trying to tweak the concept to fit in with one or more principles.

Furthermore, the previous discussion leaves a lasting impression of the discussed theories' inadequacy to provide a basis for international tax policy on their own. The theories are quite extreme and represent an all-in approach that does not seem practical. This is a probable explanation to why the PE concept is designed without much regard for specific theories on how to divide taxation rights. Furthermore, tax treaties are by nature compromises as often both contracting states are of the opinion that they can tax an income. As was previously concluded, there are good arguments for taxation in both the state of establishment and the state of residence. To argue for one state to receive all taxation rights in this situation does not seem practically possible, nor does it seem correct.

Having observed the BEPS project, the conclusion on the value of principles seems to still hold. In the context of Action 7, the OECD seems preoccupied with solving specific problems, or abusive situations if you will, not establishing a principle-based solution. It would

seem that the main aspect considered is to align income-generating activities with taxation. However, as the PE concept is a threshold, there will always be activities that are not aligned with taxation as that is the point of having a concept such as the PE, otherwise we could just use taxation at source. Accordingly, this aspect is of little use in a policy discussion concerning the PE as it says nothing about the threshold.

2.4 The Concept of Substance-over-Form

2.4.1 In General

As mentioned in the overview of this study's topic, substance-over-form arguments are closely connected to the related person PE. This means that the relevance of substance-over-form arguments when it comes to the PE concept must be analyzed. In the following sections this is discussed from a general point of view. This means that substance-over-form is not applied to any specific situation in which the PE concept is applied. Instead, such specific application is discussed in the context of a specific PE rule or condition.

As with all concepts, it is difficult to exactly define the meaning of substance-over-form.[180] In general, the concept of "substance-over-form" can be described as assessing a certain set of facts based on the economic substance instead of following the legal form.[181] An example of this can be a leasing contract which is deemed to have the economic substance of a sale. Other examples, more relevant to this study, are a subsidiary that is deemed to conduct the parent company's business or an employee of a related company considered an employee of another related company.

The application of substance-over-form can be detailed, for example, transfer pricing, or not specified at all, which means that a general assessment of the economic substance must be made. The concept can also be used to prevent tax avoidance, for example, in a GAAR. However, in this context, namely the connection between substance-over-form and the PE concept, it is, sufficient to use the general de-

[180] See Hultqvist, A, *Legalitetsprincipen vid inkomstbeskattningen*, p. 439.
[181] Zimmer, F, *Form and substance in tax law*, p. 24 and Johansson, K, *Substance Over Form – en redovisningsrättslig studie*, p. 38-39.

scription provided above. Nevertheless, the distinction between situations that are abusive and those that are not should be observed. The specifics of applying substance-over-form to the PE concept are discussed in chapters 4-6.

Substance-over-form is common in accounting, but it is also relevant in other areas, such as tax law. As discussed above, the usefulness of a principle, or concept, depends on its connection to the specific provision, set of provisions or specific area of law.[182] Thus, the connection between substance-over-form and the OECD MTC (section 2.4.2) on the one hand, and the PE concept (section 2.4.3) on the other hand, is studied. I will not discuss all examples of substance-over-form, and the focus is on the most obvious ones and those most relevant for the related person PE situation. The reason for this is that the objective of this section is to analyze whether there is a sufficient connection between substance-over-form and the PE concept. The outcome of this analysis is important in order to fulfill the objective of the study as there is a connection between the related person PE and substance-over-form.

In addition to the above, the concept of substance-over-form may exist in domestic tax law as a general or specific principle. This situation, however, falls outside the scope of this study and will not be further discussed.

2.4.2 Substance-over-Form and the OECD MTC

Initially, it can be noted that the OECD is of the opinion that domestic anti-abuse legislation can be applied in abusive situations without considering it treaty override.[183] Substance-over-form is an example of a domestic concept that is specifically mentioned as "not affected by them ['them' being tax treaties, my remark]".[184] The reasoning provided by the OECD is that substance-over-form is used to determine the facts of the case and then presumably occurs before the application of the treaty.[185] However, the OECD states that the application of substance-over-form does not conflict with tax treaties "as a general

[182] See section 2.1.
[183] Para. 7.1, 9.2, 22 and 22.1 of the commentary to Article 1 of the OECD MTC.
[184] Para. 22 and 22.1 of the commentary to Article 1 of the OECD MTC.
[185] Hilling, M, *Skatteavtal och generalklausuler – Ett komparativt perspektiv*, p. 94.

rule".[186] This implies that in certain situations the concept may conflict with tax treaties.

Applying the OECD statements to the PE concept, it can be noted that in a situation of abuse, substance-over-form can generally be applied to recharacterize or reclassify a transaction or a legal relationship. Especially relevant to this study is the situation where the receiver of an income is redetermined, which could mean that a person is conducting the business of a foreign related person.[187] Given that one of the objectives of the OECD MTC is to prevent tax avoidance,[188] it can be concluded that, in general, it is possible to apply substance-over-form to prevent abuse. Naturally, this also encompasses the PE concept.

Substance-over-form is not only found in general statements about the OECD MTC. The concept can also be found in relation to specific articles, both in the actual treaty and in the commentary. There are three clear examples of substance-over-form that I will discuss.

First, there is the concept of "beneficial ownership" in Articles 10, 11 and 12.[189] This means that if the beneficial owner of the dividends and interest is resident in a third country, the state of source does not need to apply the restrictions in Articles 10(2) and 11(2). Similarly, when it comes to royalties, the state of source is not allowed to tax the royalty if is beneficially owned in the other contracting state according to Article 12(1). The "beneficial owner" concept is an expression of substance-over-form. According to the OECD, a person who does not have a right to use the payment but is obligated to pass it on is not the "beneficial owner".[190] In other words, a person just passing on a payment is not the economic owner even though it is the formal one. This aspect of substance-over-form is also closely connected to abuse of tax treaties, specifically "treaty shopping".

[186] Para. 22.1 of the commentary to Article 1 of the OECD MTC.
[187] Para. 22 of the commentary to Article 1 of the OECD MTC.
[188] Para. 7 of the commentary to Article 1 of the OECD MTC.
[189] For other aspects of substance-over-form in these three articles see Kosters, B, "Substance over Form under Tax Treaties", *Asia-Pacific Tax Bulletin*, no. 1 2013, p. 7.
[190] Para. 12.1-12.4 of the commentary to Article 3 of the OECD MTC.

The second example of substance-over-form is transfer pricing and the arm's-length rule in Article 9.[191] Transfer pricing, in the OECD context, allows for both adjustments of the pricing model and recharacterization of transactions. Both of these can be seen as facets of substance-over-form. Given the development in how income is attributed to a PE, one can say that Article 7 is an expression of substance-over-form as well. Transfer pricing is needed to prevent profit shifting between associated enterprises and, as such, is connected to the need to prevent abuse and excessive tax planning. The attribution of profits, however, is rather a provision to divide taxation between contracting states in the case of PEs.

The third, and final, example of substance-over-form can be found in the commentary to Article 15, which more specifically addresses the question of whether services should be considered provided by an employee or an independent service provider.[192] According to the OECD, the contracting states are free to apply substance-over-form to determine whether a person is an employee or service provider even in non-abusive situations.[193] Regarding abusive situations, the OECD refers back to the general statement regarding substance-over-form discussed above.[194]

Based on the above, it seems clear that substance-over-form is recognized and accepted by the OECD. This is especially true in abusive situations. This means that it is possible to apply substance-over-form in the assessment of facts under Article 5 in the OECD MTC, at least in abusive situations.

2.4.3 Substance-over-Form and the PE Concept

Just as with the OECD MTC there are several examples of substance-over-form within the PE concept. Starting with perhaps the most obvious example of substance-over-form, this is to artificially split things up to avoid a PE. There are two main situations covered in the com-

[191] Burmeister, J, *Internprissättning och omkarakterisering*, p. 29. Also see Monsenego, J, "The Substance Requirement in the OECD Transfer Pricing Guidelines: What Is the Substance of the Substance Requirement?", *International Transfer Pricing Journal*, no. 1 2014, p. 9.
[192] Para. 8.1-8.15 of the commentary to Article 15 of the OECD MTC.
[193] Para. 8.4 and 8.11 of the commentary to Article 15 of the OECD MTC.
[194] Para. 8.9 of the commentary to Article 15 of the OECD MTC.

mentary. In the first situation, on contract is split up into several and spread to different related companies to avoid the twelve-month threshold in the construction clause. According to the OECD, such a practice may in some situations fall under domestic anti-avoidance rules.[195] It stands to reason that this includes substance-over-form as that is one of the concepts mentioned in the discussion on abuse of treaties, as discussed in the previous section. This is also discussed in Action 7 of the BEPS project. Proposal C in the final report adds an optional rule that the treaty-concluding states may use as well as an example to be added in the new commentary to the principal purpose test to prevent abuse by splitting up contracts.[196]

The other situation entails the splitting up of negotiations and the act of signing a contract. This is relevant under the agency clause in the assessment if the agent has the authority to conclude contracts. The OECD expresses a substance-over-form view in situations where the principal "routinely approves the transactions"[197] or where an agent "negotiate[s] all elements and details of a contract".[198] Both of these examples show that the assessment of whether an agent has an authority to conclude contracts should be made with substance-over-form in mind. This approach is needed as it would otherwise be easy to avoid the agency clause by splitting up negotiations and the actual signing. This means that this approach can be linked to the idea of preventing abuse. However, not all situations covered are abusive.[199] The typical example is standardized contracts such as insurance contracts or similar. The conclusion is that the authority to conclude contracts should be assessed with reference to substance-over-form in general and not only in situations that are abusive.

[195] Para. 18 of the commentary to Article 5 of the OECD MTC.
[196] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 42-44.
[197] Para. 32.1 of the commentary to Article 5 of the OECD MTC. It can be noted that this situation is added to the actual Article in the BEPS project, OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 16.
[198] Para. 33 of the commentary to Article 5 of the OECD MTC.
[199] For an example of a non-abusive situation see American Income Life Insurance Company v. Her Majesty the Queen, 2008 CarswellNat 1512, 2008 TCC 306.

Finally, there is another, and similar, example in the BEPS project. This example deals with the splitting up of activities, usually referred to as "fragmentation", between related parties to avoid a PE by way of the exceptions in Article 5(4). The suggested method to prevent this is to add a new paragraph in Article 5 stating that "complementary functions that are part of a cohesive business operation" performed by "closely related enterprises" should either be attributed to an existing PE or be seen as one place of business when applying the exceptions.[200] This is a step away from the formal view of a group consisting of separate entities that regularly applies under the OECD MTC. Instead of a formal view, a substance-over-form approach is suggested in certain situations.

Another type of question is whether the concluded contracts under the agency clause should be binding in substance or in form. This has been debated extensively and the conclusion is that the principal needs to be legally bound by the contracts, i.e. form, and, consequently, that being economically bound is not sufficient.[201] However, the new version of the agency clause proposed in the BEPS project adds the aspect of economically binding contracts. In essence, the new wording adds to the PE concept contracts by which the principal is not legally bound but that he should perform regardless, e.g. to deliver goods or services.[202] With this, a limited substance-over-form approach is added to the assessment of whether contracts are "binding" on the principal.

As discussed in the previous section, the commentary to Article 15 is open to a substance-over-form approach when determining whether a person is acting as an employee or as a service provider. Naturally, this also has relevance for the PE concept. The OECD rightly states that it would be illogical to come to different conclusions on this question under Articles 5 and 15.[203] This means that the substance-over-form approach mentioned in the commentary to Article 15 is al-

[200] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 39-41.
[201] See section 5.3.4.
[202] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p.16.
[203] Para. 8.11 of the commentary to Article 15 of the OECD MTC.

so useful under Article 5.[204] Furthermore, the OECD suggests making this connection even clearer with the addition of a cross-reference to the substance-over-form approach under Article 15 in the commentary to Article 5.[205]

The final example of substance-over-form is the dependency assessment in the agency clause.[206] While this might not be as clear an example of substance-over-form as the ones discussed above, it is still an expression of that concept. The dependency assessment is based on the facts of the specific situation and includes legal and economic control. Basically this means that a dependent agent is conducting the business of the principal while an independent agent conducts his own business. Another way to put this would be to say that a dependent agent is acting like an employee while an independent agent acts as an independent service provider. As mentioned above, this is explicitly referred to as substance-over-form by the OECD in the commentary to Article 15. When the "different" methods described in the commentary to Articles 5 and 15 are compared, they seem to be rather similar.[207] Both are in essence substance-over-form approaches.

Regarding the dependency assessment, it is interesting to note that, as opposed to the other BEPS proposals mentioned, the OECD is moving to a more formal approach. The suggested changes to Article 5(6) mean that an agent who acts almost exclusively on behalf of closely related enterprises will always be considered dependent.[208] This means that an agent who in substance acts independently but fulfills the formal requirement mentioned will be considered dependent.

2.4.4 Conclusion

Initially, it can be concluded that substance-over-form is a recognized concept in the OECD MTC as a whole and also in the PE concept.

[204] For more on this, see section 4.2.2.1. Also see, Jacobsson, L, and Edvinsson, D, "Fast driftställe vid 'secondments'", *Svensk Skattetidning*, no. 2 2016, p. 135-148.
[205] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 23.
[206] See section 5.4 for the full discussion on the dependency assessment.
[207] Jacobsson, L, and Edvinsson, D, "Fast driftställe vid 'secondments'", *Svensk Skattetidning*, no. 2 2016, p. 143-147.
[208] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 16-17.

The connection is especially strong in situations where there is abuse of the treaty but also abuse of the concept itself. In the context of substance-over-form and abuse in general, it is important to note that the application of substance-over-form depends on whether the concept is recognized in domestic law. Because of this, results may vary between countries depending on domestic concepts aimed at preventing tax avoidance.

When it comes to substance-over-form and the PE concept, all examples presented deal with distinct situations. This is something different than the general application just discussed. The difference is that in these specific situations, a version of substance-over-form has to be applied. The agency clause in particular has a strong connection to substance-over-form. However, there are elements of the concept in the fixed place of business PE as well.[209] Naturally, substance-over-form which is included in the PE concept does not require abusive situations. Instead, it is part of the regular PE assessment. This is discussed later in relation to the specific rules and conditions.

The general conclusion is that it is in line with the PE concept and the OECD MTC to apply substance-over-form to prevent abuse. I would even argue that substance-over-form is the preferred method to prevent abuse in the context of the PE concept. The reason for this is that such an approach does not alter the conditions and structure of the PE concept as it is only the facts that are reimagined, not the PE concept.[210] Furthermore, the connection between substance-over-form and the PE concept is rather strong. This means that substance-over-form has a sufficient connection to the PE concept to be used while interpreting the latter.

However, substance-over-form should be used with care. These conclusions should not be understood as a recommendation to always interpret the PE concept in the light of substance-over-form. Nor are they an invitation to apply substance-over-form in normal tax planning.[211] Nevertheless, in a study such as this, where the central question is how to attribute activities between related persons, the conclu-

[209] See section 4.2.

[210] The same view of substance-over-form is proposed by the OECD, para. 22.1 of the commentary to Article 1 of the OECD MTC.

[211] The meaning of "abuse" and the difference from "normal tax planning" are discussed in the final chapter.

sions in this section warrant an approach that tests the PE concept and substance-over-form together in situations concerning related persons.

2.5 Concluding Remark

The objective of this chapter is to provide a general background to the PE concept and to analyze relevant theories and principles. This provides a general understanding of the PE concept on which the study is based. Additionally, the analysis of principles has highlighted what is most relevant to the PE concept. This can to some extent be used when interpreting the PE concept, but its main use is to serve as a tool for evaluating the PE concept when it comes to related person PEs. This section starts with a brief summary of the most important findings in the chapter. After this summary a few general remarks are made.

The PE concept is part of the tax treaty context, and as such it is a tool to fulfill the main objective of the treaty, which is to promote cross-border exchange and movement by eliminating double taxation. It was concluded that the function of the PE concept is to divide taxation rights between the treaty-concluding states. In addition to the main objective and function, two secondary objectives were identified. These objectives are to allocate taxing rights in an equitable and correct way, and to address neutrality considerations. Furthermore, it was argued that the PE concept should be simple and practical.

In order to better define the secondary objectives of the PE concept, an analysis of how to divide taxation rights in principle was conducted. Initially, it was concluded that the PE concept is a legal definition of source, which implies that activities of a certain magnitude are performed in the state of establishment in order for the income to have its source there. After this, it was concluded that the PE concept is not aligned with any specific theory on neutrality. Instead, recourse to the basic neutrality notion should be made when applying neutrality to the PE concept. It was also concluded that the state of establishment has the primary right to taxation of active business income but that the state of residence has a residual right to tax said income. This was based on equity arguments.

Finally, it was concluded that the concept of substance-over-form is connected both to the OECD MTC and the PE concept. Substance-over-form has relevance when preventing abuse and also in regular rules such as the attribution of profits under Article 7. Furthermore, the connection between substance-over-form and the PE concept is rather strong, which means that substance-over-form has a sufficient connection to the PE concept to be used while interpreting the latter.

A general remark is that the PE concept seems to be more of a practical compromise than a solution in principle. This relates both to the function and objective of the PE concept as well as to the discussion on how to divide taxation rights. Thus, principles, concepts and theories should be looked for within the PE concept and not outside. This means that it is not possible to apply a general theory on how to divide taxation rights to the PE concept. Principles within the concept are more related to the function and coherence of the PE on an internal level and may not translate well to a wider discussion on allocation of taxing rights in principle. One could even argue that the historical focus in literature on these principles, mainly capital-export neutrality and capital-import neutrality, has created a barrier, in the way of a faulty preunderstanding, to proper discussion and understanding of the allocation of taxing rights in general and in relation to the PE concept in particular.

Based on the above, it is suitable to use the conclusions on how to divide taxing rights in this chapter as a basis for evaluating the PE concept in the following chapters. This means that the notion of source, the basic neutrality notion and equity, all with the meanings advocated in this chapter, are used in the following in order to evaluate the PE concept in general and the related person PE in particular.

Another remark is that substance-over-form definitely has a role to play when it comes to the related person PE. However, even though substance-over-form may solve the perceived issue of profit shifting between related persons, it has added new complexities. By that I mean that courts and tax agencies typically do not articulate if they are applying substance-over-form in general, substance-over-form as part of a specific PE condition, substance-over-form to prevent abuse, or applying a domestic provision or concept that is similar to substance-over-form, or if they are simply interpreting the PE concept. In addi-

tion to this, a substance-over-form assessment, especially one that is not even articulated or discussed, is uncertain and difficult on its own.

Based on the above, it is necessary to balance substance-over-form with aspects of legal certainty and foreseeability. Because of this, the current PE concept and any proposed amendments must be evaluated with legal certainty and foreseeability in mind. The necessity for this can be derived from the objective of the OECD MTC as it seems clear that uncertainty of tax consequences is something that may hinder international trade and give rise to double taxation.

3 Related Person PE in General and the Related Company Clause

3.1 Introduction

As a starting point, the mere fact that a company owns, or is owned by, another company does not mean that either of the companies constitutes a PE of the other. This is expressed in Article 5(7) of the OECD MTC which reads as follows:

> 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.

Thus, Article 5(7) provides some level of protection for when related companies can be treated as PEs. The UN MTC contains an identical provision in Article 5(8).[212] The underlying reasoning behind these provisions is that an independent legal entity is a separate taxable subject.[213] One can note that there are no material changes to Article 5(7), nor to the corresponding commentary, proposed by the OECD in the 2017 draft update to the MTC.[214]

In principle, one can imagine three different ways to deal with related persons. The first one is that related persons never constitute PEs. This is labeled the *separate-entity approach* in this study. The second, and opposite, approach is that related persons always constitute

[212] Not only is the treaty text identical in the OECD and UN MTCs, the commentary to the UN MTC also refers back to the OECD commentary by citing paras. 40-42.

[213] Para. 40 of the commentary to Article 5 of the OECD MTC and para. 34 of the commentary to Article 5 of the UN MTC.

[214] The proposed changes are limited to changing the references to other paragraphs in the commentary due to the new numbering. The only other change is that an enumeration of the conditions in the agency clause is replaced with "the conditions of that paragraph are met". Para. 115-118 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

PEs, and it is labeled the *single-entity approach*. The final option is that related persons sometimes constitute PEs and, thus, sometimes not. Whether or not a related person constitutes a PE depends on the circumstances in the specific situation. Consequently, this option is called the *circumstantial approach*.

The principle expressed in Article 5(7) is labeled the *anti-single-entity*[215] clause by Vogel, a name derived from the German term *Antiorganschaftsklausel*.[216] This term describes the function of the provision and it is sometimes used in other literature. From a linguistic point of view, the term might seem a bit complicated compared to the term *separate-entity*.[217] However, the function of Article 5(7) is not to establish a separate-entity approach but rather to limit the use of a single-entity approach. Nevertheless, the term "anti-single-entity" only describes Article 5(7) in a narrow sense. Because of this, the term *related company clause* is used in the present work to describe Article 5(7) in the OECD MTC and Article 5(8) in the UN MTC. The term "related company clause" functions as a general description of the provision and does not imply a specific interpretation. One could perhaps wonder, given the terminology in the study, why "related person clause" is not used instead. The reason for this is that Article 5(7) of the OECD MTC explicitly uses "company" and not "person". As "company" is a term defined in the model it does not seem prudent to substitute it for "person".

This chapter deals with the related person PE in general and the related company clause and the study's first research question in particular.[218] First, the historical background is described (section 3.2). Second, the notion of the related person PE is discussed (section 3.3). Third, the policy considerations on which the principle is based are examined and evaluated (section 3.4). Fourth, the interpretation and implication of paragraphs 7 (OECD MTC) and 8 (UN MTC) are discussed (section 3.5). Finally, conclusions based on the findings in previous sections are presented (section 3.6).

[215] See further discussion in section 3.4.2.
[216] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 189.
[217] Cf. Article 7(2) of the OECD MTC where the phrase "separate and independent enterprise" is used in reference to the PE.
[218] Regarding the first research question, see section 1.4.2.1.

3.2 Historical Background[219]

3.2.1 The League of Nations, 1923 - 1946

The first model tax convention published by the League of Nations in 1927, did not contain an equivalent of the present Article 5(7). By contrast, "affiliated companies" were expressly mentioned as establishments that constituted a PE.[220] This solution did not have its origin in previous tax treaty practice, where similar inclusions of affiliated companies were unusual.[221] The 1927 report was based on the two preceding reports adopted in 1923[222] and 1925,[223] and because of the "general approval" of these reports, the changes made are related to "points of detail only", not general principles.[224] In both the 1923 and 1925 reports, taxation in the country where the income had its source was favored.[225] In Article 5 of the 1927 draft treaty, it is stated that business income should be taxable in a state where the persons controlling the undertaking have a PE. This wording is in line with source state taxation because it allows taxation of a parent company's income

[219] In this study, the historical background is limited to the development of the related company clause. Other aspects of the PE's history are on occasion discussed if needed to understand a specific interpretation or the reasoning behind a certain PE provision. For a more general historical background to the PE concept see, for example, Skaar, A, *Permanent Establishment*, p. 65-101; Kobetsky, M, *International Taxation of Permanent Establishments*, p. 106-151 and Macdonald, R, "'Songs of Innocence and Experience': Changes to the Scope and Interpretation of the Permanent Establishment Article in U.S. Income Tax Treaties, 1950-2010", *Tax Lawyer*, no. 2 09/10, p. 285-414. Also see Avery Jones, J, and Ward, D, "Agents as Permanent Establishments under the OECD Model Tax Convention", *British Tax Review*, no. 5 1993, p. 341-383, regarding the agency clause.

[220] League of Nations, *Double Taxation and Tax Evasion*, Committee of Technical Experts, Article 5, (1927).

[221] Skaar, A, *Permanent Establishment*, p. 83.

[222] League of Nations, *Report on Double Taxation*, (1923).

[223] League of Nations, *Double Taxation and Tax Evasion*, (1925).

[224] League of Nations, *Double Taxation and Tax Evasion*, Committee of Technical Experts, p. 8, (1927).

[225] League of Nations, *Report on Double Taxation*, p. 39, (1923) and League of Nations, *Double Taxation and Tax Evasion*, p. 15, (1925).

on transactions with a foreign subsidiary.[226] Thus, the inclusion of "affiliated companies" in the positive list[227] is logical considering the conclusions in the 1923 and the 1925 reports. However, this solution did not last long. In the following year this was changed, and affiliated companies were removed from the list of establishments that constituted PEs.[228] The 1928 draft treaty does not contain any explanation for this change, nor does it mention affiliated companies. This makes it difficult to determine exactly what the removal of affiliated companies was set to achieve. Thus, the 1928 draft created uncertainty about how affiliated companies should be treated, e.g. whether a parent company should be treated as its subsidiary's real center of management or the subsidiary as an agent of the parent, both were still included in the positive list.[229] Neither of these two draft conventions (1927 and 1928) contained a general PE definition; instead, a positive list of establishments constituting PEs was included. Because of this, a provision corresponding to the present Article 5(7) was not needed.

In 1933, a new draft convention, concerning allocation of business income, was presented.[230] The draft convention still relied on a positive list to determine whether a PE existed and, consequently, did not provide a general PE definition. However, the draft included a clarification on whether related companies could constitute PEs. In paragraph 2(c) of the draft convention's protocol, the positive list ends with "but does not include a subsidiary company", which expressly excludes related companies from the PE definition. The treatment of

[226] The 1927 draft convention did not have a transfer pricing rule, and the solution to include subsidiaries as PEs enabled source taxation of the parent company's income.

[227] This term is used by Skaar, A, *Permanent Establishment*, p. 113 with references, to describe the list of examples in paragraph 2, Article 5. It should be noted, however, that the list contained in the 1927 draft convention fulfills a different purpose than the present Article 5(2).

[228] League of Nations, *Double Taxation and Tax Evasion*, General Meeting of Government Experts on Double Taxation and Tax Evasion, Article 5 of Draft Convention 1a, Article 2B of Draft Convention 1b and Article 3 of Draft Convention 1c, (1928).

[229] This uncertainty can be illustrated by the fact that in Germany, a subsidiary automatically constituted a PE of its parent until 1934. Eckl, P, *Cahiers de droit fiscal international*, vol. 94a, German branch report, p. 334.

[230] League of Nations, *Report to the Council on the Work of the Fourth Session of the Committee*, (1933).

related companies in the draft is clear, a subsidiary can never be a PE, and the uncertainty from the 1928 draft is eliminated. A reason for this change could be that the 1933 draft included a transfer pricing rule that, to some extent, serves a purpose similar to that of the related company PE.[231] Furthermore, the 1933 draft also shifted from source state taxation to taxation in the state of residence.[232] Both of these changes probably affected the treatment of related companies as PEs because residence-based taxation would not be achieved if subsidiaries always constituted PEs. Another interesting report, which was probably influential on the League of Nations' work,[233] was written by Mitchell B. Carroll in 1933 and concerned the methods of income allocation. Carrol interpreted the PE definition in the 1928 draft conventions as only including the "corporate entity and its own branches".[234] Thus, according to him, there was no uncertainty in the 1928 draft on how to treat related companies. Carroll proceeded to conclude that "[e]conomic fact must inevitably give way to the definite principles and provisions of law under which business is conducted."[235] Finally, he recommended that subsidiaries, in principle, should not be treated as PEs and that income shifting should be dealt with by the arm's-length principle.[236] In conclusion, the Carroll report and the 1933 draft convention established a separate-entity approach with, as it seems, an emphasis on form.

[231] See the reasoning in League of Nations, *London and Mexico Model Tax Conventions*, Commentary to Article IV of the London and Mexico Model Tax Conventions, (1946).
[232] League of Nations, *Report to the Council on the Work of the Fourth Session of the Committee*, (1933), Article 1 of the draft convention.
[233] The League of Nation's fiscal committee stated the following on Carroll's report: "The Committee highly appreciated the value of the studies submitted to it, and more particularly the remarkable scientific and practical work of coordination of Mr. Carroll. The Committee deemed the material contained in the report was by itself adequate to facilitate the conclusion of international agreements, and with that object in view it has endeavoured to formulate in a draft convention the essential provisions which such agreements might contain." League of Nations, *Report to the Council on the Work of the Fourth Session of the Committee*, (1933). Also see Vann, R, "Tax Treaties: The Secret Agent's Secrets", *British Tax Review*, no. 3 2006, p. 362-363.
[234] Carroll, M, *Taxation of Foreign and National Enterprises Volume 4*, p. 176.
[235] Carroll, M, *Taxation of Foreign and National Enterprises Volume 4*, p. 177.
[236] Carroll, M, *Taxation of Foreign and National Enterprises Volume 4*, p. 177.

After the 1933 draft convention,[237] the League of Nations' activities in the field of the PE concept in double taxation conventions slowed down. It was not until the conferences in Mexico City (1940 and 1943) and London (1946) that new draft conventions, with changes to the PE concept, were adopted. Both the London and Mexico[238] model conventions included a provision aimed at related companies.[239] These provisions are very similar to the present related company clause and can be said to be the first version of it. The provisions state that "the fact that a parent company […] has a subsidiary in the other state does not mean that the parent company has a permanent establishment in that state".[240] When looking at the treaty text it seems that the mere fact that a subsidiary exists cannot make it a PE of the parent company. It could be argued, by interpreting the treaty text, that a subsidiary could still be regarded as a fixed place of business or an agent, under the same circumstances as an unrelated company. However, this interpretation is not consistent with the commentary to the draft convention.[241] In the commentary it is stated that par-

[237] It can be noted that the PE concept in the 1933 draft convention was upheld, with no material changes, in the revised draft in 1935, League of Nations, *Report to the Council on the Work of the Fifth Session of the Committee*, (1935).
[238] It should be noted that the Mexico model did not require a PE to levy tax at source but merely an activity exceeding "activities to the other State, through isolated or occasional transactions", leaving the PE concept a bit redundant. League of Nations, *London and Mexico Model Tax Conventions*, Article IV of the Mexico Model Tax Convention, (1946).
[239] The provision is not located in the actual treaty but in the protocol. League of Nations, *London and Mexico Model Tax Conventions*, Article 5, para. 8 of the Protocols to the London and Mexico Model Tax Conventions, (1946).
[240] League of Nations, *London and Mexico Model Tax Conventions*, Article 5, para. 8 of the Protocols to the London and Mexico Model Tax Conventions, (1946).
[241] It should be noted that the commentary to the Mexico and London models was produced by the secretariat and not by the fiscal committee themselves. As it is stated in the foreword: "The present document is intended to furnish the commentary thus requested by the Fiscal Committee. It has been prepared by the Secretariat and should not be taken as a statement in all its parts of the views of the Committee." League of Nations, *London and Mexico Model Tax Conventions*, (1946), p. 6-7. Be that as it may, the commentary is still written by people connected to the process and fairly close in time. As such, the commentary is still of great value to interpret the draft conventions some 70 odd years later.

agraph 8 of Article 5 of the protocol "states that a subsidiary cannot be regarded as a permanent establishment of its parent enterprise".[242] This is explained in the commentary as having two main consequences. First, the state of establishment can only tax dividends to the parent company and not the parent company itself. Second, the state of residence is not allowed to tax the parent company on the subsidiary's profits but only distributed dividends. Thus, the principle laid down in the 1933 draft convention and the Carroll report was reaffirmed.

In summary, the League of Nations first adopted a single-entity approach with a preference to source state taxation (1923 – 1927). This was later changed to a separate-entity approach, which emphasized residence-based taxation (1933 – 1946). This shift was connected to, one may even say a necessary consequence of, the introduction of a transfer pricing rule. The 1928 report is harder to categorize further than that it is clearly not a single-entity approach. Whether it is a circumstantial approach or, more likely, a separate-entity approach cannot be determined from the League of Nations materials.

3.2.2 The OEEC and the OECD

The OECD is well known and does not need an introduction. The Organisation for European Economic Co-operation, OEEC, however, is perhaps not as well known and deserves a short description. The OEEC was founded in 1948 to facilitate the recovery of Europe and to distribute aid after World War 2. In 1961, the OEEC was replaced by the OECD, which includes members outside of Europe and thus is a worldwide organization.

In 1956, the OEEC Working Party 1 released its first report on the PE concept, which included a draft of Article 5.[243] Paragraph 6 in the draft of Article 5 dealt with related companies and stated that control, of itself, is not sufficient to constitute a PE for either of the companies. This first version is, with a few minor updates not affecting its scope, identical to the present Article 5(7). Thus, the actual treaty text shows no sign of development regarding the principle that related companies are separate legal entities for tax purposes. However,

[242] League of Nations, *London and Mexico Model Tax Conventions*, (1946), p. 17.
[243] OEEC, *Report of Working Party No. 1 on the Concept of Permanent Establishment*, (1956).

changes in the commentary are more frequent than in the actual treaty text. Therefore, the commentary must also be examined.

The commentary on the draft of Article 5 from 1956 contains a reference to the agency rule and states that if a related company acts as an agent under the agency rule, it can constitute a PE.[244] Thus, the OEEC abandoned the separate entity approach and took a few steps towards a circumstantial approach. The fixed place of business PE in Article 5(1) is not mentioned, and it seems that, at that time, a related company could only constitute a PE through the agency clause.[245] This view is upheld until 2005, when the OECD updated the commentary to explicitly state that a related company can be a PE under both the fixed place of business rule and the agency clause.[246] With this change, the OECD seems to have taken the final step to implement the circumstantial approach. It is interesting to note that the construction PE is still not mentioned in the commentary. Given the structure of the PE concept it seems clear, however, that related companies can constitute construction PEs of each other.[247]

3.2.3 The United Nations

Article 5(8) of the UN MTC has followed the wording of the corresponding provision in the OECD MTC in all versions. Even the commentary corresponds to the OECD MTC's commentary. The only difference is in the 2011 UN MTC's commentary, where it is stated

[244] OEEC, *Report of Working Party No. 1 on the Concept of Permanent Establishment*, para. 18 of the commentary to Article 5, (1956).
[245] Skaar, A, *Permanent Establishment*, p. 541-542 and Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 192.
[246] OECD, *The 2005 Update to the Model Tax Convention*, 2004, p. 7 and para. 41 of the commentary to Article 5 of the OECD MTC. It can be noted that a related person PE according to the fixed place of business rule was found prior to this in the Swedish case RÅ 1998 not. 229. It is my opinion that this is the correct interpretation of the related company clause even before the OECD update mentioned. Regarding the interpretation, see section 3.5. Cf. Skaar, A, *Permanent Establishment*, p. 541-542 and Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 192.
[247] Skaar, A, *Permanent Establishment*, p. 551. For an example of this see the Norwegian case Siemens AG m.fl. mot Finansdepartementet, Rt. 1997 p. 653.

that using a separate entity[248] baseline may allow for abusive practices.[249] The solution for this is, according to the UN, to use domestic anti-avoidance legislation based on substance-over-form to prevent purely artificial structures. Thus, it seems like the UN opens up for a general application of substance-over-form in situations that can be deemed abusive. Such an approach will naturally broaden the scope of the related person PE. However, it may be questioned to what degree the OECD and UN MTCs differ in this respect. There are possibilities to apply an anti-avoidance perspective on the OECD MTC as well.[250] Furthermore, it can be questioned whether a substance-over-form approach falls within the boundaries of the related company clause. This seems to be more connected to the actual PE assessment and not the related company clause. Thus, the conclusion is that the historical development of the related company clause in the UN MTC coincides with the OECD development.

3.2.4 Summary of the Historical Background

In summary, it can be concluded that the related company clause, or more accurately, a treaty-based protection of related companies, can be traced back to the 1933 draft convention on allocation of business income and the Carroll report.[251] The first version of the present provision is found in the London and Mexico models. However, even though the wording is similar, the London and Mexico models seem to express a separate-entity approach. It should be noted that the inclusion of a treaty-based protection of related companies coincides with a transfer pricing provision. Thus, it seems like transfer pricing is a line that separates the single-entity and separate-entity approaches.

[248] The separate entity as a baseline should here be understood in the context of multinational groups where each company needs to be assessed on its own and not the group as a whole, para. 41.1 of the commentary to Article 5 of the OECD MTC. This specific part of the commentary was drafted as a response to the Italian case *Philip Morris*. The separate entity as a baseline does not correspond to what in this study is labeled the separate-entity approach.
[249] Para. 35 of the commentary to Article 5 of the UN MTC.
[250] See section 2.4 for a discussion about substance-over-form in relation to the OECD MTC and the PE concept.
[251] League of Nations, *Report to the Council on the Work of the Fourth Session of the Committee*, (1933) and Carroll, M, *Taxation of Foreign and National Enterprises Volume 4*.

In 1956, a limited circumstantial approach was established.[252] Ever since then, few changes have been made to the relevant provisions. Indeed, the only material change occurred in 2005, when a related company could constitute a PE, not only as an agent, but also through the fixed place of business rule. Thus, it seems like the present circumstantial approach is deeply rooted in international tax treaty law.

3.3 What Is a Related Person PE?

Before discussing policy and the scope of the related company clause it is necessary to establish how a related person PE should be understood. The reason for this is that a policy discussion will naturally be influenced by the answer to this question. For example, there is a big difference between reclassifying an entire related company as a PE and treating an office, on the premises of the same company, as a PE of a foreign related company. Furthermore, it is necessary to discuss the consequences, at least in general, of a related person PE. Even though these questions, in principle, are separate, they will to some extent be discussed together. This is because, in practice, it is difficult to draw a distinct line between them.

The first question, mentioned above, is how a related person PE should be understood. Le Gall identifies two different ways to view the related person PE. These two approaches are to *recharacterize* a related person, such as a subsidiary, as a PE or to view the related person and the PE as separate, *co-existing*, entities.[253] Based on his previous analysis of both commercial and tax law, he concludes that to recharacterize a subsidiary as a PE is in line with domestic case law in both civil and common law countries.[254] This is labeled the "single taxpayer

[252] OEEC, *Report of Working Party No. 1 on the Concept of Permanent Establishment*, (1956).
[253] Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 202.
[254] Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 202. Also see Milet, M, "Permanent Establishments Through Related Corporations Under the OECD Model Treaty", *Canadian Tax Journal*, no. 2 2007, p. 302-316, who conducts a similar analysis of case law from the United Kingdom and Canada.

approach" and implies that only one taxpayer, the related person or the foreign enterprise, exists. The second approach, i.e. the related person and the PE as co-existing entities, is favored by the OECD and is labeled the "Authorized OECD Approach", AOA. According to the OECD, a dependent agent PE through a related company may give the state of establishment taxation rights over two different entities, the foreign company with a PE and the agent provided that the agent is a resident, or has a PE, in the state of establishment.[255] Thus, with this view, a related person PE gives rise to both a transfer pricing procedure and an attribution of profits in accordance with Article 7.[256]

The arguments for these two approaches are very much connected to the question of how to attribute profits to a PE. Under the single taxpayer approach, the attribution of profits seems to be based on the activities performed by the agent. Furthermore, as only one taxpayer exists, the PE's assets and risks coincide with the related person's assets and risks.[257] This may lead to the conclusion that transfer pricing is sufficient to establish a proper PE taxation in the related person situation.

[255] OECD, *The Attribution of Profits to Permanent Establishments*, 2010 version, Part 1 para. 230. The same view is taken in the updated commentary to the "old" Article 7. Para. 26 of the 2008 commentary to Article 7 of the OECD MTC. Even though the OECD only discusses this in the context of an agent, the same reasoning can be applied to the entire PE concept. For similar opinions see Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 192 and 193; Schaffner, J, *How Fixed Is a Permanent Establishment?*, p. 247; Arnold, B, "Threshold Requirements for Taxing Business Profits under Tax Treaties", *Bulletin For International Fiscal Documentation*, no. 10 2003, p. 480 and Tittle, M, *Permanent Establishment in the United States*, p. 202.

[256] It should be noted that the AOA have been quite criticized in literature. See for instance Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 204; Kobetsky, M, *International Taxation of Permanent Establishments*, p. 391 and Baker, P and Collier, R, *The attribution of profits to permanent establishments*, p. 32-33.

[257] Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 202.

By contrast, the AOA is focused on a fictional[258] attribution of assets and risk, which, in turn, is based on the significant people functions performed in the PE.[259] Because this approach recognizes two taxpayers, the arm's-length remuneration paid to the related person is deducted from the PE's profits. Thus, if the PE, through the related person, performs no, or very few, significant people functions, the result is likely to be that only the arm's-length remuneration is taxable in the state of establishment. Conversely, if the PE performs most of the significant people functions, most of the residual profit is taxable in the state of establishment. An example of this is provided in the BEPS report discussing attribution of profits in the context of the changes proposed under Action 7.[260] In the example, a company acts as a sales agent on behalf of a foreign related company in such a way that it constitutes a PE. The PE's profit is calculated as the revenue from the sales minus the arm's-length price of inventory economically owned by the PE,[261] other costs and the arm's-length remuneration to the agent. In essence, this means that the PE's taxable result is calculated to achieve the same taxation as if an unrelated domestic company bought the goods and used an agent to sell it, i.e. both the company and the agent are taxed on their respective incomes.

The attribution of profits, however, is only one aspect, or more precisely, the consequence of the PE concept. Hence, it is necessary to turn from the context of attribution of profits towards the PE definition. Does the PE definition, on its own, support the approaches discussed above? If so, could, and should, the PE definition influences how the related person PE is perceived?

Starting with the single taxpayer approach, as noted above, it has been argued that a single taxpayer is more in line with civil and tax

[258] "Fictional" should be understood in a purely legal context. From an economic point of view it could, depending on the actual circumstances, be said that the real "owner" of an asset is the related person PE.

[259] OECD, *The Attribution of Profits to Permanent Establishments*, 2010 version, Part 1 para. 232.

[260] OECD, *Discussion Draft on Additional Guidance on the Attribution of Profits to Permanent Establishments*, para. 23-27.

[261] This is based on the analysis of significant people functions and assumption of risk.

case law.[262] However, it must be noted that this analysis is to a large extent based on abuse of legal personality by total dependence.[263] It does not seem as natural to recharacterize a related person as a PE where, for instance, only part of the related person's business belongs to another company. Furthermore, the single taxpayer approach does not comply with the principle that related persons are legally independent entities when it comes to taxation.[264] It could be argued that the principle of independent legal entities supports the notion of two taxpayers in a situation with a related person PE.

The single taxpayer approach also seems to produce some unwanted situations. An example can illustrate this. We have company A, resident in state X, and its subsidiary B, who is a resident in state Y. B is a regional head office of the group and acts as an agent for A in states Y and Z. The conditions for a dependent agent PE are fulfilled in state Z. B has no premises or personnel in Z and flies in employees about 10 times a year to conclude contracts on behalf of A. It is clear that it is A, not B, that conducts business in Z and consequently has a PE. Under a single taxpayer approach, however, it could be said that B is the PE of A. This becomes unnecessarily problematic as Z then should levy taxes on B, which is a foreign company without a taxable presence in Z.[265] Clearly, transfer pricing alone is not a sufficient method to produce a correct allocation of taxation rights in this situation according to the OECD MTC.

Let us move on to the approach favored by the OECD with two distinct and separate taxpayers. Initially, it is interesting to note that it has been argued that the agency PE becomes pointless under both of the discussed approaches. First, the OECD argues that the single taxpayer approach leads to the same result as transfer pricing, which makes the agency PE redundant as there would be no difference in

[262] Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 202.
[263] Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 198.
[264] Para. 40 of the commentary to Article 5 of the OECD MTC.
[265] See Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 203, who argues that the taxpayer under the single taxpayer approach is the related person deemed a PE.

taxation between dependent and independent agents.[266] The OECD argues that it must be assumed that every word in a treaty has a meaning and, thus, an interpretation that removes the meaning from the agency clause cannot be accepted. By contrast, Vann argues that the difference between dependent and independent agents becomes blurred with the AOA interpretation.[267] His reasoning is that the attribution of profits is not related to the agent's independence but rather to the functions attributed to the agent, consequently leaving the independence test without meaning as the same result is achieved as with transfer pricing. Furthermore, he argues that the PE threshold should indicate a significant right to taxation, which is not guaranteed under the AOA.

As a starting point, the question of whether a PE exists concerns who the taxpayer is and, as such, cannot in principle be regarded as irrelevant, regardless of the outcome of the attribution of profits. Despite the strong connection between Articles 5 and 7, they still are separate in the treaties and MTCs. As the latest update of Article 7 has shown, the attribution of profits can change without any changes being made to the PE concept. This clearly shows that the interpretation of the PE concept is a separate question that is relevant on its own. With that said, the practical relevance of the existence of a PE will of course be greatly influenced by the result of the attribution of profits. As demonstrated above, whether an agent is a PE or not will still affect the outcome in situations where both the agent and principal are residents outside the state of establishment. Thus, the OECD's argument that the agency clause is redundant with a single taxpayer approach cannot be accepted. The same can be said about the argument against the AOA. The PE concept deals with the question of whether a jurisdiction has a right to tax a foreign company. The PE provisions that do not require a fairly substantial physical presence, i.e. agency, service and insurance PEs, are still vital in dividing taxation rights between states in the related person PE situation. It can definitely be said that the traditional PE provisions are under pressure from source

[266] OECD, *The Attribution of Profits to Permanent Establishments*, 2010 version, Part 1 para. 239.
[267] Vann, R, "Tax Treaties: The Secret Agent's Secrets", *British Tax Review*, no. 3 2006, p. 379.

countries, BEPS and the digital economy. It seems likely that PEs requiring less physical presence will be more common in the future.

Against this background it can be concluded that the PE concept is relevant regardless of how one deals with the related person PE. This, however, does not answer the question of how the related person PE should be understood. To begin with, one basic question needs to be answered. Is the related person PE such a uniform notion that it is warranted to always perceive it the same way? The related person PE question exists in a lot of different situations and is based on different circumstances. The two approaches discussed above can be said to be two extremes, situated on opposite sides of the related person PE spectrum.

The problem is that most situations are not as clear and easy to categorize. For instance, a foreign company keeps an office at a subsidiary that manufactures and sells goods. At that office the group executive board holds meetings every two weeks, thus constituting a place of management for the foreign group parent.[268] In this situation, it would be quite strange to recharacterize the entire subsidiary as a PE as the business activity of managing the foreign company is not connected to the subsidiary's "own" business. This situation is basically the same as if the foreign company had rented the office space from an unrelated company. Clearly, the AOA fits better in this situation.

If we add some facts to the situation above, the conclusion may be different. In this example the subsidiary is totally dependent on its foreign parent. The parent does all decision making and the subsidiary's employees are instructed and controlled by the parent. In this situation it could be argued that the subsidiary, in reality, does not have a business of its own but rather just conducts the business of the foreign parent.[269] Provided that this reasoning is correct, the single taxpayer approach seems, at a first glance, like an appropriate solution as the subsidiary is completely dependent and controlled by its foreign parent. However, the AOA could still be applied to this situation

[268] This example is influenced by a case from the Swedish Supreme Administrative Court, RÅ 1998 not. 229, where a similar situation was considered to be a PE.

[269] A similar reasoning resulted in a Swedish company's premises and employees being treated as at the disposal of and employed by, respectively, the foreign parent. Kammarrätten i Stockholm, mål nr 7453-02, May 31 2005.

without causing any particular tension. First, the subsidiary would get remunerated at arm's-length for the services provided: mainly personnel, premises and equipment. Second, an attribution of profits to the PE would be performed, including a deduction of the remuneration paid to the agent. In this situation, the AOA seems like the practically more complicated solution, but it is still an option from a principle point of view.

According to the OECD, a related person PE should exist in the same situations as unrelated persons or branches constitute PEs.[270] Thus, a comparison of this situation without a subsidiary might provide guidance on which approach is most suitable when studying the PE definition. The comparable situation is that the foreign company rents premises, personnel and equipment from one or more unrelated companies in the state of establishment. We continue with the manufacturing establishment in the previous example. Given the establishment's business, manufacturing and selling goods, which are core business activities, it seems certain that this establishment would amount to a PE. Clearly, two or more taxpayers exist in this situation. It can hardly be argued that the remuneration received by the unrelated resident companies, which by definition is at arm's-length, is sufficient to divide the taxation rights between the involved countries. If this view were accepted, the PE concept would be pointless. Indeed, the business conducted in the PE should be taxed as well and in the hands of the foreign company. Vann exemplifies this with an agent: "[I]t is the profit of the principal on the actual activities of the agent as such which is attributable to the agency PE. This profit is additional to that made by the agent."[271] With this approach there will usually be some residual profit attributed to the PE in addition to any direct dealings. Thus, it must be concluded that even in a situation with total dependence, the co-existing taxpayer approach as manifested by the AOA is the preferred option. This means that the notion of "solving"

[270] Para. 41 of the commentary to Article 5 of the OECD MTC. Also see Skaar, who argues that "a subsidiary PE is only created when the parent company itself would have met the conditions for PE if the transactions had not been performed through a subsidiary." Skaar, A, *Permanent Establishment*, p. 554.

[271] Vann, R, "Tax Treaties: The Secret Agent's Secrets", *British Tax Review*, no. 3 2006, p. 379.

the related person PE problems with transfer pricing alone cannot be accepted.

The single taxpayer approach, however, cannot be completely disregarded. As discussed above, both commercial and tax case law support a recharacterization in certain situations.[272] This solution seems connected to a situation with abusive practices and might not be easily transferred to a non-abusive PE situation. Furthermore, it can be noted that a full recharacterization can be said to fall outside the scope of this study as the related person is completely disregarded and is not even deemed to exist.[273] There is no support for this view in the PE concept, which means that domestic concepts must be applied. Thus, from this perspective, such a situation is no different from a situation with a branch. In addition to this, given the study's starting point,[274] it is natural to give certain weight to the OECD's opinion, which in this case is the AOA. Consequently, for all these reasons, in this study the situation with a related person PE is seen as containing two or more co-existing taxpayers.

3.4 Policy Considerations

3.4.1 Introduction

The related company clause is based on the assumption that each company is an independent legal entity, according to both private law and tax law.[275] The adopted provision lacks further analysis, at least in the OECD and UN material, and is seemingly based on a formal understanding of the concept of legally independent entities. As the re-

[272] Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 202. Also see Milet, M, "Permanent Establishments Through Related Corporations Under the OECD Model Treaty", *Canadian Tax Journal*, no. 2 2007, p. 302-316.

[273] Sasseville, J, and Skaar, A, *Is there a permanent establishment?*, p. 56.

[274] See section 1.6.2.

[275] Para. 40 of the commentary to Article 5 of the OECD MTC. Also see Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 189.

lated company clause, and the PE concept in general, is based on this view, it is necessary to examine what it really implies.

In this section, policy considerations concerning the treatment of related persons are discussed. Two different aspects of this are considered. First, three possible[276] ways to deal with related persons are discussed. Second, these different approaches are analyzed and evaluated in the light of the conclusions drawn in chapter 2.

3.4.2 Three Possible, and Historical, Ways to Treat Related Persons

3.4.2.1 A Separate-Entity Approach

A separate-entity approach means that related persons should always be treated as separate entities. Thus, under this approach, a related person can never constitute a PE. As previously discussed, this view was present in the League of Nations documents between 1933 and 1946. In order for this approach to work, some kind of transfer pricing rule is needed. Otherwise, multinational groups could shift their income to low-tax jurisdiction through intra-group transactions.

The main benefit of the separate-entity approach is its simplicity. Related persons would simply be outside the scope of the PE concept and the question would be shifted to a pure transfer pricing issue. Furthermore, this approach could be implemented in the current MTCs without the need to make dramatic changes, thus making it a realistic possibility. The OECD MTC, with the 2010 update to Article 7, is already prepared for this approach with allocation rules based on transfer pricing principles. Indeed, one could argue that the attribution of profits under Article 7 was essentially an expression of the arm's-length principle even before this update.[277] Thus, one might question whether the present solution, seen as a whole, already supports the separate-entity approach and whether Article 5(7) is needed at all.[278]

[276] The three different views are identified in the historical background in section 3.2.
[277] Bierlaagh, H, "Permanent establishments, the separate enterprise fiction: is it a fact?", *Intertax*, no. 3 1992, p. 157.
[278] Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 212.

The weakness of this approach is that it could be argued that a multinational group generates profits, exceeding the intra-group dealings, which would not be taken into account with transfer pricing. Furthermore, as shown above, in situations with PE provisions requiring minor physical presence, it would not necessarily produce a desirable result.[279]

3.4.2.2 A Single-Entity Approach

A single-entity approach would lead to the opposite result compared to the separate-entity approach, i.e. related persons would be treated as a single entity. Under this approach, a related person would be seen as an integrated business or an extension of the controlling enterprise's business. This view could be argued to be more in line with the economic reality for a multinational enterprise.[280] A multinational enterprise is naturally interested in the result of the group as a whole, and from the enterprise's perspective it would be artificial to disregard that.

Like the separate-entity approach, the single-entity approach is, in theory, easy to apply, at least from a PE perspective. In essence, a related person would always be a PE and the main question would be how the income should be allocated between the involved related persons. However, in practice, this approach would require changes to the current MTCs. In order to achieve a pure single-entity approach, a multinational group's income would have to be consolidated and then attributed to the different branches and subsidiaries. This would not be possible under the current system, which is based on intra-group transactions. The present system with bilateral treaties would also complicate this as the consolidation should be worldwide in order to produce a correct result and often involves more than two countries. Thus, an effective and applicable system based on the single-entity approach would require multilateral treaties, or a highly harmonized and extensive network of bilateral treaties, and a different attribution

[279] See section 3.3.

[280] See for instance Kobetsky, M, *International Taxation of Permanent Establishments*, p. 432 and Sheppard, L, "Revenge of the Source Countries?", *Tax Notes International*, March 28 2005, p. 1132-1139. However, this may not always be true. A subsidiary can be quite independent and not be a part of an integrated business.

method, i.e. some kind of formulary apportionment.[281] Furthermore, differences in tax bases and income or cost definitions would create problems under this approach. Ideally, a harmonization of domestic tax law would have to be done as well. It seems unlikely that any of these changes can be accomplished on a worldwide scale. On a regional level, however, it could be possible.

An example of this is the EU project CCCTB.[282] The problem with this is that the consolidation would only be regional, not worldwide. Hence, the single-entity approach would be achieved within the EU, i.e. to a limited extent. In conclusion, the single-entity approach does not seem like a realistic solution outside of the regional level. Indeed, it is questionable, to put it mildly, whether it is possible to achieve this even within the EU in the foreseeable future.

Despite the practical problems connected with this approach, the single-entity approach is not in any way a dead option. In the United States, scholars have been debating whether the tax system should be based on worldwide taxation, without deferral, or territorial taxation, with exemption and deferral.[283] This debate has influenced the government to examine this option as a possible way to reform the domestic income tax.[284] A unilateral shift to the single-entity approach, however, would require a termination, or a renegotiation, of existing treaties in force. Furthermore, a well-functioning unilateral tax credit is needed in order to avoid double taxation.

[281] An attribution method based on transactions, fictional or real, would not be sufficient to establish a single-entity approach. The group as a whole never generates any profit on internal transactions; only outbound transactions can generate profit.

[282] European Commission, *Proposal for a COUNCIL DIRECTIVE on a Common Consolidated Corporate Tax Base (CCCTB)*, COM(2011) 121/4.

[283] See for instance Fleming, C, Peroni, R, Shay, S, "Perspectives on the Worldwide vs. Territorial Taxation Debate", *Tax Notes International*, January 4 2010, p. 75-105 and Fleming, C, Peroni, R, Shay, S, "Worse than Exemption", *Emory Law Journal*, no. 1 09/10, p. 79- 149.

[284] Office of Tax Policy U.S. Department of Treasury, *Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century* and The President's Economic Recovery Advisory Board, *The Report on Tax Reform Options*.

3.4.2.3 A Circumstantial Approach

The circumstantial approach is somewhere between the two approaches discussed above, i.e. instead of treating all related persons the same way, the existence of a PE will depend on the actual circumstances. The main function, or at least the historical roots, of the circumstantial approach is to prevent the use of the single-entity approach. At the same time, it is not consistent with the separate-entity approach either. As such, the circumstantial approach means that the PE concept retains its relevance in the related person situation.

The function of this approach is to decide whether a related person constitutes a PE on a case-by-case basis. This can, in general, be achieved in two different ways. The first option is to treat related persons the same way as unrelated ones. This is the former standpoint taken by the OECD.[285] This view is appealing from a neutrality perspective because related and unrelated persons are treated the same way. However, this is mostly relevant when a related person acts as an agent.

Under the fixed place of business rule, it is more difficult to see a situation with related and unrelated persons, respectively, as being comparable. In certain situations his difference may make the provision, which is developed with branches in mind,[286] difficult to apply to related persons.

The second option is to construct specific provisions, or interpretations, which define when a related person constitutes a PE. The OECD seems to move a bit towards this as there is a specific rule for

[285] Para. 41 of the commentary to Article 5 of the OECD MTC.

[286] While a basic PE definition existed in some countries' domestic law and tax treaties, it did not get introduced in the model conventions until 1956. Thus, when the fixed place of business PE was properly introduced on the international stage, related persons was excluded from its scope. See section 3.2.2. For example, the Swedish domestic PE definition from 1928 included a general definition, which required a fixed place with facilities, or otherwise adapted to the company's needs, which is used for business, Municipal Income Tax Act, 61 § and Eberstein, G, *Om skatt till stat och kommun – senare delen*, p. 796-797. Also see Skaar, A, *Permanent Establishment*, p. 72-75 and OEEC, *Report of Working Party No. 1 on the Concept of Permanent Establishment*, (1956).

related companies in the proposals in BEPS Action 7.[287] The main benefit with this approach is that the provision would be adapted to related persons and would be more distinct and possibly easier to apply. The increased applicability, however, may infringe on neutrality as related and unrelated persons would be governed by different rules in some situations. Furthermore, the PE concept might become diluted and encumbered with too many specific rules.[288] With too many different rules focusing on different businesses or situations, the PE concept runs the risk of losing its character as a tax subject rule and becoming an income allocation rule.

3.4.3 Conclusion

The examination of these different approaches, for dealing with related persons in tax treaties paints a somewhat different picture than the commentary does.[289] What is described as "generally accepted" is in reality questioned, although indirectly, by the EU, the United States and scholars. In addition to this, CFC rules and similar legislation are common and, to some extent, are contrary to this principle. Furthermore, the latest update on the attribution of profits in Article 7 can be interpreted as an indication that the OECD is not fully convinced about its own statement regarding related persons. As mentioned above, some argue that the new attribution method shifts the question away from whether a related person constitutes a PE to transfer pricing. This shift in focus is one of the things that characterize the separate-entity approach. This shows that it is not always easy to classify which category a treaty represents. In essence, all three approaches recognize that related persons must be dealt with, but they use different methods to do just that. Thus, the different approaches share the

[287] Specifically, the proposed wording of Article 5(6)a where an agent is considered dependent if it acts almost exclusively on behalf of a "closely related" enterprise. Also see the new proposed paragraph 1 in Article 5(4) where related enterprises may not use the exceptions for preparatory and auxiliary activities in certain situations. OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*.

[288] Other examples of specific rules could be service PEs and e-commerce, neither of which is included in the OECD MTC. However, also see the insurance PE in Article 5(6) and the service PE in Article 5(3a), both in the UN MTC.

[289] Para. 40 of the commentary to Article 5 of the OECD MTC.

same foundation and are more similar than it would appear after a quick glance at the different alternatives, at least when combined with other rules, e.g. Articles 7 and 9.

Given that all three approaches deal with the same issue and share the objective of correctly dividing taxation rights between states, one may argue that any of these methods would be adequate. However, the approaches have different strengths and weaknesses, which warrants a policy discussion on which approach should be considered preferable.

Starting from a practical point of view, the separate-entity and the circumstantial approaches seem to be the best options. This is because these could be implemented with relatively small changes to the existing treaties. In fact, the circumstantial approach can be said to be the approach presently in force. The single-entity approach, on the other hand, seems quite unlikely as it would require the acceptance and development of a system of formulary apportionment.

In addition to the practical aspect, these approaches should be evaluated with the conclusions of chapter 2 in mind. It can be noted that all the approaches are fairly in line with the basic neutrality notion. One could question whether the circumstantial approach fulfills this notion, but under the assumption that the PE concept is not too burdened by specific rules for related persons, it can be said to comply with it.

In a similar fashion one can question whether the other two approaches are in line with the basic neutrality notion when it comes to agents. The separate-entity approach would not include an agency PE in situations where a related person acts as an agent from a third state. This situation would amount to a PE between unrelated persons. Similarly, it seems unlikely, but possible in theory, that this would be covered by the formulary apportionment in the single-entity approach. As it was concluded that the notion of source when it comes to the PE concept should be understood as activities of a certain magnitude carried out in the state of establishment, which includes agents, it seems questionable whether the separate-entity and single-entity approaches comply with this idea. Additionally, there is a connection between the source of income and the equitable allocation of taxing rights. If the source of income is considered to be in the state of establishment, e.g. presently when a PE exists, equity considerations imply a right for the state of establishment to tax such income. Yet again, this would not

be fulfilled in a situation with a related person, situated outside the state of establishment, acting as an agent.

Finally, the three approaches are analyzed from the perspective of legal certainty. Initially, it can be concluded that the separate-entity and single-entity approaches both provide a high degree of legal certainty when it comes to the PE question. However, this is because the PE question does not have any relevance under these approaches. Thus, legal certainty will depend on the rules concerning transfer pricing and attribution of profits. By contrast, with the circumstantial approach the PE is still relevant and could potentially, as is currently the case, impede the legal certainty.

Based on all of the above, the conclusion is that the preferred option from a policy perspective is the circumstantial approach. This approach is practically possible. Additionally, it best fulfills the notion of source and equity considerations. However, one must be cautious with this approach to make sure that acceptable legal certainty is upheld. Too many specific rules targeting related persons could end up breaching the basic neutrality notion. As such, the circumstantial approach is not perfect, which can be seen in the need for this study, but it is a compromise in the spirit of the PE concept.

3.5 The Scope of the Related Company Clause

3.5.1 Introduction

This section deals with the scope of the related company clause. The scope can be divided into a personal and a substantive scope, i.e. who is covered and what does the provision mean for those covered by it. A central question in this section is whether the related company clause has any substantial scope or whether, as argued by some, it is "legally superfluous".[290] It should be noted that the related company clause is rarely mentioned in case law, and when it is, it is often just a statement of its existence. I have actually not found a single case where the court discusses the scope of the related company clause ex-

[290] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 384.

plicitly. Thus, the analysis of the related company clause's scope is, by necessity, mainly conducted with the commentary and literature, in addition to the clause itself. The scarce discussion of the related company clause might be an indication that it really is just declaratory as courts and scholars seem to deem it fairly unimportant. Nevertheless, given the topic and objectives of this study, it is necessary to analyze the scope of the related company clause in an open-minded way.

The personal and substantive scopes, with subordinate questions, are intertwined. When analyzing these questions, it was necessary to hop back and forth between the questions as the answer to one question depended on other aspects of the related company clause. However, it is not possible to present such a chaotic method in an understandable form. Because of this, the different questions are presented separately.

3.5.2 Personal Scope

The related company clause uses the term "company" to the entities covered. This is different from the rest of Article 5, where "person" and "enterprise" are used. According to Article 3(1)b, the term "company" should be understood as "any body corporate or any entity that is treated as a body corporate for tax purposes". The term "company" is not often used in the MTC but is specifically linked with the related company clause in the commentary.[291] The OECD states that the definition of company is specifically written with dividends in mind and that the term is only relevant to Articles 5(7), 10 and 16. Nevertheless, it has been argued that the provision should be given a wide scope, including "enterprises".[292] Presumably, this opinion is derived from a notion that all control should be treated the same way. According to this reasoning, an individual who owns shares in a company should receive the same protection as would a legal person that ows the shares. Consequently, if this reasoning is accepted, the term "company" should be disregarded and instead be understood as "person". The reason that the term "person" is proposed instead of "enterprise" is because it is more accurate. An "enterprise" is defined as the carry-

[291] Para. 3 of the commentary to Article 3 of the OECD MTC.
[292] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 191. Also see Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 387, who seem to share this view.

ing on of any business, according to Article 3(1)c while "person" is defined as an individual, a company or any other body of persons in Article 3(1)b. Thus, "person" is focused on the subject while "enterprise" is focused on the nature of the activity. Coming back to the example of an individual shareholder, it is not certain that ownership in a company would be considered business income. Given this, the term "person" seems better if one wants a wide personal scope of the related company clause.

In general, this view is appealing. This is mainly because it would seem inconsistent to be allowed to automatically classify an individual shareholder as a PE while maintaining a protection for legal persons in the same situation. Nevertheless, the term "company" is defined in the MTC, and that definition cannot simply be ignored. Consequently, individuals and entities not covered by the company definition fall outside the personal scope of the related company clause. This, however, does not mean that it is in accordance with the PE concept to automatically treat individuals as PEs because they own shares in a foreign company. No provision in the PE concept allows for such an approach. However, it cannot be ruled out that the existence and scope of the related company clause creates a difference between those covered by the clause and those that are not. This is connected to the substantive scope of the related company clause, which is discussed next.

3.5.3 A Substantive Scope or a Redundant Reference to the Fixed Place of Business Rule and the Agency Clause?

3.5.3.1 The Term "Control"

The discussion of the term "control" is divided into two separate questions: which circumstances can lead to control and what type of power, or actions, can be said to constitute control?

The first question that comes to mind when studying the related company clause is what the term "control" means. Control is not explicitly defined in the MTC. This means that control should be interpreted according to domestic law unless the context of the treaty re-

quires another interpretation.[293] Recourse to domestic law should only be had when an autonomous interpretation has failed.[294] Thus, the first step in interpreting control is to study it in the light of the MTC's context.

The provision indicates that the fact that a company controls or is controlled should be disregarded, at least in some situations. Turning to the commentary, the related company clause is discussed in the context of a parent and a subsidiary.[295] Furthermore, the OECD discusses multinational groups in the commentary.[296] Thus, the common denominator seems to be ownership, direct or indirect. Based on this it seems that the term "control" refers to control established through ownership. As Arnold notes, however, control is not defined by the OECD.[297] He continues to highlight the difficulty in precisely defining control through ownership; for instance, more than 50 percent of the shares, as such an on-or-off test, is wide open to abuse. It is important, however, to avoid getting stuck in a discussion about a certain required percent. Ultimately, control defined as a percentage of capital, or votes, would be interesting if the related company clause stated that controlled companies *always* constituted PEs. As this is not the case, it is not necessary to define control through degree of share ownership. Let us say that 51 percent was required to make the related company clause applicable, would anyone consider a company that is only owned by 30 percent to automatically qualify as a PE? I doubt it.

Nevertheless, such definitions exist in some tax treaties. One example is the tax treaty between India and the United Kingdom,[298] where Article 5(7) states that control is "the ability to exercise control over the company's affairs by means of direct or indirect holding of

[293] See Article 3(2) in the OECD MTC. Also see Tittle, M, *Permanent Establishment in the United States*, p. 192-194, for a discussion of the U.S. domestic meaning of control in the context of the related company clause.
[294] See section 1.6.3.3.
[295] Para. 40 and 41 of the commentary to Article 5 of the OECD MTC. Also see para. 38.1 of the commentary to Article 5 of the OECD MTC, which deals with independent agents.
[296] Para. 41.1 and 42 of the commentary to Article 5 of the OECD MTC.
[297] Arnold, B, "Threshold Requirements for Taxing Business Profits under Tax Treaties", *Bulletin For International Fiscal Documentation*, no. 10 2003, p. 489.
[298] Double Taxation Convention between India and the United Kingdom, October 25 1993.

the greater part of the issued share capital or voting power in the company." The rest of Article 5, even though it deviates significantly from the OECD model, however, does not support a view that a PE can exist solely through ownership. This means that the added limitation to the related company clause does not have any influence on which establishments constitute PEs. Thus, it can be concluded that defining control through percent of shares is not advisable, nor is it necessary. Interestingly, the OECD has proposed a definition of a "closely related enterprise" under Action 7 of the BEPS project. In the proposed new Article 5(6)b, the question of whether enterprises are closely related should be determined "based on all relevant facts and circumstances".[299] However, direct or indirect ownership of shares, votes or beneficial interest exceeding 50 percent shall be considered to be closely related. This indicates that the OECD considers ownership above 50 percent to imply dependence, i.e. control, in certain situations.

It has been suggested that the related company clause should be "interpreted broadly".[300] With a broad interpretation, the present, vague, notion of control can be retained. A broad interpretation could include other types of control that are not strictly based on ownership, thus allowing for a more general assessment of all relevant circumstances in a specific case. Reimer defines control as the power to "substantially influence […] all major operational business decisions of the other company."[301] This definition is not limited to ownership situations; rather, he argues, control should be understood as any "obligation to obey under private law".[302] While it is true that the wording of the related company clause only mentions control, not how the control is established, the historical development clearly indicates that

[299] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 16-17.

[300] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 191.

[301] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 388.

[302] It should be noted that Reimer advocates the idea that the related company clause has no substantive scope. Whether a wide or narrow interpretation is applied will not matter that much when the overarching idea is that the provision has no substance. Also see Skaar, A, et al, *Norsk skatteavtalerett*, p. 188.

it is control through ownership that is intended. The same view seems to be expressed by the OECD as all of the paragraphs in the commentary concerning the related company clause revolve around companies that are related through ownership.[303] Based on the above, it seems clear that the term "control" must be understood as something derived from some sort of ownership. In this context, ownership should encompass direct, indirect and common ownership.[304] Furthermore, ownership should be interpreted to include similar situations. The reason for this can be illustrated with an example. For instance, it can be difficult to draw a clear line between debt and equity as both can be used to finance a company. It would not make sense to automatically exclude creditors as, depending on circumstances, a big creditor can definitely influence business decisions of the debtor. This means that control established through a loan should be considered within the boundaries of the related company clause. Another example is control through an agreement between shareholders. Granted, in this example it is a combination between ownership and the agreement that grants control. Nevertheless, a minority shareholder might not be seen as having control through ownership alone, but with the addition of an agreement, that could change. Thus, control should be understood as something derived from ownership. Ownership should be interpreted broadly to include facts that are similar to, or intertwined, with ownership.

The second question concerns the actual controlling power or activity. A suitable point of departure is the general power of a shareholder. As control is mainly based on ownership, it seems plausible that, at least, the formal power that comes with shares is included in the notion of control. The main formal influence that a shareholder has is the power to appoint the board of directors. Of course, this will to some extent ensure that the owner's view on how the business should be run is achieved. This type of control must be considered to be covered by the related company clause. This is the most basic power of the shareholder, and if this could constitute a PE, the related company clause would be without purpose. A shareholder must be al-

[303] Para. 40-42 of the commentary to Article 5 of the OECD MTC.
[304] Para. 41.1 of the commentary to Article 5 of the OECD MTC. Also see Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 194.

lowed some degree of control without being considered to conduct the business himself. Thus, the formal power connected with ownership falls within control under the related company clause. The difficult question is to determine how much control should be allowed, beyond the formal control, before a PE is found.

In reality, a sole shareholder, the situation most relevant for this study, has a lot more power than just the formal kind. The United States' Supreme Court described this as "[u]ndoubtedly the great majority of corporations owned by sole stockholders are 'dummies' in the sense that their policies and day-to-day activities are determined not as decisions of the corporation but by their owners acting individually."[305] It is not unlikely that the board of directors would consult the shareholder about certain decisions. Furthermore, executives of the parent company may hold important positions, e.g. as a CEO or a member of the board, in the subsidiary. In such situations it can be difficult to distinguish whose business and interests are really represented.

Given the objective of the related company clause, that ownership should not automatically qualify a related company as a PE, it can be argued that the "normal" control exercised by an owner should be within the scope of the term "control". The question then is what constitutes normal control? Naturally, as has been concluded above, the formal control that a shareholder has is covered by the related company clause and, consequently, must be considered to be normal control. As related companies should constitute PEs under the same circumstances as unrelated companies, it is necessary to study control in the light of the entire PE concept. Both the fixed place of business rule and the agency clause include aspects of control. Control there seems to focus on detailed instructions regarding the day-to-day business activities.[306] In the context of the agency clause, the OECD describes an independent agent as responsible for the result but able to decide for himself how the result should be achieved.[307] Applied to

[305] National Carbide Corp. v. Commissioner of Internal Revenue, 336 U.S. 422.

[306] Para. 10 and 38 of the commentary to Article 5 of the OECD MTC.

[307] Para. 38.3 of the commentary to Article 5 of the OECD MTC. There are of course limits to this view. A principal will always have some control and influence because of quality requirements and other contractual obligations

control in the related company clause, this means that general policy decisions made by the controlling company should be regarded as normal control. Detailed instructions of the day-to-day business, however, *may* be outside the scope of the term "control". The reason that it only *may* be outside what can be considered to be normal control is that different types of industries may have varying practices based on sound business reasons. It would not be reasonable to disregard this.[308]

In summary, the term "control" should be understood as influence derived from ownership or circumstances similar to ownership. Control should be interpreted as meaning normal control. What is to be considered normal must be assessed on a case-by-case basis with the demands of the particular line of business taken into account. This means that it is not possible to exactly define control. The formal power of a shareholder and general policy decisions, however, must be considered to be normal control. Detailed instructions, on the other hand, may indicate control outside of what can be considered normal. Based on these conclusions, the term "control" will henceforth refer to the normal control that is derived from ownership.

3.5.3.2 "Of itself"

In the previous section the term "control" was discussed. In this section, the impact of control is analyzed. The related company clause establishes that *normal* control *of itself* should not result in either the controlling or controlled company being deemed a PE of the other. The phrase "of itself" indicates that if the only argument for a PE is the power to control another company, then that should not be enough. But what happens if a company has control over a related company and there are also other circumstances at hand that can be used as arguments for the existence of a PE? Does "of itself" mean that control, in the context of the related company clause, is completely removed from the PE assessment, or can control be combined with other circumstances to reach the PE threshold? In this context it is interesting

of the agent. This is similar to the normal control in the related company clause.

[308] For a similar conclusion regarding the ordinary course of business test see Skaar, A, *Permanent Establishment*, p. 516-519.

to note that the 2016 United States MTC uses the phrase "shall not be taken into account" instead of "of itself".

A literal interpretation, based on the common understanding of the words, clearly indicates that control could still be included in the PE assessment, provided that there are additional circumstances involved. But what if a PE is found based 95 percent on control and 5 percent on additional circumstances? Does that fulfill "of itself"? It has been suggested that the important aspect of the related company clause is its "object and purpose".[309] If one agrees with this, then it might seem questionable to base a PE on control to such a large extent. However, it is a hopeless endeavor to quantify where the line should be drawn. Consequently, a textual interpretation only takes us so far as to conclude that control can still have a role to play. Exactly what that role is must be examined further.

The OECD does not state anything explicitly regarding this question. However, the structure and internal coherence between the related company clause and the rest of Article 5 can be of use in interpreting "of itself". As established above, there is a notion of neutrality between related and unrelated companies. This neutrality is manifested in the commentary, where it is stated that related companies can be regarded as PEs under the fixed place of business rule or the agency clause.[310] Thus, it is necessary to briefly study the requirements of these provisions, i.e. do the fixed place of business rule and agency clause include elements of control that, to some extent, coincide with the related company clause? It should be noted that the fixed place of business rule and agency clause are studied in later chapters, and this chapter is not to precede the later analysis, consequently, elements of control will only be identified in this section.[311] If neutrality is to be upheld, "of itself" cannot be interpreted as removing situations of control that are covered by other parts of Article 5.[312]

[309] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 389.

[310] Para. 41 of the commentary to Article 5 of the OECD MTC.

[311] See chapters 4 and 5.

[312] See Skaar, A, *Permanent Establishment*, p. 541-542. Skaar concludes that this is true for the agency clause but not the fixed place of business rule. However, the commentary has since been changed to explicitly include paragraph 1. Skaar's *de lege ferenda* reasoning can thus be said to describe the current opinion of the OECD. Also see Schaffner, J, *How Fixed Is a Permanent Establish-*

Both the fixed place of business rule and the agency clause include aspects of control. If we start with the fixed place of business rule, the most obvious aspect of control is that the fixed place of business must be at the *disposal* of the enterprise. For an enterprise to have something at its disposal can be said to include some control. At the very least, complete lack of control probably leads to the disposal test not being fulfilled. This means that in some situations a company, for example, can have a fixed place of business at the premises of a related company. It seems plausible that the right of disposal can be linked to control as understood in the related company clause. Another aspect of control that is included in the fixed place of business rule is who is actually conducting the business. According to the OECD, a company conducts its business mainly through "employees and other persons receiving instructions from the enterprise".[313] This is a more elusive notion of control, but it could nevertheless be linked to control through the related company clause. One might even claim that such control must be because of ownership, in a wide sense, as it is unlikely that two completely unrelated companies would end up in this situation. Thus, this is similar to the core situations covered by the related company clause as the business and employees of one company are attributed, because they are conducting the other company's business, to another related company, i.e. in reality disregarding the separate legal entities.

Turning to the agency clause, only dependent agents can constitute PEs. An agent needs to be independent both legally and economically in order not to be seen as dependent.[314] In the commentary it is stated

ment?, p. 248. Furthermore, it must be mentioned that neutrality is a rather blunt instrument to apply to the related persons PE situation. It stands to reason that the business relations between related persons can, and will, differ from those between completely unrelated parties. This means that the neutrality notion advocated by the OECD can be described as applying the same rules to, at least sometimes, substantially different situations. Whether this should be called neutrality, or even achieve it, can definitely be questioned as it could be argued that equal treatment requires, at the very least, similar situations. If the circumstances, in general, differ substantially between related persons and from those between unrelated persons, separate practices will by necessity be developed.

[313] Para. 10 of the commentary to Article 5 of the OECD MTC.

[314] Para. 37 of the commentary to Article 5 of the OECD MTC.

that a sign of dependence is being "subject to detailed instructions".[315] The right to instruct is of course connected to control. It should be noted, though, that control exercised in the "capacity as shareholder is not relevant in a consideration of the dependency".[316] This is a reference to the related company clause, but the phrasing "not relevant" seems to suggest that control covered by the clause should not affect the dependency test *at all*. This is not consistent with previous findings in this section, e.g. the textual interpretation of "of itself" and the notion of neutrality. In the French case *Interhome*[317], the Supreme Administrative Court found that a subsidiary, whose activities were exclusively performed on a mandate from the parent, while at the same time not receiving adequate remuneration, could not be considered independent. It was enough to only work for, and on the mandate of, the parent to be considered legally dependent. Having a company acting exclusively on behalf of another related company is, of course, very common. The reason for this exclusivity is the common interest, established through ownership that exists within a group. It seems convincing that this situation can be linked to control within the related company clause context. Indeed, in many of these situations it is plausible that the "agent" company is established with the objective of acting exclusively for another group company.

The conclusion from the above is that "of itself" should be interpreted as not excluding any aspects of control from the PE assessment.[318] The reason for this is that it is supported by a textual interpretation of the provision. Furthermore, both the fixed place of business rule and the agency clause includes aspects of control which means that "of itself" cannot be interpreted as restricting the regular PE conditions as the neutrality notion would then not be retained.

[315] Para. 38.3 of the commentary to Article 5 of the OECD MTC. Also see para. 38 of the commentary to Article 5 of the OECD MTC.
[316] Para. 38.1 of the commentary to Article 5 of the OECD MTC.
[317] Conseil d´Etat, RJF 10/03, No. 1147, June 20 2003 from 5 *ITLR*, p. 1023 (unofficial translation to English).
[318] A similar view is expressed in the Indian case EPCOS AG v. Assistant Commissioner of Income Tax, ITA Pune No. 398 2007. In this case the court stated, in paragraph 38, that "[i]n principle, there cannot be any bar on a subsidiary being a PE of the parent company."

3.5.3.3 Related Company as a "Place of Management"

Regarding both "control" and "of itself", it has been argued above that they should not exclude any circumstances relevant to the PE assessment. In general, the OECD expresses the same view in the commentary. However, in the commentary it is stated that a parent company, that manages a subsidiary's business, does not constitute the parent a fixed place of business PE for the subsidiary.[319] Place of management is mentioned in the list of examples in Article 5(2)a as an establishment that typically constitutes a place of business. Furthermore, a place of management is a special kind of establishment in the list as it includes a core business activity and not only a place of business, which means that a place of management is an example of a PE.[320] There seems to be an inconsistency between paragraph 2a and the commentary statement referred to above. Both the commentary statement and paragraph 2a are quite clear. As such, the question is whether or not a parent company, acting as a place of management, can constitute a fixed place of business PE of its subsidiary.

As far as I have found, this has not been discussed in any detailed manner in literature. The commentary statement is usually just mentioned as an established truth without any reasoning as to why it is this way.[321] Skaar seems to be of the opinion that the view expressed in the commentary has a material meaning and in fact limits the scope of the fixed place of business rule.[322] It must be noted, however, that the commentary is not only inconsistent with paragraph 2a but also with itself. As has been concluded in the previous sections, the related company clause establishes that the same rules that apply to branches and unrelated companies should apply to related companies as well. Given this conclusion, it would be strange to completely remove par-

[319] Para. 40 of the commentary to Article 5 of the OECD MTC.
[320] Skaar, A, *Permanent Establishment*, p. 115-117.
[321] See for instance Vogel, K, *Klaus Vogel on Double Taxation Conventions*, Article 5, marg. no. 190; Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 389 and Tittle, M, *Permanent Establishment in the United States*, p. 195-196. Also see Huston, J and Williams, L, *Permanent Establishments*, p. 144, who seem to express the same view but discuss the reasons behind the statement and also point out differences between the OECD MTC and United States' domestic law.
[322] Skaar, A, *Permanent Establishment*, p. 543-544.

ent companies as related person PEs when they function as places of management for subsidiaries. An interpretation more in line with previous conclusions and the structure and context of the related company clause is that "management" in the commentary should be understood as within the normal control. With this interpretation, detailed management of the day-to-day business by a parent company may result in a PE. Thus, related companies as places of management should be assessed the same way as any other related person PE situation.[323]

3.5.4 Conclusion

In this section, the questions of the related company clause's personal and substantial scope have been examined. The result of this section is the answer to the second subordinate question of the first research question, i.e. regarding the scope of the related company clause.

The conclusions reached are as follows. Regarding the personal scope, it is argued that a term defined in the MTC should be respected. This means that the personal scope is limited to companies and, consequently, that, for example, individual shareholders are outside the related company clause's scope. The implications of this are discussed below.

The second question that was studied concerned the substantive scope of the related company clause. It was argued that control should be understood as derived from ownership or circumstances similar to ownership. Control refers to *normal* control, which will vary depending on the industry. However, the formal powers granted by ownership and general policy decisions should be considered to be normal control. Furthermore, it was argued that the phrase "of itself" should be understood as not limiting the PE assessment. From a practical point of view, "normal control" will rarely be relevant when deciding whether a PE exists.

Based on the results reiterated above I will now try to formulate a general statement regarding the scope of the related company clause. The study shows that the related company clause does not have a substantial scope as it does not put any limits on the other PE provisions.

[323] For a similar conclusion see Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 513.

Considering this result, the fact that the personal scope is limited to "companies" does not have any practical relevance.

Based on these conclusions, one could ask oneself what the point of the related company clause is. As it adds nothing to the PE concept, from a strict legal standpoint, one could argue that it could just as well be removed. However, I believe it is not that easy. Even though the related company clause has no substantive scope, it sends a signal, clarifies, if you will, that related companies should be seen as separate legal entities as a starting point. It does not seem unlikely that the existence of the related company clause is part of the reason for the traditional view that related companies can only constitute PEs through the agency clause. Given the current, quite rapid, development in this area, the related company clause may have an important function in reminding us that relatedness does not equal PE.

3.6 Conclusion

The objective of this chapter was to study and provide an answer to this study's first research question, which is to define the scope of the related company clause. This was done by studying the historical development of the related company clause as well as studying the present version of it. The short answer to the first research question is that the related company clause has no substantive scope. This basically means that the related company clause does not put any limitations on when a related company can constitute a PE.

Was this chapter an exercise in futility, then, as it mostly confirmed what was already considered the conventional wisdom? Again, the short answer is no and the reason for this is the slightly longer answer to both of the questions previously mentioned.

First of all, the history, policy and general understanding of what a related person PE is provides a necessary background that is helpful while studying the specific rules in the following chapters.

Starting with the history, it can be concluded that the scope for the related person PE has been quite narrow for a long time. However, as with other aspects of the PE concept, the strict approach, i.e. a high threshold, to related person PEs has, over time, been loosened to allow for more neutral treatment of branches and subsidiaries. This is

not a sudden shift in policy but rather a slow and gradual transition over time. Considering this, it is no surprise that the OECD, with the BEPS project, suggests a further widening of the related person PE scope. It is also no surprise that countries have gradually applied the PE concept in a similar, broader, way when it comes to related persons. The circumstantial approach is still strong. The conclusion that it is a gradual rather than a sudden shift is important as this acts as a balance to the idea that the stricter approach is still in force when it is already abandoned in a rather non-dramatic way.

Second, the historic development shows three different ways to deal with related persons. The present policy is the circumstantial approach. This is reinforced by the suggestions under Action 7 in the BEPS project, which make it clear that related person PEs are here to stay for the foreseeable future. This means that the single-entity and separate-entity approaches are of less interest and have little impact on the following chapters.

Finally, the general conclusion of this chapter is that the aspects discussed here do not imply any direct limitations on the related person PE.

4 Article 5(1) – The Fixed Place of Business PE and Related Persons

4.1 Introduction

This chapter deals with the fixed place of business PE and the study's second research question. Article 5(1) in the OECD MTC contains the fixed place of business rule. There, a PE is defined as "a fixed place of business through which the business of an enterprise is wholly or partly carried on." In the commentary, this definition is broken down into three conditions: (1) the existence of a place of business, (2) the place of business must be fixed and (3) the business must be carried on through the place of business.[324] However, these conditions are broken down further in both the commentary and literature. The general conditions for the fixed place of business PE thus are: (1) place of business, (2) fixed, (3) at the disposal, and (4) through. This is the classification used in this study.[325] Additionally, one could add a fifth condition relevant for the related person PE situation. This condition is whose business is being conducted at the fixed place of business.

The fixed place of business rule is often regarded as the most basic form of a PE. The PE concept emerged in the middle of the 19th century in the German Empire and required a fixed place of business from the start.[326] Around the start of the 20th century, a general definition, with similar criteria as in the modern version, had been devel-

[324] Para. 2 of the commentary to Article 5 of the OECD MTC.
[325] Other classifications of the conditions exist as well. For instance, Skaar uses a system that further divides them and places them into three different categories. These categories are objective presence, subjective presence and the functionality of presence. Skaar is influenced by the Swiss author Herbert Wetter. See Skaar, A, *Permanent Establishment*, p. 103-107 with references.
[326] Skaar, A, *Permanent Establishment*, p. 72-73.

oped in Germany.[327] This approach was not adopted by the League of Nations, and the fixed place of business PE consisted of a list of places of business in all of their models.[328] It was not until 1956, when the OEEC had taken over the development of the MTC, that a general definition was included.[329] This definition remained unchanged and was introduced in the 1963 OECD MTC.[330] From then on, the only change to the definition was to replace "in" with "through" and "the" with "an". These changes were made in the 1977 update of the model.[331] Thus, the definition of the fixed place of business PE is virtually the same in the 1963 OECD MTC as it is today, at least from a linguistic point of view.

This chapter starts with some general questions regarding the fixed place of business rule and related persons, most notably the question of whose business is being conducted (section 4.2). After this the different conditions for the fixed place of business PE are discussed, namely, place of business (section 4.3), fixed (section 4.4), at the disposal (section 4.5) and through (section 4.6). Finally, the chapter is summed up with general conclusions (section 4.7).

4.2 Related Persons and the Fixed Place of Business Rule in General

4.2.1 Introduction

There are a couple of specific questions in a PE situation involving related persons, most notably the question of whose business is being conducted. Some of them can be said to precede the regular PE assessment while others are relevant in relation to the conditions of the

[327] Skaar, A, *Permanent Establishment*, p. 74-75.
[328] 1927, 1928, 1933, 1935 and 1943/46. See section 3.2.1 for a further discussion of these models.
[329] OEEC, *Report of Working Party No. 1 on the Concept of Permanent Establishment*, (1956).
[330] The phrasing that the fixed place of business should be located "in one of the territories" was omitted in the 1963 OECD MTC. This difference did not change the material scope of the fixed place of business rule.
[331] OECD*, Model Double Taxation Convention on Income and Capital: Report of the OECD Committee on Fiscal Affairs*, (1977).

fixed place of business rule. The common denominator of these questions is that they are central, or at least important, for the related person situations but rather uncommon, or less important, in other situations. In this section, two general questions that do not relate specifically to any of the conditions in the fixed place of business rule are discussed. These questions are whose business is being conducted and whether it is possible to consider the businesses of related persons as *one* business.

Before discussing these two questions, one clarification needs to be made. When it comes to the fixed place of business rule, two different types of situations can be identified. The first situation concerns an arrangement where a person, using its own personnel and resources, is acting on behalf of another related person. In this situation, it can sometimes be questioned whose business the service provider is conducting. It is this situation that the following sections deal with.

The second situation is characterized by the presence of a person, with its own personnel and resources, in the premises of a related person. This situation is similar to renting premises from an unrelated person and does not give rise to the question of whose business is being conducted. Consequently, it is not discussed here. However, this situation is discussed under the different conditions of the fixed place of business rule.

In other words, the following discussion is centered on situations where it can be questioned whether the activities of one person should be considered to belong to another related person. This means that the following discussion deals with a specific situation and not the general situation between related persons.

4.2.2 Whose Business Is Being Conducted?

4.2.2.1 Whose Business Is Being Conducted from a Principle Point of View?

An initial question when it comes to a related person PE situation is whose business is being conducted at the place of business.[332] To illustrate this question, and why it precedes the regular PE assessment, an example can be used.

[332] See Skaar, A, *Permanent Establishment*, p. 543, who identifies this question as central in determining whether a related person PE exists under the fixed place of business rule.

A parent company has a foreign subsidiary that is highly integrated with the parent's business. The subsidiary conducts extensive business activities from its fixed place of business. If the subsidiary had been a branch, it would be beyond doubt that it would be a PE. However, as the OECD MTC, as well as tax law in general, recognizes a subsidiary as a separate entity, a subsidiary will in most situations not be a PE of its parent.

According to Skaar, the OECD MTC presumes that the business of a related person is its own.[333] This approach is not absolute but rather seeks to achieve neutrality between related and unrelated persons. The fixed place of business rule requires that the "business of an enterprise" be carried on through the place of business. Thus, in the example, the *business of the parent* must be carried on through the place of business owned by the subsidiary for a PE to exist. Of course, a person may conduct its own business as well as the business of a related person. Therefore, it is necessary to separate the activities performed by the related person according to whom they economically belong, e.g. a substance-over-form approach. The reason this question precedes the regular assessment is that, in most situations, a subsidiary, for instance, will have a fixed place of business. The only issue is to whom the activities economically belong and, possibly, whether they are preparatory or auxiliary.

How does one decide to whom the relevant activities belong? According to the OECD, an enterprise's business is conducted either by the entrepreneur himself or persons in a paid-employment relationship.[334] Furthermore, it is stated that such persons include "employees and other persons receiving instructions from the enterprise". Persons receiving instructions are exemplified with dependent agents. In literature, the dependent agent has been described as someone who conducts someone else's business,[335] is personally dependent in a comprehensive way similar to an employee[336] and represents the merging

[333] Skaar, A, *Permanent Establishment*, p. 545.
[334] Para. 10 of the commentary to Article 5 of the OECD MTC. Also see para. 10.2 of the commentary to Article 1 of the OECD MTC.
[335] Huston, J and Williams, L, *Permanent Establishments*, p. 128.
[336] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 169.

of business between agent and principal.[337] Reimer is of a different opinion and argues that both independent and dependent agents conduct their own business as well as the business of the principal.[338] However, his main objection seems to be the view that an agent exclusively conducts either his own or the principal's business. Thus, one can argue that there is a connection between the agency clause and the fixed place of business PE when it comes to determining whose business is being conducted. The same conclusion is also reached by Le Gall.[339]

In addition to the dependency assessment under the agency clause one can seek guidance from Article 15 in the OECD MTC. Article 15 deals with income from employment, and the interesting part is the discussion in the commentary regarding the distinction between "contract for service" and "contract of service". In essence, this discussion deals with the question of whether a person acts as an independent service provider or an employee, i.e. whose business the person conducts. In the context of this study, the situation of a "secondment" is a common example.[340] When employees are temporarily transferred between related persons without formally changing employer, the question of whose business those employees are conducting is relevant. In short, the commentary to Article 15 discusses who should be considered the economic employer.[341] In the commentary to Article 15 it is stated that this assessment is also relevant for the PE assessment and that it would be illogical to reach a different conclusion for

[337] Skaar, A, *Permanent Establishment*, p. 465.

[338] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 340.

[339] Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 202 and 205.

[340] A secondment can in this context be described as a temporary transfer of an employee from one part of an enterprise to another. An example could be an employee at the group parent who transfers to a foreign subsidiary to perform tasks on behalf of that company without changing who the formal employer is. Reasons for not changing the formal employer may have to do with labor law or social security, for example.

[341] Para. 8-8.15 of the commentary to Article 15 of the OECD MTC. One should note that determining the economic employer under Article 15 is not compulsory. It will depend on the domestic laws of the involved countries and whether they use substance-over-form on employment relationships.

the same situation under Articles 5 and 15.[342] A corresponding passage in the commentary to the agency clause is proposed in the BEPS project.[343] A similar reference to Article 15's commentary was suggested in the 2012 OECD report, but under the commentary to the fixed place of business PE.[344] In the proposed 2017 update to the OECD MTC, the reference to the commentary under Article 15 is included under both the fixed place of business rule and the agency clause.[345]

To determine which person is the economic employer, the OECD suggests that one assess who bears the economic risk; who has the authority to instruct the employee; who controls and is responsible for the workplace, tools and equipment; who decides work schedule and vacation; who decides how many workers there should be and what qualifications they should have and the financial arrangement between the two involved parties.[346] This list can be condensed into two different categories, namely "economic" factors and control. This is rather similar to the agency clause's economic and legal dependence, and it seems clear that the control stipulated under Article 15 is sufficient to constitute a dependent agent under the agency clause. Thus, the commentary to Article 15 provides additional support to the notion that a dependency assessment is suitable to determine whose business is being conducted.

Reimer is of a slightly different opinion. He argues that emphasis should be put on the functions and risks assigned to each company.[347] This should be done by adopting a substance-over-form approach, and guidance can be had from Articles 7 and 9 in the OECD MTC. Reimer seems to disregard instructions and control as relevant factors to consider. This conclusion can be explained by the fact that he does not make a distinction between what I call normal and PE-

[342] Para. 8.11 of the commentary to Article 15 of the OECD MTC.
[343] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 23.
[344] OECD, *OECD Model Tax Convention: Revised Proposals concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, 2012, p. 15-17.
[345] Para. 39 and 103 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[346] Para. 8.13-8.15 of the commentary to Article 15 of the OECD MTC.
[347] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 406.

constituting control.[348] This approach is somewhat supported in the *Morgan Stanley*[349] case from the Supreme Court in India. The Supreme Court stated that a functional and factual analysis should be made to determine whether the foreign company's business was conducted at the office of the local subsidiary. However, this is not elaborated and it is not clear if a PE was denied because the conditions in the fixed place of business rule were not fulfilled or because the activities were auxiliary. Thus, it is difficult to determine how this analysis should be done and if an assessment similar to Article 7 was implied.

Regarding guidance from Articles 7 and 9, it does not seem that helpful when deciding whose business is being conducted. Articles 7 and 9 do not look at how the risk is actually divided between the two parties. Instead, these provisions provide a fictional attribution of risk based on the functions performed. Thus, there is a difference between risk in Article 5 and in Articles 7 and 9. The difference lies in actual risk (Article 5) versus fictional risk (Articles 7 and 9). Thus, the assessment of risk in Articles 7 and 9 cannot replace the one made in Article 5. However, Articles 7 and 9 could complement the risk element in the dependency assessment. As Articles 7 and 9 are supposed to establish how the risk would have been divided if the involved parties were separate and unrelated, it may serve as a benchmark when determining economic dependence. In other words, if a related person assumes less risk than stipulated by Article 9, it is an indication of economic dependence.

As the discussion in the following chapter will show, the function of the dependency assessment is to determine whether the agent conducts his own business or the business of the principal.[350] This means that the conditions to decide whether an agent is dependent or not can be used as guidance in the context of the fixed place of business PE to determine whose activities are being performed. If the related person is considered a dependent agent, the conclusion may be that it conducts someone else's business. However, it must be reiterated that this is the exception, not the norm. For instance, a subsidiary per-

[348] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 386-389 and 404.
[349] Director of Income Tax v. Morgan Stanley & Co, Supreme Court No. 2914 of 2007.
[350] See section 5.4.3.1.

forming the same business activities as its parent does not automatically mean that it is conducting the parent's business. Dependency can be difficult to assess between related persons in the context of the fixed place of business PE. In a "regular" agency situation there is an agency agreement between the two parties that serves as a point of departure for the assessment. It is also clear that the agent is acting on behalf of the principal. This is not always the case in the related person PE situation. Instead of a formal agreement there may be informal connections, such as a directorate consisting of members from both companies and persons active in both companies. The existence and implications of such informal connections are often difficult to determine and prove.

Because of the difference between the agency clause and the fixed place of business PE, it is necessary to apply a higher standard of dependency.[351] This is especially true where no formal agency agreement exists. Conversely, if an agency agreement exists, it is already established that the agent acts on behalf of the principal, just as it is under the agency clause, and the requirement of dependence can be set a bit lower. This higher standard can be contrasted with the agency clause's requirement of absolute independence. In the absence of an agency agreement, I would argue that the fixed place of business PE usually requires detailed instructions or comprehensive control. Consequently, in these situations, economic dependence is, in general, not sufficient to conclude that a related person is conducting someone else's business. However, it is not possible to state that this is always the case. Each situation must be assessed on its own, and the facts of a specific case may support the conclusion that economic dependence is sufficient in that specific case. Finally, it seems clear that the best way

[351] Le Gall, J P, "Can a Subsidiary Be a Permanent Establishment of its Foreign Parent?", *New York University Tax Law Review*, no. 3 06/07, p. 205. Le Gall argues that the dependency assessment is difficult and, thus, a related company PE according to the fixed place of business rule should be limited to the obvious cases. Also see Skaar, A, *Permanent Establishment*, p. 545, who argues that the OECD MTC presumes that the business of a company is its own. In an agency situation it could be argued that this presumption is not as strong because the agent acts on behalf of its principal and, thus, conducts both its own and the principal's business. In the absence of an agency relationship, however, Skaar's argument supports the notion of a higher standard of dependency.

to answer the question of whose business is being conducted is to apply substance-over-form. The discussion above suggests using the dependency assessment in the agency clause as *guidance* when analyzing this question under the fixed place of business rule.

As we are now discussing this in the context of the fixed place of business PE, it is important to note that it is not required that the agent has any authority to conclude contracts in the name of the principal.[352] However, compared to the agency clause the additional requirements according to the fixed place of business rule must be fulfilled for a PE to exist. This means that it is not enough that the related person is dependent. These additional requirements are discussed later in this chapter.

4.2.2.2 Summary of the Dependency Elements of the Agency Clause

In the previous section it was argued that the dependency assessment under the agency clause can be used as guidance when determining whose business is being conducted. Because of this, a brief description of the dependency assessment under the agency clause is provided here.

There are three main conditions for dependency under the agency clause listed in the commentary. These are: instructions and control, entrepreneurial risk, and number of principals. As these conditions are discussed in detail in the following chapter, only a brief discussion in the context of the fixed place of business rule is necessary here. For a more detailed discussion see section 5.4.3.

Starting with instructions and control, arguably the most relevant, and complicated, condition,[353] it must first be stated that it is detailed instructions or comprehensive control that is required. This mostly refers to the day-to-day business. General policy instructions and control are not, in themselves, enough for an agent to be considered dependent. This is consistent with the related company clause and how it relates to the fixed place of business PE.

The next condition is entrepreneurial risk.[354] It can be assumed that an independent person receives part of the profits, assumes part of the risk, pays his own expenses and is responsible for his own assets.

[352] Para. 10 of the commentary to Article 5 of the OECD MTC.
[353] See section 5.4.3.2.
[354] See section 5.4.3.3.

Conversely, an agent that is shielded from losses is a strong indication of dependence. Thus, remuneration, who pays the agent's expenses and who owns the assets used by the agent are important factors when assessing the entrepreneurial risk. In a related person situation there may be other factors to consider as well, such as shareholder contributions and common economic interest.

The last factor to assess dependency mentioned in the commentary is the number of principals.[355] Having one or just a few predominant clients is an indication of dependence. However, this factor is not sufficient to establish dependence on its own. Thus, the number of principals strengthens or weakens dependency arguments based on control and risk.

4.2.2.3 Related Person PE According to the Fixed Place of Business Rule Accepted

This section covers court cases where related companies and persons are involved. All of these cases deal with the questions of whose business is being conducted and dependence, although the courts seem reluctant to state this explicitly. As we will see, dependence is a two-headed creature and can be used as a PE argument by both countries involved. I will illustrate this with three court cases from Sweden and one from India. There are aspects of these cases that can be criticized, but as this section concerns the question of whose business is being conducted, and aspects not related to that question are not discussed.

In the first case, *MML*[356], a company from Cyprus, MML, had a Swedish subsidiary, MPG. MPG acted as MML's agent in Sweden in relation to the production of movies. MPG acted as an agent in the production phase and also in the completion phase. In the production phase MPG hired, instructed and supervised external contractors, such as movie producers and photographers, on behalf of MML. In the completion phase MPG completed the movies according to MML's general guidelines on production and quality. In the second phase MPG did not have any authority to bind MML.

MML argued that its business was mainly to hold trademarks, provide financing, take risks and provide know-how. Furthermore, the

[355] See section 5.4.3.4.
[356] Kammarrätten i Stockholm, no. 7453-02, May 31 2005.

company argued that MPG's business was to distribute movies and that the activities performed on behalf of MML were auxiliary. The Administrative Court of Appeals, however, did not agree with this description of the facts. The court considered that MML's main business was to produce movies. The main source of income for MML was derived from the production and distribution of movies, even though they used agents to do this. The court found that MPG had a predominant role in the production of movies on behalf of MML. MPG was subject to comprehensive control and detailed instructions and did not bear the economic risk. The conclusion was that MPG was dependent and in reality conducted the business of MML. Consequently, MML had a PE in Sweden according to the fixed place of business rule as it had its subsidiary's personnel and premises at its disposal. MML having MPG's personnel at its disposal was considered to mean that the personnel were de facto employees of MML.

This case is quite far reaching as it basically reclassifies the dependent subsidiary as a branch. The method used by the court to assess dependence was the same as under the agency clause. The court used language similar to that in the agency clause and tested both legal and economic dependence with the result that both aspects indicated dependence. It is difficult to assess from the ruling whether MPG really was dependent as the court's reasoning is brief and the facts are not described in detail. From a principle point of view, however, this ruling supports the notion that a dependent related person performs, at least partly, someone else's business activities.

The second case is from India and concerned the *Rolls Royce*[357] group. Rolls Royce PLC, RR, was incorporated and tax resident in the United Kingdom. RR had a wholly owned subsidiary, RRIL, incorporated in the United Kingdom but with an office in India. The companies had entered into an agreement, which stated that RRIL was to provide services to RR. The services included media relations, information gathering and analysis, as well as technical and administrative support. RRIL got reimbursed for its costs with a markup of 5.1-6 percent. The Indian tax agency argued that RR had a PE in India through the premises belonging to RRIL. The fixed place of business rule in the relevant treaty followed the wording of the OECD model.

[357] Rolls Royce Plc v. Deputy Director of Income Tax, ITA Nos. 1496 to 1501/DEL 2007.

The court started by noting that RR's employees frequently visited India and used the office of RRIL during those visits. The court continued by stating that "[i]n a way, the appellant [RR, my remark] maintains the premises but on the face of premises, it is being stated as occupied by RRIL." The court also noted that the expenses for RRIL's office had been paid for entirely by RR. After establishing these facts, the court discussed the conditions for the fixed place of business rule. Most notably the court discussed that an enterprise conducts its business through persons dependent on the enterprise, i.e. raising the question of whose business is being conducted. Finally, the court concluded that the office of RRIL was used for RR's business. Consequently, RR had a PE in India through its subsidiary RRIL.

It is somewhat difficult to pinpoint whether RR had a PE by virtue of its own employees occupying the premises of RRIL, through the employees of RRIL or by a combination of both. The court seems to have based its conclusion on two facts: first, that the premises were used by RR's employees, and second, that the expenses related to said premises were paid for by RR. The first argument indicates that it was RR's employees' use of the premises of RRIL that caused a PE. The second argument relates to the economic dependency assessment and implies that RRIL was economically dependent and that its employees conducted the business of RR. However, additional guidance on the court's reasoning can be found in its assessment on preparatory or auxiliary activities, and the agency clause. When analyzing the court's assessment of the exception for preparatory and auxiliary activities, it becomes clear that the court considered that RRIL performed activities on behalf of RR that were in addition to the ones stipulated in the service agreement. The court found that RRIL received and analyzed orders and attended meetings with RR's customers where its employees had power to make decisions, and that senior directors of RRIL were functionally responsible to RR. When it comes to the agency clause, the court stated that RRIL was "totally dependent" on RR, a fact that RR did not deny.[358] These additional circumstances led to the

[358] RRIL was considered an agency PE of RR. However, the basis for this was a special rule in the treaty between the United Kingdom and India, which stipulated that a dependent agent that habitually secured orders wholly on behalf of one enterprise (associated enterprises are seen as one) constituted an agency PE.

conclusion that RRIL's employees were in fact employees of RR. Thus, it seems that RR would have had a PE regardless of the fact that its formal employees were using the premises in India.

As it was not denied that RRIL was dependent, the court did not elaborate on this. Nevertheless, it is clear that the court considered the dependency assessment as the basis for determining whose business was being conducted from the fixed place of business. This case is similar to the *MML* case discussed above as both courts considered the formal employees of a subsidiary to be, in fact, employees of the parent. Thus, in both rulings, the courts adopted a substance-over-form approach to determine who the subsidiary's formal employees belonged to in substance.

The third case,[359] *Galantus*, involved the company Galantus, which was resident in Belgium, and its 99 percent owner GW, an individual resident in Sweden. The case concerned a restructuring and an external sale of a Swedish company. It seems like the restructuring was done to avoid capital gains taxation in Sweden on GW's shares in the Swedish company by selling it in two steps to a subsidiary of Galantus before the external sale. In addition to selling its subsidiary, Galantus lent money to GW and managed its investments. The main question in the case was whether Galantus had a place of management, constituting a fixed place of business PE, in Sweden through the home of its owner, GW.

The Administrative Court of Appeals found that Galantus's board of directors consisted of three persons, two individuals from Belgium and GW, but that the board did not have any real influence on the company's business. Instead, it was concluded that GW alone held the real power of decision making. This conclusion seems to be mainly derived from the fact that GW had decided to sell his Swedish company to an external buyer before Galantus even existed. Another aspect that might have led to this conclusion was that the directors from Belgium were from a company that provided administrative assistance to foreign investors in Belgium. Based on this, the court found that Galantus had a fixed place of business PE in Sweden through the home of GW.

This case is difficult to reconcile with the notion of control and instructions previously discussed. It seems like all of the decisions con-

[359] Kammarrätten i Stockholm, no. 1580-1581-08, July 19 2010.

cerning the transaction had already been made before Galantus was founded. That a company's business purpose is being decided by its future owner can in most cases be considered to be a general policy decision, which falls within a shareholder's normal control. The question at hand is whether such policy instructions de facto influence the day-to-day operations in a way that can be seen as comprehensive. As the income from the sale of Galantus's subsidiary was supposed to be reinvested, at least partly, it is difficult to consider GW's influence on that transaction as de facto influencing the day-to-day business in a comprehensive way. Indeed, the day-to-day business of Galantus was the management of investments. If deciding the company's business purpose is sufficient to constitute control, the use of holding companies in transactions would in general be at risk of being considered dependent as it can be assumed that the holding company's owner had decided its business beforehand. A pure holding company, in general terms lacks the ability to run an active business because it does not have any employees. I would argue that, in such cases, occasional instructions on transactions are not enough to consider the holding company dependent, even if those instructions cover are all the activities taking place.

It may be the case that the court was considering the loan and investment management as well. The exact extent of these activities is not specified in the ruling, but the court stated that it could be assumed that those activities were performed by GW in Sweden. Nevertheless, the focus is on the sale of the Swedish company and the lasting impression is that it was that activity that caused the PE.[360] In summary, it can be said that the court considered that GW acted as an extension of Galantus and not in his capacity as owner.

The fourth case, *X AS*,[361] is an advance ruling and involved an individual resident in Sweden, A, and his wholly owned Norwegian company, X. As it is an advance ruling, the facts of the case are described by X and, in general, not questioned by the court. X did not have any employees and bought administrative services such as accounting from unrelated companies in Norway. The board of direc-

[360] For the same conclusion see Berndt, F, "Rättsfallskommentar - Kammarrättens i Stockholms dom den 19 juli 2010 i mål 1580-1581-08", *Skattenytt*, no. 11 2010, p. 807.
[361] RÅ 2009 ref. 91.

tors was situated in Norway and consisted of A and another individual, who was resident in Norway. A was going to sell his shares in a listed Swedish company to X. The sole business of X was to manage its investments by buying and selling new shares with the dividends received. All investment decisions, however, were made by A. It was submitted that the estimated annual number of transactions was between 10 and 30, never exceeding 50. X did not have an office or any other premises in Sweden. A was going to give the buy and sell orders to a Swedish bank, either by telephone or a personal visit to the bank's office. When giving orders by telephone it was submitted that A would do this where he happened to be located at the time, for instance, at home or his place of work.

The Swedish Supreme Administrative Court concluded that investment management was business according to the OECD MTC, the relevant tax treaty and the domestic PE provision. The court noted that a place of management is an example of a place of business. Furthermore, the court stated that the place of business had to be at the disposal of X but that no legal right was necessary. Instead, it was sufficient that the place of business de facto was at X's disposal and was used in its business. Finally, the court concluded that because A could be at his home when giving buy or sell orders it could find no reason to doubt that additional activities related to X's business were, at least partly, conducted there. Thus, the home of A was considered a fixed place of business PE of X.

This case did not explicitly include a dependency assessment. The reason for this is probably that it was undisputed that A was in fact the one performing all of X's core business activities and consequently did not act in his capacity as owner. However, as previously argued, the control in the related company clause, the agency clause and the fixed place of business rule is similar. Based on this it can be argued that A utilized the same form of control of his company that would have been sufficient for a PE if he had instead instructed an employee in X, who then performed the actual activities.

Comparing these four cases, a few things can be noted. As mentioned above, control and instructions can be used as an argument for a PE in the state where the controlled company is resident as well as in the state where the controlling company resides. In *MML* and *Rolls Royce*, a controlling foreign company was considered to have a PE through the premises and personnel of the controlled company. By

contrast, in *Galantus* and *X AS* the controlled companies had PEs through the controlling shareholders in Sweden. In the *MML* and *X AS* cases, the courts adhere to the notion that PE-constituting control requires control of the day-to-day business. In *Rolls Royce* it is not clear how the control was exercised, although the phrasing "totally dependent" implies control of the day-to-day business. By contrast, in the *Galantus* case it seems that the general purpose of the holding company, which was decided by its shareholder, was the most important factor. In both *MML* and *Rolls Royce*, the courts found that the subsidiaries were economically dependent. In all four cases the relevant companies seems to have been considered legally dependent.

All of the cases discussed in this section support the notion that whose business is being conducted is determined through a dependency assessment similar to the one in the agency clause.

Looking at the Swedish cases, all three cases featured one company without any employees[362] to conduct the company's business. Another common feature is that all three cases concerned structures to minimize taxation in Sweden. Whether the prevention of tax avoidance is a valid concern in the PE assessment is discussed in chapter 7. One can note that there are quite a few cases from Sweden following the outcomes of *X AS* and *Galantus* cases, i.e. a place at a related person's disposal being considered a place of management, or otherwise a place of business, and thus a fixed place of business PE.[363] From a Swedish perspective, an individual living in Sweden with a holding company abroad runs the risk of having his home or office declared a PE. This is especially true in situations involving tax planning, but one cannot rule out that this case law migrates into "regular" situations.

[362] None of the companies had any formal employees. In *MML*, however, the subsidiary's employees were considered employees of MML in substance.
[363] Kammarrätten i Göteborg, no. 622-626-17, August 29 2017; Kammarrätten i Göteborg, no. 2821-2823-16, December 15 2016; Kammarrätten i Stockholm, no. 1183-1186-15, February 23 2016; Kammarrätten i Sundsvall, no. 425-428-13, February 19 2014; Kammarrätten i Göteborg, no. 6941-6945-12, June 18 2013; Kammarrätten i Göteborg, no. 2692-11, January 1 2013; Kammarrätten i Göteborg, no. 3464-3465-09, December 15 2011 and Kammarrätten i Jönköping, no. 2181-2185-09, December 1 2010.

4.2.2.4 *Related Person PE According to the Fixed Place of Business Rule Rejected*

In contrast to the previous section, this section deals with situations where it has been held that the person in the state of establishment did not perform activities belonging to the foreign related person. In general, the same factors discussed previously are relevant here, i.e. a dependency assessment similar to the agency clause, but also the general question of whether substance or form should prevail.

The first case is from Sweden and concerned the Swedish shipping group *Stena.*[364] It is worth mentioning at the start that this case concerned Sweden's domestic PE legislation as no tax treaty existed. However, the Administrative Court of Appeals used the commentary to the OECD MTC to interpret the domestic rule as it was modeled on Article 5 in the OECD MTC. Thus, this case is still relevant to interpret the PE concept in this study.

The situation was a follows. The Swedish group company Stena Rederi AB conducted an international shipping business. The ships used for this business, however, were owned by foreign subsidiaries and not by Stena Rederi AB. The reason for this was that ships owned by Swedish companies must be registered in Sweden and, consequently, must comply with Swedish regulations, such as those concerning the ship's technical specifications and wages for the crew. Stena Rederi AB submitted that the cost to rebuild a foreign ship to comply with Swedish regulations made such an operation unprofitable. Furthermore, a Swedish crew would cost about three times more than an international one. Thus, the organization with foreign subsidiaries was mainly based on business reasons other than taxation.

The business was organized with foreign subsidiaries, which usually owned one ship. The ships were then leased by Stena Rederi AB, who subsequently leased out the ships to external customers. It was submitted that it was Stena Rederi AB who decided when a new ship was to be purchased, and when a contract was negotiated, a foreign subsidiary was set up and entered the contract. This specific case concerned the subsidiary Stena Ocean Line Ltd, which was set up on the Cayman Islands in order to have its ships registered in the United Kingdom. The board of directors consisted of four individuals living

364 Kammarrätten i Göteborg, no. 1776-1995, May 20 1999.

on the Cayman Islands and three individuals from Sweden. The three individuals from Sweden were also present in the Stena group's executive board. The company did not have any employees. Otherwise the situation followed the structure described above.

The Swedish tax agency argued that Stena Ocean Line Ltd had a permanent establishment in Sweden. The argument was that the Swedish group company performed management functions and its facilities in Sweden constituted a place of management for Stena Ocean Line Ltd. This was based on the fact that the strategic decision to buy and lease the ships was made in Sweden.

Stena Ocean Line Ltd, on the other hand, argued that its board of directors had the final say on whether the company should enter contracts to buy ships and whether the terms of the contract were acceptable or should be renegotiated. Furthermore, the board of directors continuously supervised the fulfillment of the lease contract with Stena Rederi AB.

The Administrative Court of Appeals started by concluding that Stena Ocean Line Ltd's board of directors' activities were located on the Cayman Islands. This was based on the fact that the company had monthly board meetings at its registered address in Georgetown, Cayman Islands. The court also noted that it was only the local board members who were normally present at these meeting.

The court continued by exploring whether any other circumstances meant that the company had a PE in Sweden. The strongest argument for a PE, according to the court was that the strategic decisions to buy, finance and lease a ship had been made by the group's executive board located in Sweden. The court did not agree with Stena Ocean Line Ltd's argument that its board had the final say in its dealings with the group but rather maintained that the board was bound by the group executive board's directives. Thus, according to the court, the real center of management for the company was in Sweden. Nevertheless, the court concluded that no PE existed in Sweden. The court's reasoning is not completely clear, but it seems that this conclusion was reached by putting an emphasis on the fact that the formal decision making was taking place outside of Sweden. Furthermore, the court added that no agency PE existed as no binding contracts had been concluded in Sweden.

As already mentioned, this case represents a rather formal view on whose business is being conducted. The fact that the formal decisions

were taken outside of Sweden was considered more important than the fact that the de facto decision making was taking place in Sweden. One can compare this case with the *Galantus*[365] case discussed in the previous section. In that case, the fact that the de facto decision making was done by the owner in Sweden meant that the foreign company had a PE in Sweden, even though the decisions were formally taken by the board of directors abroad.

A difference between these two cases is that they are separated by a decade of development towards a wider PE concept when it comes to related persons. Another difference is that the structure in the *Stena* case was not primarily put in place to avoid taxation in Sweden while the opposite was the case in *Galantus*. Especially the latter can reconcile the seemingly stark contrast between these two cases. As concluded previously, the application of substance-over-form to prevent tax avoidance is in line with the OECD MTC and the PE concept.[366] However, I am critical of the reasoning in the *Galantus* case, especially when it comes to the application of the different PE conditions. The *Stena* case is quite similar, with few decisions taken by the owner, possibly even before the company was created, and is more like deciding the business purpose of a subsidiary. Neither of the cases seems to include continuous management of the foreign companies by the respective owners.

Based on this, the *Stena* case has the correct outcome, i.e. no PE in Sweden. Perhaps one could argue for the wrong reasons as the formal aspects seem to have been decisive. The preferred reasoning is that the Swedish company's management activities fall within what can be considered *normal control*, which is not in itself PE-constituting. This is because the Swedish parent company acted in its capacity as owner and did not conduct the business of its foreign subsidiary.

The second case is from India and concerned the German company *Epcos AG*[367] and its two Indian subsidiaries. Epcos AG provided services for the Indian subsidiaries. The services provided were related to product marketing and sales support as well as information and technology support. Both of these types of services were centralized at

365 Kammarrätten i Stockholm, no. 1580-1581-08, July 19 2010.
366 See section 2.4.
367 EPCOS AG v. Assistant Commissioner of Income Tax, ITA Pune No. 398 2007.

Epcos AG and provided to the group worldwide. Epcos AG did not have any employees in India relating to the services. It was not disputed that the remuneration for these services was paid at arm's-length. The tax treaty between India and Germany followed the OECD regarding the fixed place of business rule.

The tax agency argued that Epcos AG had a PE in India through its subsidiaries with employees. The reasoning was that Epcos AG provided guidance related to sales, marketing and IT, which dictated the actions of the subsidiaries' employees. In other words, the argument was that Epcos AG in reality exercised control by way of managing its subsidiaries' day-to-day business.

According to the court, when assessing a related person PE situation, "[t]he true test, in our considered view, is whether or not business of the foreign enterprise is carried out by the PE." The court concluded that Epcos AG did not receive any remuneration for the work performed by the subsidiaries' employees. This meant that Epcos AG's business was not conducted through those employees. Furthermore, the fact that the subsidiaries' employees also performed marketing and IT support did not mean that those activities could be attributed to the foreign company unless it also received remuneration for said activities. Just because the subsidiaries had Epcos AG perform part of the marketing did not imply that the subsidiaries themselves would not perform similar activities. The court's conclusion was that just because a company conducted its business with guidance from a foreign company did not mean that the foreign company had a PE.

The court used the phrases "guidance and supervision" and "help and guidance" to describe the influence Epcos AG had on the subsidiaries' relevant activities. This is different from comprehensive control and detailed instructions. The phrasing used implies control on the policy level, which is not sufficient to constitute a PE. The court's second argument was that Epcos AG did not receive any remuneration nor was it entitled to any profits from the activities performed by the subsidiaries' employees. This relates to the economic dependence. In general, a subject that bears its expenses and receives the profits related to those expenses indicates independence. However, the situation between related persons is special as remuneration and profits can be transferred by other means. Thus, I do not agree with the conclusion

that the lack of formal remuneration automatically means that a related person conducts its own business.

An interesting situation is when a person is conducting the business of two related companies. One example of this is a person who is employed in both companies involved. This is interesting as it is necessary to distinguish which activities belong to which company. A Swedish advance ruling dealt with this question.[368] In this case, the Danish company A/S housed its group's executive board. The plan was to transfer the group executive board to the Swedish company AB, which belonged to the same group. The CEO of A/S was a member of the executive board and was to be employed in AB. It was submitted that AB would perform services on behalf of A/S. As examples of such services, consolidated financial statements and investment analysis were mentioned. The services were supposed to be performed by AB's employees, including the CEO of A/S. The remuneration for these services was to be paid on an arm's-length basis. In addition to this, it was submitted that the CEO would perform his duty as CEO on location in Denmark.

According to the Board of Advance Rulings, it was possible to separate the role as CEO and member of the group executive board. The functions related to the role as CEO were performed exclusively in Denmark. Furthermore, the board noted that the remuneration was at arm's-length and taxed in the hands of AB. The conclusion was that A/S did not have a place of management PE in Sweden through the CEO's office at AB.

It seems that the deciding factor to determine whose business was being conducted was that the remuneration was at arm's-length, i.e. a strong indication of economic independence, and that the roles of CEO and employee of AB were possible to distinguish. Thus, in two of the cases where a related person PE was rejected, the courts put an emphasis on the fact that remuneration was at arm's-length. In the *Stena* case the pricing was not at arm's-length, but the difference was benefiting Sweden and it was not discussed by the court. Furthermore, none of the cases in this section seem to have had any significant element of tax planning. By contrast, in all of the cases discussed where a related person PE was accepted, the remuneration was either not paid at all or was below what could be considered arm's-length. The con-

[368] Skatterättsnämnden, dnr 93-99/D, December 13 1999.

clusion from this is that arm's-length remuneration is a strong indicator that a company is conducting its own business. It must be noted, however, that neither of the cases had elements of comprehensive control or detailed instructions.

The cases discussed in this section follow the notion that a dependency assessment similar to the agency clause can be used under the fixed place of business rule to determine whose business is being conducted. The reason no PEs were constituted was that the relevant companies were acting independently. In addition to this, none of the cases had significant elements of tax planning, which means that the main driving force behind the related person PE development was missing. Finally, one can mention that the *Stena* case featured a formal view on whose business is being conducted and, although the outcome was correct, more recent case law may have made that particular part of the ruling questionable.

4.2.2.5 Recent Case Law from Spain

There are two cases from Spain regarding the related person PE that have received quite a lot of attention in the international tax community recently. These two cases are not unique in the way the courts' reasons compared to the cases discussed in the two preceding sections. Why are these cases discussed separately, then? The reason is that the two cases are to some extent more far reaching than the majority of the cases previously discussed. Additionally, in one of the cases it is rather difficult to understand how the court actually reasoned, which creates some uncertainty in the analysis. Because of this, these two cases are discussed in a separate section.

The first case is commonly labeled *Roche*[369] and deals with the Swiss company Roche Vitamins Europe, hereafter RVE, and the Spanish company Roche Vitaminas, hereafter RV. As already mentioned, this case is somewhat difficult to understand, and I have in addition to the actual case, used articles that discuss and describe the case to improve my understanding.[370]

[369] DSM Nutritional Products Europe Ltd v General State Administration, STS 201/2012, recurso no 1626/2008, January 12 2012, from 14 *ITLR* p. 892 (unofficial translation to English).

[370] See Martín Jiménez, A, "The Spanish Position on the Concept of a Permanent Establishment: Anticipating BEPS, beyond BEPS or Simply a Wrong

The facts of the case were as follows. RVE and RV belonged to the same group. Between these two companies were two contracts. The first contract stipulated that RV should manufacture and package products on behalf of RVE. For this, RV received remuneration on a cost-plus basis. The second contract was an agency agreement in which RV was to represent RVE in Spain by promoting its products, as well as a lease of a warehouse to store RVE's products. The products promoted and stored were the same products as RV manufactured on behalf of RVE, with the addition of products manufactured outside of Spain. For acting as RVE's agent, RV again received remuneration on a cost-plus basis. Additionally, RV received rent for the warehouse. It can be mentioned that prior to this organization, RV both manufactured and sold the products in Spain for their own account. With the reorganization, it seems that part of the previous tax base in Spain was shifted abroad.

The Spanish tax agency argued that RVE had a fixed place of business PE in Spain through RV's facilities. This seems to be based on the opinion that RVE bore the financial risk and acted as if it was its own business. The tax agency also argued that RV was "completely dependent" on RVE because of detailed instructions from RVE and financial control, i.e. both legal and economic dependence. Additionally, it seems that the tax agency was of the opinion that an agency PE also existed, even though RV did not conclude contacts in the name of RVE.

RVE argued that they did not have a fixed place of business in Spain, presumably because the fixed place of business belonged to RV. RVE also rejected the claims that it had an agency PE as RV did not have an authority to bind RVE.

RVE appealed the decision by the tax agency to the Tribunal Económico Administrativo Central, hereafter TEAC, which found

Interpretation of Article 5 of the OECD Model?", *Bulletin for International Taxation*, no. 8 2016, p. 458-473; Carmona Fernández, N, "The Concept of Permanent Establishment in the Courts: Operating Structures Utilizing Commission Subsidiaries", *Bulletin for International Taxation*, no. 6 2013; Obuoforibo, B, "In the Name of Clarity: Defining a Dependent Agent Permanent Establishment", *Taxation of Business Profits in the 21st Century – Selected Issues under Tax Treaties*, ed. Gutiérrez, C, and Perdelwitz, A and Baker, P, "Dependent Agent Permanent Establishments: Recent OECD Trends", *Dependent Agents as Permanent Establishments*, ed. Lang et al.

that RVE had a fixed place of business PE and denied the appeal. RVE then appealed to the Audiencia National, hereafter AN, which found that RVE had an agency PE despite the fact that RV did not have the authority to conclude binding contracts on behalf of RVE. Finally, the AN's ruling was appealed to the Spanish Supreme Court, Tribunal Supremo.

The ruling of the Supreme Court is confusing. In essence, the Supreme Court started by describing Article 5 in the relevant tax treaty. The court then summarized the appealed ruling from the AN, which came to the conclusion that RVE had an agency PE. The Supreme Court then proceeded to quote a passage from the TEAC judgment where it was concluded that RVE had a fixed place of business PE. Finally, the Supreme Court stated, immediately after the quote, that the "above leads us to reject the argument", which in this case was the argument that no PE existed. Thus, it seems to me that the Supreme Court accepted both lines of reasoning, which means that RVE had a fixed place of business PE as well as an agency PE in Spain.[371] As the Supreme Court just quoted with approval without any of their own reasoning, we must return to the reasoning in the initial ruling by the TEAC.

The TEAC started out by identifying that the question was whether the activities carried out in RV's facilities belonged to RVE or RV, i.e. the question of whose business is being conducted. To answer that question, the TEAC established that both manufacturing and sales were managed from Switzerland by RVE. This was based on the two contracts, specifically that RVE decided what was to be manufactured and in which quantities, deadlines and the details of the sales, i.e. price and customer. The TEAC then stated that it was clear that RVE used RV's facilities and that said facilities were used exclusively on behalf of RVE. Thus, the activities carried out in Spain belonged to RVE. Additionally, RVE received the economic benefits and bore the risk, ac-

[371] For similar conclusions see Martín Jiménez, A, "The Spanish Position on the Concept of a Permanent Establishment: Anticipating BEPS, beyond BEPS or Simply a Wrong Interpretation of Article 5 of the OECD Model?", *Bulletin for International Taxation*, no. 8 2016, p. 462 and Carmona Fernández, N, "The Concept of Permanent Establishment in the Courts: Operating Structures Utilizing Commission Subsidiaries", *Bulletin for International Taxation*, no. 6 2013.

cording to the TEAC. Based on this, and the fact that a factory naturally fulfils the rest of the conditions, RVE had a fixed place of business PE in Spain. Finally, the TEAC dismissed the argument that the management and pricing structure used was common in several different types of business by stating that it did not change the previous conclusion. The TEAC also added that the remuneration RV received was "not even close to market".

Analyzing the arguments provided by the TEAC, we can note that we recognize them. In essence, the TEAC's conclusion that it is RVE's business that is conducted in Spain is based on RVE's detailed instructions and control, that RVE bore the economic risk, that RV exclusively worked on behalf of RVE, and that the remuneration was not at arm's-length, i.e. legal and economic dependence. Once again, a court has relied on the dependency assessment of the agency clause as guidance on how to determine whose business is being conducted.

However, some caution is warranted regarding this case. This is mainly because the Supreme Court did not provide any reasoning of their own but merely quoted the two, quite different, previous rulings. A Spanish commentator has suggested that the Supreme Court preferred the reasoning of the AN, which dealt with the agency clause and not with the fixed place of business PE.[372] Nevertheless, despite these uncertainties, the case still provides yet another example of applying substance-over-form with guidance from the dependency assessment of the agency clause to answer the question of whose business is being conducted under the fixed place of business rule.

The second case is *Dell Spain*.[373] This case concerned the question of whether a local subsidiary that acted as a commissionaire constituted a PE for its foreign principal. The Dell group used a similar set-up in most of Europe, and it is interesting to note that it had previously been challenged by the Norwegian tax agency as well. The Norwegian Supreme Administrative Court, however, found that no PE existed in

[372] Martín Jiménez, A, "The Spanish Position on the Concept of a Permanent Establishment: Anticipating BEPS, beyond BEPS or Simply a Wrong Interpretation of Article 5 of the OECD Model?", *Bulletin for International Taxation*, no. 8 2016, p. 462.

[373] Dell Products Ltd v General State Administration, STS 2861/2016, recurso no 2555/2015, June 20 2016, from 19 *ITLR* p. 633 (unofficial translation to English).

Norway.[374] Even more interesting is that, to my knowledge, the structure has not been challenged in any other country.

The facts of the case were as follows. Dell Products LTD, hereafter Dell Ireland, was an Irish company in the Dell group responsible for selling computers in Europe. Dell Computer S.A., hereafter Dell Spain, was a Spanish company belonging to the same group and acted as a commissionaire agent for Dell Ireland in Spain. Additionally, Dell Spain was involved in functions complementing the sale of the Dell group's products, such as marketing, logistics, warehousing and other support services. Previously, Dell Spain had acted as a distributor and sold the group's products on its own account. After it was transformed into a commissionaire it can be assumed that part of the previous tax base in Spain was moved abroad.

The Spanish tax agency argued that Dell Ireland conducted its business through the personnel and facilities belonging to Dell Spain, which meant that Dell Ireland had a fixed place of business PE in Spain. Dell Ireland objected to this conclusion. Its principal argument was that the facilities of Dell Spain were used by Dell Spain and that Dell Ireland did not have any right of disposal of said facilities. In essence, the tax agency argued from a substance point of view while the taxpayer argued from a form perspective.

The Supreme Court started by concluding that the notion of a fixed place of business was a flexible one and that it did not matter if you owned the facilities or used the facilities of another company. Likewise, the notion of "disposal" should be understood in a flexible and wide sense including acting on behalf of another enterprise. In relation to these conclusions the Supreme Court stated that the objective of a tax treaty is to govern international taxation and that the increased globalization makes it essential to account for the substance of new business models when interpreting the PE concept. Not surprising, the Supreme Court then dismissed Dell Ireland's argument for a formal approach to the notion of disposal.

The Supreme Court then proceeded to state that Dell Ireland's appeal was based on the interpretation of facts which could not be appealed. Thus, as the facts had previously been established and the substance-over-form approach was established by the Supreme Court, the

[374] See section 5.3.4.3.

conclusion was that Dell Ireland had a fixed place of business PE in Spain.

The previous court was the Audiencia Nacional, AN, which established that an enterprise could carry on its business either directly or through another entity performing the activities that can economically be said to belong to the enterprise, provided that these activities take place at the enterprise's request and under its control. This was the case in this situation according to the AN. The exact reason for this is not presented in the translated ruling, but it seems that it was because of detailed control and instructions paired with economic risk.[375]

The most interesting thing about this case, at least in my opinion, is that the Supreme Court is clear about the need to apply substance-over-form when interpreting the PE concept. The Supreme Court seems to be of the opinion that presently the PE concept is too dated to produce "correct" results in certain situations. Presumably the Supreme Court means situations with aggressive tax planning or new business models resulting in a substantial shift in tax base between countries. In the specific case it is a commissionaire arrangement, which even the OECD in principle has deemed an abusive practice.[376] Thus, to some extent it is a statement that yesterday's system for dividing taxation rights between countries is in principle correct and that that order should be restored. This is a similar notion to the OECD's objective of "restoring the full effects and benefits of international standards".[377]

It is interesting to note that the Supreme Court is specifically addressing *new business models* in relation to substance-over-form. Read on its own, this statement does not seem that controversial. If one con-

[375] Martín Jiménez, A, "The Spanish Position on the Concept of a Permanent Establishment: Anticipating BEPS, beyond BEPS or Simply a Wrong Interpretation of Article 5 of the OECD Model?", *Bulletin for International Taxation*, no. 8 2016, p. 465 and Bal, A, "The Spanish *Dell* Case – Do We Need Anti-BEPS Measures If the Existing Rules Are Broad Enough?", *European Taxation*, no. 12 2016, p. 575.

[376] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 15. Also see Pleijsier, A, "The Artificial Avoidance of Permanent Establishment Status: A Reaction to the BEPS Action 7 Final Report", *International Transfer Pricing Journal*, no. 6 2016, p. 442-444.

[377] OECD, *Action Plan on Base Erosion and Profit Shifting*, p. 18-21, which encompasses Actions 6-10.

tinues reading the *Dell Spain* case, however, another, more controversial, view emerges. The Supreme Court did not stop after they had established that a fixed place of business PE existed in Spain. Instead, it proceeded to discuss whether an agency PE existed or not. This part of the ruling will not be discussed in detail here but rather in the chapter that deals with the agency clause.[378] The interesting parts relating to the Supreme Court's statement about substance-over-form, however, are discussed in the following.

Dell Spain did not conclude contracts in the name of Dell Ireland. As already mentioned, Dell Spain acted as a commissionaire which means it acted in its own name but on behalf of Dell Ireland. The Supreme Court concluded that it was not necessary to conclude contracts "in the name" of Dell Ireland, i.e. contracts that legally bound Dell Ireland.[379] Instead, it was sufficient to conclude contracts that were binding. It is not completely clear what the Supreme Court meant by "binding", e.g. economically or legally binding. That question was in fact not that relevant, according to the court. What was relevant was a "functional bond" between the agent and principal as I understand it. The Supreme Court argues that one should not focus on the form but rather on the functional and factual aspects of the relationship between agent and principal. As examples of what to assess, the court mentions instructions, control, economic risk and business organization. Additionally the Supreme Court makes a statement that the agency clause cannot be interpreted in a formalistic and literal way. This is based on the discrepancy between the objectives of the tax treaties and current business practices.

Two things are troublesome with this reasoning and in stark contrast with the statement the Supreme Court made in relation to the fixed place of business PE. First, in relation to the agency clause, the Supreme Court does not distinguish between substance-over-form when it comes to the facts and the actual treaty text. It is one thing to apply substance-over-form to the facts of the case. It is another thing entirely to apply it to the actual text. What the Supreme Court did was basically *redefine* the agency PE from a substance point of view. But what is the substance of the agency clause, then? It certainly is not a "functional bond" but rather a requirement of a legally binding con-

[378] See chapter 5.
[379] See section 5.3.4.

tract. The interpretation provided by the Spanish Supreme Court is questionable to say the least.

Second, by focusing on the relationship between the agent and principal, the Supreme Court basically ignores the first part of the agency clause. In some sense they create a new PE for related persons, the *dependent related person PE*.

Based on the discussion about the agency clause, the conclusion about the ruling on the fixed place of business PE must be re-examined. Given the Supreme Court's wide view when it comes to substance expressed in the reasoning about the agency clause, does my initial conclusion still seem correct? It is difficult to answer, but given the Supreme Court's wide interpretations of the agency clause, one could argue that it is at least a risk that they could do the same under the fixed place of business PE in the future. This case displays a disregard of the PE concept. The lasting impression is that a related person, who is dependent, will constitute a PE in Spain provided that the business is structured to minimize taxation. This is what I meant by a dependent related person PE. Thus, it seems that according to the Supreme Court in the *Dell Spain* case, a related person who is also dependent is considered to conduct the business of the person it is dependent on provided that it is a situation where tax avoidance or profit shifting is somehow achieved.

As already mentioned, the two cases from Spain are not unique when it comes to the reasoning provided by the courts and the tax agency. In essence, the Spanish Supreme Court follows the previously discussed trend of being influenced by the dependency assessment when determining whose business is being conducted. The Spanish Supreme Court, however, seems to position themselves on the more extreme side on the spectrum emerging from the discussed cases. This is especially noteworthy as it is a Supreme Court which establishes this position. In fact, the other more "extreme" cases discussed are not from a Supreme Court but rather from lower courts. This makes the Spanish cases troubling as, even though I agree with the main principle of using the dependency assessment as guidance, the conclusions are far reaching and will carry the extra weight of a Supreme Court ruling.

What is it I disagree with, then? Primarily it is the notion that a dependent related person is more or less deemed to conduct someone else's business and constitute a PE without a thorough assessment of

the various conditions in the fixed place of business rule. In short, these two cases lack nuances regarding the question of whose business is being conducted and the application of the following conditions under the fixed place of business rule.

Furthermore, the Supreme Court's reasoning regarding the need to realign the outcome of the PE assessment with some original intent lacks, yet again, nuances. There is definitely merit to the basic notion expressed by the Supreme Court, but it must be applied with caution. One should not lightly apply a principle or an idea to override the wording of a provision such as the PE.

In closing, the case law from Spain discussed above follows the formula of using the dependency assessment to determine whose business is being conducted. While such an approach in principle is recommended, the Spanish Supreme Court takes this approach too far. Regardless of this, however, these two cases support the notion that a dependency assessment similar to the one of the agency clause is suitable to answer the question of whose business is being conducted under the fixed place of business rule.

4.2.2.6 The United States – A Different Approach

The United States seems to have a different approach to this question. This approach is in line with the traditional opinion that related person PEs can only be constituted through the agency clause. The United States' case law discussed in this section mainly concerns domestic law. Thus, a certain caution needs to be exercised when assessing its tax treaty implications. Nevertheless, these cases are interesting as they express a different view on the question of whose business is being conducted. Another way to put this is that these cases emphasize *form* more than most of the cases previously discussed. Additionally, these cases concern situations that are similar to previous cases discussed but with somewhat different outcomes. As such, these cases can be placed in the same context as the previous cases and are interesting for this study.

The first case discussed is in stark contrast to the Swedish cases *Galantus* and *X AS* discussed above.[380] The case concerned *Perry R.*

[380] See section 4.2.2.3. Also see note 363 for further references to similar Swedish case law.

Bass, [381] a United States citizen, and his wholly owned Swiss company Santus A.G. Perry Bass had sold a share of working interest in oil and gas leases to Santus. Santus's board of directors was situated in Switzerland and consisted of three Swiss citizens. Santus was liable to pay taxes in Switzerland and paid both cantonal and federal tax. Santus also received the profits and paid its share of expenses connected to the oil and gas leases. Santus reported the income in both Switzerland and the United States but claimed that the income was exempted in the United States according to the tax treaty. The Internal Revenue Service was of the opinion that Santus was created with the sole purpose of avoiding taxes and, thus, should be ignored.

The Tax Court presented the problem as a question of substance-over-form. The court started by stating that form should, in general, be respected. If the company, however, is not "formed for a substantial business purpose or actually engage in substantive business activity", it can be disregarded for taxation.[382] The court concluded that Santus, among other things, purchased and held title in oil and gas leases, paid its own expenses, collected income and signed contracts related to the leases. This meant that Santus acted like a viable company and these activities constituted a substantial business.

The Internal Revenue Service was of the opinion that these activities did not matter as it was Mr. Bass who made all of the business decisions. They based this on Mr. Bass's extensive experience in the oil industry and Santus's board of directors' "complete lack of knowledge" of said industry. The court dismissed this argument by citing *National Carbide Corp.*,[383] "[u]ndoubtedly the great majority of corporations owned by sole stockholders are 'dummies' in the sense that their policies and day-to-day activities are determined not as decisions of the corporation but by their owners acting individually." This means that even if the owner controls the company down to the "minutest detail" it does not affect taxation. Finally the court dismissed the argument that Santus's corporate status should be ignored because it was created to avoid taxes. The reason for this was that Santus was "managed as a viable concern, and not as simply a lifeless

[381] 50 TC 595.
[382] The court based this on two rulings from the Supreme Court. See *Moline Properties*, 319 U.S. 436 and *National Carbide Corp.*, 336 U.S. 422.
[383] 336 U.S. 422.

façade." Thus, based on the above, the court concluded that Santus should be treated as a separate entity.

Although this case does not deal with the PE definition specifically, it is still interesting in this context. The case deals with the recognition of a separate legal entity for domestic tax purposes. This is different from a related person PE where the separate entities are respected in principle even though in practice the result may be the same as if they had been disregarded. The situation in this case is similar to the *Galantus* and *X AS* cases. In all three cases there were companies owned by a single individual shareholder who also seemed to exercise most of the decision making. Yet, the results in the two Swedish cases are the opposite of the United States one. In the United States it seems that a related person can be seen as a PE only if there is an agency situation.[384] This is a narrower approach than in the OECD MTC and the PE concept. In addition, the United States' agency assessment seems narrower than the OECD counterpart.[385] It must be noted, however, that *Perry R. Bass* was decided at a time when the conventional opinion was that related person PEs could only be constituted through the agency clause. Considering the domestic agency conditions, the outcome is not surprising.

Another interesting case is *Inverworld.*[386] The facts of the case were as follows. LTD, a company registered in the Cayman Islands, owned the United States company INC through a United States holding company. LTD's business was to help its clients invest in the United States. This was done through INC, which acted as an agent for LTD. The interesting question in this context was whether LTD was engaged in trade or business in the United States through its subsidiary INC.

The Tax Court started by assessing whether INC was a dependent agent and found that it was.[387] The Internal Revenue Service argued that INC's office in the United States should be considered the office

[384] See *Moline Properties*, 319 U.S. 436, *National Carbide Corp.*, 336 U.S. 422, *Bollinger*, 485 U.S. 340 and *Inverworld*, 71 TCM 3231. Also see Williams, L, *Fundamentals of Permanent Establishments*, p. 178-180, specifically note 212, and Skaar, A, *Permanent Establishment*, p. 545-547.
[385] Skaar, A, *Permanent Establishment*, p. 547.
[386] 71 TCM 3231.
[387] See section 5.4.3.4.

of LTD. According to the domestic provisions, one should assess "fixed facilities", "management activity" and "agent activity".[388] The domestic provisions also provided that fixed places of business of related persons should not of itself be considered places of business for the foreign company.

Regarding "fixed facilities", the court found that LTD had a fixed facility because it used INC's office to conduct its business. The court based this on the facts that transactions on behalf of LTD were executed from the office, LTD used the office as the return address in communication with clients, LTD maintained client files at the office, and it was not shown that LTD had any other fixed facilities from which to conduct its business.

The condition "management activities" includes both top management decisions and the day-to-day business. The court found that LTD's day-to-day business entailed providing its clients access to the United States' investment market. This was conducted at the office as the investment orders was received and processed there. In addition, the documentation of clients and transactions were produced and stored at the office. The court concluded that LTD's day-to-day business was conducted at the office.

Finally, the court assessed the agent's activities. To have an agent's office considered a place of business for the principal, the domestic provisions required that the agent had an authority to negotiate and conclude contracts in the name of the principal on a regular basis. The court found that INC had such authority and exercised it regularly. Consequently, the office of INC was considered a fixed place of business for LTD.

As with the previous case, an agency relationship was required. Basically, the entire agency clause in the OECD MTC had to be fulfilled in order for INC's office to be attributed to LTD. This is a stricter approach than in the OECD MTC, where it is not necessary for the agent to have an authority to conclude contracts if it works at a fixed place of business attributed to the principal.

Naturally, the value of these cases is low when interpreting the OECD MTC and tax treaties based on the model. The main reason is

[388] Another factor to consider was employee activity. As LTD did not have any employees at the office and it was not argued that INC's corporate status should be ignored, the court did not have any reason to assess this factor.

that they concern domestic legislation and not tax treaties. Nevertheless, these cases deal with the basic question of whose business is being conducted in a similar context as the cases from the other sections, and as such the arguments presented can be useful as long as they are persuasive. In other words, these cases deal with the question of how to attribute activities between related persons in cross-border situations. The rulings lend support to the notion that the agency clause, or rather an assessment similar to the one used in the agency clause, is relevant when deciding whose business is being conducted. Although the United States uses stricter conditions, a dependency assessment similar to the OECD MTC is still required. Another conclusion is that it is unlikely that a country with stricter requirements, such as the United States, would reach the same result as in the Swedish, Spanish and Indian cases previously discussed if a similar case involving tax treaties were to be decided. The reason for this is that it makes little sense to investigate whether a PE exists according to a tax treaty if there is no basis in domestic law for taxation.

4.2.2.7 The Question of "Whose Business Is Being Conducted?" in Situations with Unrelated Persons

The question of whose business is being conducted is not relevant only in the related person PE situation. This is important as it means that this question is inherent in the PE concept in general and not only for situations with related persons. To some extent, this serves to dismantle the argument that the related person PE, according to the fixed place of business rule, is something strange. Additionally, it is interesting to see that this question has general relevance for the PE concept and how this question is settled in a situation with unrelated persons. In this section, a Swedish Supreme Administrative Court case is used to illustrate that the question has relevance for the PE concept in general.

The case[389] concerned UH, an individual who had been living in Sweden but moved to Belgium, where he was considered a resident according to the relevant tax treaty. UH owned several forestry properties located in Sweden. UH had entered into a service agreement

[389] RÅ 2001 ref. 38. Also see Kammarrätten i Göteborg, no. 7956-7957-11, June 2 2014. The ownership structure in the case is somewhat unclear but it seems as the involved companies were not related.

with a forestry company in Sweden, which meant that said company would perform all forestry activities on UH's properties and buy the lumber. Approximately 16 months after his move to Belgium he sold the properties. The question of this case was whether UH was conducting the forestry business through a PE in Sweden, which would allow Sweden to tax the capital gain resulting from the alienation of the forestry properties. In other words, did the Swedish forestry company conduct its own business or the business of UH regarding the activities relating to the service agreement?

To answer this question, the Supreme Administrative Court started by analyzing the service agreement. They concluded that the forest company was supposed to suggest, carry out and supervise the forestry operations on UH's properties. Additionally, other related activities were to be suggested and subsequently performed by the company. The forestry company was obligated and had the right to purchase the lumber from the forestry operation. For this the company paid an arm's-length price. Finally, UH was obligated to pay for the company's expenses for the forestry operations.

Based on this, the court established the following. First, all essential measures in this forestry operation were subject to UH's approval. Second, as the arrangement was that UH paid the company's expenses and the company bought the lumber for an arm's-length price, the court concluded that UH received the profits and bore the risk of losses from the forestry activities. By contrast, the forestry company's interest seems to have been to secure access to raw material. The profit of the forestry company was entirely connected to the further processing of the raw material. Finally, the court concluded that it was UH's business that was being conducted.

Based on the court's reasoning it is clear that they answered the question of whose business is being conducted in a way similar to the dependency assessment. The court focused on legal and economic aspects. The fact that UH had the final say in all essential matters, i.e. UH had control of the forestry operations, implies that it was he who conducted the business. The fact that UH also received the profits and bore the risk of losses is a strong indication that it was his business and not the forestry company's.

This case shows that the question of whose business is being conducted is relevant not only in the related person PE situation but also in situations with unrelated parties. This case also shows that aspects

of legal and economic dependence, or control, are useful when attributing activities between unrelated parties. The general conclusion from this case is that there is in principle no difference between related and unrelated persons when assessing whose business is being conducted. The difference likely lies in how often this question has relevance. It seems probable that it is more common in the related person PE situation.

4.2.2.8 Conclusion

Initially, it was argued, in principle, that to determine whose business is being conducted under the fixed place of business rule one can use the dependency assessment of the agency clause for guidance. After having examined case law, this argument is strengthened. It seems clear that the most relevant factors to assess when determining whose business is being conducted are the legal and economic relationships between the involved persons, i.e. control and profit or risk. This has been examined in the context of the fixed place of business PE with guidance from the agency clause. Of course, this means that this question should be assessed in a similar way under the agency clause. What about the rest of the specific PE rules, then? I see no reason to assess this in any other way under the other PE rules. Thus, the discussion and conclusions presented here have relevance for the service and construction PEs as well.

For example, one can easily imagine a situation similar to the *Epcos AG* case where the question is about who performs the services. Such a situation could be a foreign company instructing employees of a local company. Depending on the level of control and how the foreign company is remunerated, it could be considered that it is the foreign company that performs the services.

The same can be said about the construction PE. The Norwegian *Siemens*[390] case from the Supreme Court is an example of this. In this case the question was whether a foreign company acted independently or as a subcontractor for a domestic company in the same group. In essence, this is the same question as the one discussed in this section but approached from the opposite direction, i.e. instead of determining whether a company is dependent, the question was whether it was

[390] Høyesterett, Rt. 1997 p. 653.

independent. The Supreme Court concluded that the domestic company never had the resources to complete its undertaking on its own, that the foreign company possessed specific know-how relevant to the assignment as well as necessary resources, and that the foreign company had an active and leading role in all phases of the project. Thus, the conclusion was that the foreign company conducted its own business and not the business of its group company. Consequently, the foreign company had a construction PE in Norway.

Based on the above it can be concluded that the discussion in this section has general relevance for the PE concept and not only for the fixed place of business rule.

However, it is not always prudent to ask the question of whose business is being conducted. As this section has shown, the question is closely connected to the objective of preventing tax avoidance. Why is that, and why should one not ask this question in all situations if substance-over-form is an inherent part of the PE concept?

First of all, determining whose business is being conducted is a difficult operation. As such, this assessment adds complexity and decreases legal certainty. These negative aspects can be accepted in the interest of upholding the notions of source, equity and basic neutrality. In a situation with excessive tax planning resulting in base erosion and profit shifting, it may not be possible to uphold the notions of source, equity and neutrality without applying a substance-over-form approach to whose business is being conducted. Thus, one can accept increased complexity in these situations to achieve a result more in line with the objective and underlying principles of the PE concept. By contrast, when there are no tax planning or BEPS concerns, increased complexity with decreased legal certainty cannot in general be accepted.

In certain situations, however, it may be necessary to answer this question to achieve the PE concept's objective even if the situation is not abusive in itself.

4.2.3 When Is It Possible to Aggregate the Activities of Related Persons?

4.2.3.1 Introduction

This section deals with the question of whether it is possible to aggregate the activities of several different related persons in the PE assessment. This is different from asking whose business is being conducted. If a person conducts another related person's business, those activities can be attributed to the person they economically belong to. Thus, the two persons' activities are not aggregated but rather allocated, and the different legal persons are still considered to be separate. By contrast, the aggregation of activities from several related persons is something different, perhaps a more economic approach, viewing the group as a single unit. This section concerns the question of whether it is possible to aggregate activities where several related persons conduct their own business but in the context of a group's common business. Examples of situations where this could be relevant are if a number of persons control a related person together or if a number of related persons have establishments that separately are auxiliary but seen together constitute a core business activity for the group, in part or as a whole.

The starting point, as stated previously, is that related persons are independent entities.[391] However, there is a notion of neutrality in the PE concept and the OECD MTC that stipulates that related and unrelated persons should be treated the same way.[392] Furthermore, it is stated in the commentary that the PE assessment must be made separately for each company in a multinational group.[393] This is further clarified to mean that the existence of a PE does not mean that the entire group has a PE. Thus, it can be said that the PE concept respects the notion that companies in the same group are separate entities. This means that aggregation of activities in such a way that, for instance, a company's legal personality is not respected is not possible under the PE concept, e.g. subsidiaries are considered PEs of the group parent based on the view that the group is one unit. In fact, that approach is exactly what the related company clause is designed to

[391] Para. 40 of the commentary to Article 5 of the OECD MTC.
[392] Para. 41 of the commentary to Article 5 of the OECD MTC.
[393] Para. 41.1 of the commentary to Article 5 of the OECD MTC.

prevent. Consequently, any aggregation of activities must be made with these general boundaries within the PE concept in mind.

Two central questions on aggregation of activities can be identified. The first question is whether several related companies can exercise control over another related company in such a way that it can be dependent. The second question is related to Action 7 in the BEPS project and concerns the aggregation of activities to assess the exceptions in Article 5(4). In the following section, only the first question is discussed. The second question is merely described, since it is discussed in chapter 6, which deals with preparatory and auxiliary activities.

4.2.3.2 The Aggregation of Several Related Persons in the Dependency Assessment

In the commentary it is stated that if several principals "act in concert to control the acts of the agent", that could lead to the agent being legally dependent on those principals.[394] As the same rules apply between related and unrelated persons, several related persons could be considered to be controlling another related person. As previously established, there is a connection between the dependency assessment under the agency clause and a related person PE according to the fixed place of business rule. Because of the special situation between related persons, it was previously argued that a higher standard is appropriate when assessing dependency in the context of the fixed place of business rule.[395] This conclusion is supported by the statement in the commentary referenced above as it is required that there is a principal-agent relationship. In the absence of an explicit principal-agent relationship a higher standard of dependency should be applied.

As a starting point I will discuss the debated and criticized Italian case concerning the *Philip Morris*[396] group. The facts of the case were as follows. The Italian company Intertaba, part of the Philip Morris group, was manufacturing cigarette filters. Intertaba also performed various services on behalf of foreign group companies without receiving remuneration. The service deemed most important by the Italian

[394] Para. 38.5 of the commentary to Article 5 of the OECD MTC.
[395] See section 4.2.2.1.
[396] Corte Suprema di Cassazione, No. 3368, March 7 2002 from 4 *ITLR*, p. 926 (unofficial translation to English).

Supreme Court concerned the supervision of a contract between non-resident group companies and the Italian tobacco administration. This contract concerned the license to manufacture and sell Philip Morris products in Italy. Furthermore, representatives from Intertaba had been present when the contract it supervised was negotiated. The relevant treaty was between Italy and Germany and followed the OECD MTC in relevant parts. It can be noted, however, that at that time Italy had made an observation on the commentary stating that it considered the list of examples in Article 5(2) to be places always constituting PEs unless proven otherwise by the taxpayer.

The Supreme Court started by stating that it was undisputable that Intertaba performed the role of a PE for several group companies within the common group strategy. It did not matter that the PE assessment was made only for the German company. Thus, Intertaba constituted a PE for various group companies in different countries without a need for a separate assessment for each company and tax treaty. The court continued to state that even though a group was not a taxable subject, neither in domestic law nor in the tax treaty, it could not be dismissed as Intertaba performed management functions on behalf of several companies according to a group-wide plan. Thus, the synergies between the various group companies for which Intertaba performed management functions meant that *dependence* could only be assessed by adopting a global approach, considering the strategy of the whole group. Additionally, the court considered that a global approach should be applied when determining whether Intertaba performed preparatory or auxiliary activities. Furthermore, the court considered the group's organization odd and designed to hide a PE in Italy. The court did not settle the case but rather sent it back to the regional court with guidance on how to interpret the PE concept.

The Italian Supreme Court's reasoning in this case focuses on substance-over-form as the main principle when applying the PE concept. The economic reality is, of course, that a group is an economic unit and, consequently, the court assesses the group as a whole. This meant that Intertaba was considered a PE of the group. This approach is not consistent with the previously outlined starting point that each company in a group is a separate legal entity, and the ruling has been

criticized, rightly so in my opinion, on this point.[397] Indeed, the above-mentioned statement in the commentary, that the PE assessment should be made separately for each company in a group, was a direct response to the *Philip Morris* ruling.[398] Furthermore, the notion that persons from third countries can constitute PEs according to a tax treaty they are not covered by is far reaching and strange. Nevertheless, in principle, a person can constitute a multiple PE for a number of related persons, provided that the conditions are fulfilled for each person according to the relevant tax treaties. There is no limit in the PE concept on how many persons can use the same fixed place of business.

Despite the critique of the *Philip Morris* case, the BEPS project seems to move closer to the Italian Supreme Court's reasoning on a principle level. In *Philip Morris* an economic approach was adopted, the group seen as one unit, with a focus on substance-over-form. The proposals presented under Action 7, concerning the artificial avoidance of PE status, increase the focus on the group as a unit in several cases. Three proposals are especially relevant to this discussion in the final report on BEPS Action 7.[399] These proposals concern when an agent is dependent, the splitting up of contracts under the construction PE, and the exceptions for preparatory and auxiliary activities.

When it comes to the dependency assessment, the report proposes that an agent who acts exclusively or almost exclusively on behalf of one or more closely related principals should not be considered independent.[400] Thus, a group is by default seen as a single business unit when determining the number of principals under the agency clause

[397] See for instance Gazzo, M, "Permanent Establishments through Related Corporations", *Bulletin for International Fiscal Documentation*, no. 6 2003, p. 263, and Trutalli, F, "Independent Legal Entities or Permanent Establishments?", *European Taxation*, no. 8 2002, p. 367-369.

[398] Para. 41.1 of the commentary to Article 5 of the OECD MTC. It can be noted that Italy responded to this change by making an observation on the commentary in that part, stating that "its jurisprudence is not to be ignored in the interpretation of cases falling in the above paragraphs [including 41.1, my remark]", para. 45.10 of the commentary to Article 5 of the OECD MTC.

[399] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*.

[400] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 16-17 and 25-26.

according to the proposal in the Action 7 report. To some extent this means that one can assess dependency on a group level, as suggested by the Italian Supreme Court in *Philip Morris*, creating a dependent agent for the entire group.[401] The most interesting question here is how this proposal should be dealt with when assessing a related person PE under the fixed place of business rule. Presently, the number of principals is not in itself decisive when determining whether an agent is dependent.[402] Instead, it acts as an argument to strengthen or weaken the general analysis of dependence. The proposal, however, strengthens the position of the number of principals argument as an agent who acts almost exclusively on behalf of one or more closely related principals is considered dependent. If this proposal were to be used as guidance under the fixed place of business rule, the consequence would be that all companies that only perform services on behalf of other group companies would be dependent and run the risk of constituting fixed place of business PEs. This does not seem suitable and I submit that *if* this proposal is adopted by the OECD, it should not carry over to the fixed place of business rule.

There are three arguments to support this conclusion. The first argument is that the agency clause and the fixed place of business rule are two separate rules. This means that there is no automatic exchange of conditions between them. Thus, a change in the agency clause's dependency assessment does not automatically lead to a corresponding change under the fixed place of business rule.[403] This leads to the second argument, which is that the proposal is not helpful while applying the fixed place of business rule. The point of the dependency assessment in the context of the fixed place of business rule is to determine whose business is being conducted. Consequently, the proposal must be helpful when answering that question to be of any use under the fixed place of business rule. To begin with, it can be noted that the proposal seems to be a deeming provision on dependence. Presently, an agent that is legally and economically independent is considered independent even if it has only one client. Indeed, this is the case even if that client is a related person. This would, in general, not be the case

[401] Provided the agent acts on behalf of all group companies.
[402] See section 5.4.3.4.
[403] See section 4.2.2.1 where it is argued that a higher standard of dependency should be applied in the context of the fixed place of business rule.

for related persons under the BEPS proposal.[404] Thus, an agent who is considered absolutely independent is deemed dependent if it acts almost exclusively on behalf of group companies. Such a deeming rule is of little interest under the fixed place of business rule as it does not answer the question of whose business is being conducted. Furthermore, one must observe the context of this proposal. It comes from the BEPS project's Action 7, which concerns the artificial avoidance of PE status. More specifically, this proposal is one part of several proposed changes to make sure that commissionaires are considered agency PEs. Commissionaire structures are in identified the report as often being used "primarily in order to erode the taxable base of the State where sales took place."[405] The proposal concerning the number of principals is said to address this by preventing an agent acting as a commissionaire exclusively on behalf of closely related persons from avoiding being considered a PE.[406] Nowhere in the report is the question of whose business is being conducted touched upon. Thus, the proposal can be considered an anti-avoidance provision that deems an agent dependent regardless of whose business the agent conducts. Based on the above, the conclusion is that the proposed change to the agency clause does not help in determining whose business is being conducted under the fixed place of business rule.

The third, and last, argument is that the proposal at the very least comes close to breaching the notion that related persons are separate entities when it comes to taxation, both according to the agency clause and, if applied, to the fixed place of business rule. Having companies in a group that only performs services on behalf of other group companies or having group companies as their only clients is common. If the proposal were to be used as guidance under the fixed place of business rule, such companies would be viewed as conducting the business of a related person, or persons, rather than their own. As this situation is common it could possibly be the norm that a subsidiary

[404] One can note that the proposed new commentary, which is based on the final report for Action 7, seems to put more emphasis on the number of principals than the current commentary. See para. 111 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[405] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 15.
[406] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 15.

engages in its parent's business rather than its own. This is not in line with the related company clause and the general structure of the PE concept. Thus, based on the three arguments presented above, if this proposal is adopted in the OECD MTC it should not be used as guidance when determining whose business is being conducted under the fixed place of business rule.

Another change to the PE concept presented under BEPS Action 7 is that it should be possible to consider the businesses of several related persons when assessing preparatory or auxiliary activities.[407] However, this suggestion is limited to activities carried out in the state of establishment.[408] This proposal is also a step closer to seeing related persons as one unit. This is discussed further in the chapter dealing with preparatory and auxiliary activities.[409]

Another interesting proposal in the BEPS project's Action 7 concerns the construction clause.[410] More specifically, the proposal is focused on the splitting up of contracts between related persons in order to avoid the twelve-month threshold. To prevent this behavior a new alternative provision is introduced to be included if the contracting states feel it is necessary, which states that connected activities performed by closely related enterprises at the same site or same project but at different periods of time, should be aggregated when assessing the twelve-month threshold. The "sole purpose" of this aggregation of activities is the twelve-month threshold. This is explained in the first Action 7 public draft as not affecting the attribution of profits or "attributing the activities of one enterprise to the other".[411] Consequently, the result is several PEs and not a group PE. The problem of splitting up contracts is already recognized in the commentary.[412] There it is stated that this abusive practice may fall under domestic an-

[407] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 39-41.
[408] There are further requirements in the proposed new rule. This is discussed in detail in section 6.5.3.
[409] See chapter 6.
[410] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 42-44. One should note that the OECD proposes to use the new Principal Purposes Test as the preferred option.
[411] OECD, *BEPS Action 7: Preventing the Artificial Avoidance of PE Status*, Public Discussion Draft, 2014, p. 22.
[412] Para. 18 of the commentary to Article 5 of the OECD MTC.

ti-avoidance provisions but that countries may want to put a special provision in their treaties to counter this further.

As with the two previously discussed proposals under Action 7, this one can be seen as a shift towards a more economic approach when it comes to related persons, i.e. the activities of several related persons on the same site or project can be seen as one business. Yet again, the question is whether this influences the assessment of whose business is being conducted under the fixed place of business rule. The same arguments against using this under the fixed place of business rule that were discussed in relation to the suggestion on the number of principals are relevant here. These arguments were that it concerned different rules, had an anti-avoidance purpose and was not designed to solve the question of whose business is being conducted, and that it may breach the notion of companies being separate entities. The third argument is less relevant as it is explicitly stated that this suggestion should not be applied to attributing activities between related persons. This statement also strengthens the second argument as it is clear that this proposal concerns anti-avoidance only, not whose business is being conducted. Thus, the conclusion must be the same as before, namely, that it is not appropriate to use this view as guidance under the fixed place of business rule. It should be noted, however, that the commentary on the fixed place of business rule refers to the construction clause when companies abuse the temporal aspect of "fixed" under that rule.[413] Nevertheless, this approach seems best suited to counter abuse of the temporal aspect of "fixed" and not in general when assessing the related person PE.

Having concluded that the relevant proposals under BEPS Action 7, concerning related persons as an economic unit, are not suitable to use as guidance under the fixed place of business rule, we return to the question at hand, i.e. to what extent can one aggregate the activities of related persons under the dependency assessment to determine whose business is being conducted under the fixed place of business rule? Despite this conclusion, the proposals in the BEPS project indicate a shift in how this question is perceived. Naturally, it is not possible to quantify how big or small this shift is. However, the BEPS pro-

[413] Para. 6.2 of the commentary to Article 5 of the OECD MTC, which refers to para. 18 of the commentary to Article 5 of the OECD MTC.

ject, the commentary update[414] and the case law discussed in section 4.2.2 clearly indicate a less distinct line between related persons when it comes to the PE concept.

It is now time to revisit the Italian Supreme Court's reasoning in *Philip Morris* regarding the possibility of determining dependency by considering the strategy of a group as a whole. As mentioned previously, the OECD is not entirely against considering several related persons when determining dependency. However, this is in the context of a number of principals acting together to control the agent and to prevent various types of abuse. The phrasing used in the commentary is "act in concert", which implies a conscious strategy. This situation is less likely to occur when the principals are not related somehow. It would seem that this approach is designed to prevent the conscious splitting up of controlling elements between related persons. Thus, it can be seen as a tool to prevent tax avoidance. One must be cautious when applying concepts designed to prevent tax avoidance in situations without this element. This leads to the conclusion that it is possible to consider the group's strategy, at least regarding the agency arrangement, in the dependency assessment. It seems to me that the court in *Philip Morris* considered that the group's strategy with the chosen organization was to avoid taxation in Italy. With that in mind, the court's reasoning regarding dependence does not seem that far from the OECD position. Nevertheless, the court's approach is wider and is used in a dependency assessment under the fixed place of business rule. The question of whether this is possible, or desirable from a policy perspective, remains unanswered.

To answer this question a couple of things need to be clarified and discussed. First, I have already concluded that it is possible to use the dependency assessment, although somewhat modified, as guidance under the fixed place of business rule to determine whose business is being conducted. Second, it is clear that creating a "group PE" is not in line with the PE concept in principle. However, in practice one could argue that this is what the OECD does, in a limited sense, with the BEPS proposal to always treat agents as dependent if they almost exclusively perform activities on behalf of related persons. This is a

[414] The update referred to here is the one in 2005, where it was stated that a related person could constitute a PE according to the fixed place of business rule.

deeming provision that is based on form. As I argue for a substance-over-form approach to determine whose business is being conducted, I do not approve of this view as guidance under the fixed place of business rule.

Having said that, if elements of control are split up between related persons in a way that each person by themselves cannot be considered to control another related person, it seems suitable to aggregate these elements.[415] This is provided that these elements of control are connected. Based on this, the conclusion is that one can aggregate the activities and controlling elements of several related persons when assessing whose business is being conducted. Finally, I want to stress that even if a person is acting exclusively on behalf of related persons, the first mentioned person can still conduct its own business, and, consequently, not constitute a PE.

4.3 The Existence of a "Place of Business"

4.3.1 Introduction

In this section the term "place of business" is discussed. This condition can be said to be the most basic one in the fixed place of business rule. Without a place of business there can be no fixed place of business PE. This condition signifies the need for a physical presence in the state of establishment to have a fixed place of business PE. This requirement separates the PE concept from pure source taxation as what is assessed is the taxpayer's, not the income's, connection to the state of establishment. However, not all places of business are PEs; the other conditions in the fixed place of business rule need to be fulfilled as well.

This section deals with three questions. The first one is what the term "business" means (section 4.3.2). The second question focuses on the meaning of the term "place of business" (section 4.3.3). The third question concerns the implications of the list of examples in Article 5(2) (section 4.3.4). Finally, some general conclusions are presented (section 4.3.5)

[415] See section 5.4.3.4 for a similar conclusion and further discussion in the context of the agency clause.

4.3.2 The Meaning of "Business"

It is not sufficient for a foreign company to just have a physical connection, a place. It must be considered a place of *business*. The term "business" is not defined in the OECD MTC. The only clarification in the model is that "the performance of professional services and of other activities of independent character" is included in the term "business", Article 3(1)h. This clarification is included to ensure that the activities previously covered by Article 14 are covered by Articles 5 and 7 in the case that these activities are not being considered to be business in domestic law.[416] According to Article 3(2), any term not defined in the convention should have the meaning it has under domestic law of the state applying the treaty. However, the article continues by clarifying that even without an explicit definition, the domestic meaning can only be applied to the extent that it does not conflict with the context of the treaty. This means that terms that are not explicitly defined in the OECD MTC can still be considered defined if one examines the treaty and its context. Thus, as business is not explicitly defined, it is necessary to examine the term in the light of the entire OECD MTC.

It has been argued convincingly that with the deletion of Article 14, and the subsequent clarification in Article 3(1)h mentioned above, the term "business" is sufficiently defined in the MTC.[417] This means that no recourse to domestic law is needed, nor is it allowed. "Business" must then be understood as any activity covered by Article 7. Consequently, anything covered by other articles cannot be considered "business" according to the OECD MTC. The function of the term "business" is to exclude passive investments from the PE concept.[418] However, passive investments may be attributed to the business of an enterprise provided that it is effectively connected to an already established PE.[419]

In conclusion, the term "business" should be understood as any independent income-generating activity. By contrast, purely passive

[416] Para. 10.2 of the commentary to Article 3 of the OECD MTC.
[417] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 24.
[418] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 18.
[419] See Articles 10(4), 11(4) and 12(3) of the OECD MTC.

investments are not "business" according to the OECD MTC. Thus, whether any activity has taken place seems to be the deciding factor. Whether an activity is independent or dependent seems to be of less importance as a person performing a dependent activity, e.g. an employee, would at the same time mean that the employer is present through said employee. Thus, this has more to do with who is present and not whether the relevant activity is business or not.

4.3.3 The Place of Business

In order for a fixed place of business PE to exist, the enterprise needs to be physically present in the state of establishment. The required physical presence is that the enterprise has a place of business. In most situations this is fairly easy to determine because an objective physical presence, an office for instance, can be observed.

The term "place of business" is broad and encompasses any types of physical locations and objects as long as they are used to carry on the enterprise's business. This is exemplified in the commentary with premises, facilities, installations and even just a certain amount of space at the enterprise's disposal.[420] It is not necessary to have a human presence to have a place of business. This means that fully automated equipment, such as vending machines and servers, can be places of business.[421] Naturally, intangibles such as patents, trademarks, bank accounts and websites cannot be considered places of business on their own as they lack physical form.[422]

In the commentary it seems to be implied that normally a place of business is in the form of premises but can also be, in "certain instances, machinery or equipment".[423] Skaar interprets "certain instances" as a reservation, which means that only significant machinery or equipment can constitute places of business.[424] Another way to interpret the phrase "certain instances" is that it just expresses a difference between what is normally the case and the more uncommon situation where an enterprise has machinery or equipment but no premises. Re-

[420] Para. 4 of the commentary to Article 5 of the OECD MTC.
[421] Para. 42.6 of the commentary to Article 5 of the OECD MTC.
[422] Para. 42.2 of the commentary to Article 5 of the OECD MTC and Skaar, A, *Permanent Establishment*, p. 121-122.
[423] Para. 2 of the commentary to Article 5 of the OECD MTC.
[424] Skaar, A, *Permanent Establishment*, p. 120.

gardless of which interpretation one prefers, there is likely little practical difference between the two. Skaar defines the place of business as "any substantial, physical object which is commercially suitable to serve as the basis of a business activity".[425]

Vogel describes the place of business as "all the **tangible assets** used for carrying on the business; in marginal cases, one such tangible asset would be sufficient".[426] The key phrase here is "used for carrying on the business". As we can see, both Skaar and Vogel emphasize the actual use of the physical object. There is no minimum requirement on the space used to be classified as a place of business.[427] A server, for instance, can in many cases be quite small but still enable extensive business activities. Instead, the crucial question is whether the space or equipment is used for carrying on business. If that is the case, it is a place of business. It makes no sense to require an arbitrary size or similar conditions on the place of business. What is interesting is whether the physical connection is used to conduct business in the specific case. Thus, the question of whether a physical location or object constitutes a place of business must be assessed on a case-by-case basis, taking into account the specifics of the enterprise's business.

It is not necessary for an enterprise to have facilities or equipment to have a place of business. As mentioned above, mere access to a certain amount of space can be sufficient. As an example of this, the OECD mentions that a pitch in a market square could constitute a place of business.[428] In the Norwegian case *Scanwell*,[429] a desk on an oilrig constituted a place of business for a Swedish company. It was not an office but rather just several desks situated in an empty room. The Scanwell employee could choose an empty desk and occupy it for his 14-day shift, but he did not have a specific one designated to him. The court concluded that about 25 percent of Scanwell's work was paperwork and performed at the desk.

425 Skaar, A, *Permanent Establishment*, p. 123.
426 Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 23.
427 Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 16.
428 Para. 4 of the commentary to Article 5 of the OECD MTC.
429 Gulating lagmannsrett, March 15 1991.

When it comes to the related person PE and the place of business, there is not much to say in addition to the above. It is explicitly stated in the commentary that a place of business can be "situated in the business facilities of another enterprise".[430] Naturally, this facility could belong to a related person. In a Swedish case,[431] a foreign parent that held its group executive board meetings every other week in the office of a Swedish subsidiary had a place of business in Sweden. Renting an office from a related person is no different in principle from renting from an unrelated person. The difficult question when it comes to related persons is not whether a place of business exists but rather to which of the related persons the place of business belongs. In most situations a local subsidiary, for instance, will have a place of business in the state of establishment, and the most relevant question is whether it can be attributed to the foreign parent.[432]

4.3.4 Article 5(2) – A List of Examples

According to Article 5(2), "the term 'permanent establishment' includes especially;

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

This list contains examples and it is explicitly stated in the commentary that the list is not exhaustive.[433] The OECD continues with the statement that the examples must be read with the fixed place of business rule in mind, which means that any item listed must fulfill all of the requirements in the fixed place of business rule in order to consti-

[430] Para. 4 of the commentary to Article 5 of the OECD MTC.
[431] RÅ 1998 not. 229. Also see Kammarrätten i Stockholm, no. 383 and 5145-1996, December 17 1999.
[432] "Relevant" should here be understood in the sense of determining whether a related person PE exists. However, this question does not arise in the majority of situations with related persons as in most cases it is clear from the start that the involved persons conduct their own business.
[433] Para. 12 of the commentary to Article 5 of the OECD MTC.

tute a PE. Given this requirement, it seems doubtful that this list adds any clarity to the PE concept.

Furthermore, the examples are a bit misleading as they are places of business rather than PEs.[434] The only example of a PE is the place of management, provided that it is "fixed", as that is not only a location but also an activity that is always considered a core business activity. By contrast, an "office" is not a PE on its own. Whether an office is a PE or not is entirely dependent on whether the conditions in the fixed place of business rule are fulfilled or not, i.e. what activities are performed, duration of activities and whether the office is fixed.[435] This is explicitly stated in the proposed new commentary to the 2017 draft update of the OECD MTC.[436] Additionally, it is clarified in the proposed commentary that the listed locations are examples of places of business and not PEs.

Granted, a factory or mine being used in what can be considered a "normal" way is of course likely to constitute a PE. But it is not guaranteed that such places of business constitute PEs.

Nevertheless, this means that instead of adding clarity, the list of examples may cause some unnecessary confusion. The list may be misinterpreted as stating that an office, for example, always constitutes a PE. The list of examples seems to be a redundant remnant from a time where treaties did not contain an explicit definition of the fixed place of business PE. Based on this, it would be better to delete Article 5(2) from the OECD MTC.

4.3.5 Conclusion

Regarding the existence of a fixed place of business and the related person PE situation, it can be concluded that no particular question relating specifically to this condition has been identified. This means that the assessment of whether a place of business exists should be made the same way for related and unrelated persons. However, as previously discussed, the general question of whose business is being conducted may be relevant in the related person PE situation. Thus, if

[434] Skaar, A, *Permanent Establishment*, p. 113.
[435] For example, an office located on a ship that is not permanently moored at the docks is likely not "fixed".
[436] Para. 45 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

a person is considered to conduct the business of another related person, the first person's formal place of business may be attributed to the other person.

4.4 The Place of Business Must Be "Fixed"

4.4.1 Introduction

A "place of business" on its own is not enough to conclude that a foreign enterprise has a PE. The place of business must be "fixed" for a PE to exist. The term "fixed" includes both a geographical and temporal aspect. The geographical aspect of fixed means that a connection between the place of business and a specific geographical point, or in certain instances an area, is required. In general, this means that the place of business cannot move around and still be considered fixed.

The temporal aspect of "fixed" concerns the duration of the place of business. A place of business needs to exist long enough to be considered fixed. In the following sections, these two aspects are discussed. The geographical connection is discussed in section 4.4.2 and the temporal aspect in section 4.4.3. The discussion about "fixed" is concluded with some general remarks in section 4.4.4.

4.4.2 The Geographical Connection

4.4.2.1 Introduction

Traditionally, "fixed" meant that the place of business was located at a specific geographical point, the typical example being an office building or a factory. As time marches on, technology improves and business practices change, and the traditional notion of "fixed" has to some degree been broadened to encompass these new practices. Of course, when the underlying circumstances change, e.g. different business practices are adopted, a legal concept such as the PE may "change" as well. This happened to the PE concept, and the notion of "fixed" now also includes an area that is a coherent whole both commercially and geographically. Both the traditional (section 4.4.2.2) and the more recently adopted (section 4.4.2.3) approaches are discussed in the following sections.

4.4.2.2 The Specific Geographical Point

According to the OECD, "fixed" should normally be understood as a "link between the place of business and a specific geographical point".[437] This means that, to have a PE, an enterprise needs to conduct its business from a specific, stable location, within a contracting state. One can note that this type of connection is always sufficient to be considered fixed in the geographical sense. This fixedness, however, does not necessarily imply that the place of business is immovable or fixed to the soil. It is sufficient that the place of business does not move and, thus, the potential for moving is immaterial. This means that even equipment that can be moved by a person, such as a small computer server, is considered fixed as long as it is not moved in practice. Another example of this is that a place of business located on a ship that moves cannot be considered "fixed" in the sense of a specific geographical point.[438] However, if the ship were permanently[439] moored at a specific location and constituted a place of business, it would be "fixed". The position expressed in the commentary seems to be the conventional wisdom on the subject, and most authors do not write much about this, but what is written tends to be in line with what is stated above.[440]

However, it can be noted that Reimer has a slightly different view. It seems that the results would not differ much between this view and the one discussed above when it comes to "fixed" as a specific geo-

[437] Para. 5 of the commentary to Article 5 of the OECD MTC.
[438] One can note that this situation is discussed in the proposed new commentary, para. 26 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[439] Permanent should be understood as any duration fulfilling the temporal aspect of "fixed", not everlasting. See section 4.4.3.
[440] Huston, J and Williams, L, *Permanent Establishments*, p. 13; Williams, L, *Fundamentals of Permanent Establishments*, p. 20-21; Tittle, M, *Permanent Establishment in the United States*, p. 67-69; Mehta, A, *Permanent Establishment in International Taxation*, p. 54; Sasseville, J, and Skaar, A, *Is there a permanent establishment?*, p. 25-26; Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 24; Schaffner, J, *How Fixed Is a Permanent Establishment?*, p. 158-160; Skaar, A, *Permanent Establishment*, p. 126; Waltrich, A, *Cross-Border Taxation of Permanent Establishments – An International Comparison*, p. 15 and Karundia, A, *Law and Practice Relating to Permanent Establishment*, p. 71 and 77.
[440] See section 1.4.2.

graphical point.[441] Nevertheless, the difference is interesting in principle. According to Reimer, the use of the word "fixed" implies that "it requires a firm connection of the facility to the soil."[442] It is somewhat difficult to pinpoint what he means by a "firm connection of the facility to the soil". He defines fixed as a link to a specific geographical point.[443] So far it follows the reasoning presented above. However, the *link* must function "as a connection which avoids any dislocation of the establishment." Examples of this are the ground and walls of a cellar and the brakes of a vehicle.[444] Thus, as a general rule, the firm connection to the soil requires the piece of equipment to be mechanically fixed, i.e. somehow prevented from moving, to a specific geographical location. However, Reimer has an exception to this rule. The exception applies to types of equipment that are usually not moved for long durations of time and for which relocations typically only happen with changes of ownership or function.[445] As examples of such equipment he mentions internet servers and mobile homes. With this reasoning, equipment that is not "connected to the soil" and that typically is not stationary for a sufficient period of time would not qualify as fixed regardless of how long it was operated at a single location.

Even though the difference between Reimer's view and my own is small in practice, it warrants a few comments. It seems problematic to advocate a system where, in principle, a car using its parking brake can be fixed but a car not using said brake cannot. Whether or not a parking brake is used is of no consequence when assessing a state's right to taxation, i.e. the use of a parking brake can never be an argument in a discussion on how to divide taxing rights. What matters is whether business activities are carried out from a specific geographical location

[441] The difference is more pronounced in the context of a commercially and geographically coherent whole. This is discussed in the following section.
[442] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 42.
[443] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 46.
[444] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 47.
[445] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 49.

for a sufficient duration, i.e. whether or not the place of business actually moves.

It seems that Reimer reaches his conclusions through a strict grammatical analysis of the ordinary meaning of the term "fixed".[446] In fact, he explicitly states that one has to leave all "teleological and fairness aspects" aside when interpreting in order to achieve a uniform interpretation among countries.[447]

This method seems to be derived from the Vienna Convention on the Law of Treaties. Indeed, according to Reimer, any interpretation other than this "strict interpretation" would be in breach of the ordinary meaning of the word "fixed".[448] This includes what is stated by the OECD in the commentary.

First, it must be said that Reimer's and my own view on interpretation are quite different.[449] This may explain his different view on the meaning of the term "fixed". Second, given a strict interpretation of the ordinary meaning of "fixed", it seems inconsistent to allow exceptions; either the ordinary meaning requires a mechanical fixation or it does not. Regardless, as stated above, the difference in practice is small. In essence, the difference is that I argue that whether the place of business is stationary in practice is decisive while Reimer argues that without a connecting factor, only places of business that typically do not move for a sufficient duration can be considered "fixed".

In summary, "fixed" in the traditional sense requires a connection to a specific geographical point. Ships, vehicles and movable equipment fulfill this requirement provided that they are not moved in practice. Finally, it can be concluded that this assessment does not have any particular relevance to the related person PE. This means that the connection to a specific geographical point should be determined the same way for related and unrelated persons. Of course, as already discussed at length, the question of whose business is being conducted may influence who has the fixed place of business.

[446] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 40-44.
[447] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 45.
[448] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 45, 51 and 59.
[449] See section 1.6.3 for my view on interpretation.

4.4.2.3 A Commercially and Geographically Coherent Whole

As discussed in the previous section, "fixed" normally means a connection to a specific geographical point. However, in the commentary a less strict approach to "fixed" is discussed. According to the OECD, an enterprise that moves around can still be considered to have a single fixed place of business.[450] This requires that the different locations from which the activities take place can be considered a commercially and geographically coherent whole. This should be assessed in the "light of the nature of the business".[451]

This approach was included in the commentary in 2003, but in the report that was leading up to the change it was concluded that "fixed" had been applied in a flexible manner historically.[452] It is noted in the report that "virtually all" countries interpret "fixed" in a wider sense than a specific geographical location.[453] Emphasis is put on the nature of the business and that "fixed" should be interpreted in the light of said nature.[454] Thus, the nature of the business is considered with commercial and geographical coherence.

It can be noted that the idea that a commercially and geographically coherent whole could constitute a single place of business was already recognized under the construction clause. This was mentioned in the report, and the commentary also contains a specific reference to the parts concerning the construction PE.

An initial question, then, is how the fixed place of business rule and construction clause relate to one another. As a starting point, the fixed place of business rule and the construction clause are two *distinct and different* rules. This means that it is not automatically the case that they should have the same meaning in this situation. With that said, these rules exist in the same context, namely, the context of PEs, and deal with the same question. Therefore it is justified to glance at the construction clause while interpreting the fixed place of business rule.[455] This is especially true in this case as the commentary regarding the term "fixed" contains an explicit reference to the corresponding

[450] Para. 5.1 of the commentary to Article 5 of the OECD MTC.
[451] Para. 5.1 of the commentary to Article 5 of the OECD MTC.
[452] OECD, *2002 Reports Related to the Model Tax Convention*, p. 76.
[453] OECD, *2002 Reports Related to the Model Tax Convention*, p. 76.
[454] OECD, *2002 Reports Related to the Model Tax Convention*, p. 77.
[455] This is the case for the PE concept in general.

parts concerning the construction clause.[456] Indeed, the basis for the notion of a commercially and geographically coherent whole is credited, or perhaps justified, to the part of the commentary dealing with the construction clause.[457]

However, it is important to reiterate that the starting point is that the fixed place of business rule and construction clause are different rules and may have different meanings.[458] A reason for such different meanings is that the OECD stresses the importance of the nature of the business. The activities covered by the construction clause are of a specific nature. Indeed, that specific nature of business is the reason that the construction clause exists in the first place. By contrast, the activities covered by the fixed place of business rule are much more varied, and some have little in common with construction-type activities. The conclusion of this is that one can consider how the commercially and geographically coherent whole is interpreted under the construction clause and use it as guidance when interpreting the fixed place of business rule.

Turning back to the question of the meaning of a commercial and geographical whole, a suitable point of departure is the view expressed by the OECD in the commentary. To further clarify what this notion means, the OECD provides a few examples. The first example is that a large mine where activities move around "clearly constitutes a single place of business".[459] Another example is an office hotel, where an enterprise regularly occupies different offices. In this situation the entire building constitutes a geographical whole according to the OECD.

As an example of a situation that does not constitute a single place of business, the OECD mentions a painter who works in the same building in consecutive but unrelated contracts with different clients.[460] In this example, the unrelated contracts mean that commercial coherence is missing. By contrast, if the painter works under a single contract, a single place of business exists according to the OECD.

[456] Para. 5 and 5.1 of the commentary to Article 5 of the OECD MTC.
[457] Para. 5.4 (which references para. 18 and 20) of the commentary to Article 5 of the OECD MTC.
[458] For a similar opinion see Schaffner, J, *How Fixed Is a Permanent Establishment?*, p. 169.
[459] Para. 5.2 of the commentary to Article 5 of the OECD MTC.
[460] Para. 5.3 of the commentary to Article 5 of the OECD MTC.

Another example provided by the OECD is a consultant training the employees of a bank under a single contract.[461] The employees are situated in different offices and consequently the consultant moves around.[462] According to the OECD, this situation constitutes a commercial whole as the work is undertaken under a single contract. However, the geographical coherence depends on whether the different offices are situated in the same building, or more accurately, *at the same location*.[463] In the case of a single location there is geographical coherence, and a single place of business can exist. In the case of two or more locations at different branches, the geographical coherence is missing. The structure of this example is somewhat surprising. It is difficult to see what the point of the expanded geographical coherence that these examples are supposed to illustrate is. The examples seem to imply that basically the same location is required. This would reduce the impact of geographical coherence in these situations to using different offices in the same building. Is that really necessary to "clarify" in the commentary? Is the meaning of the traditional idea of a specific geographical point so narrow that it does not include changing offices within the same building? I do not think it is. The two examples with the consultant do not seem useful in providing additional clarity. Instead, they might add some confusion as one tries to find some hidden meaning to justify having them in the commentary.

Schaffner argues that the "commercial" aspect and not the "geographical" is the most important.[464] This is because the geographical nexus requirement is already softened in the context of the "coherent whole" concept. In essence, he argues that the commercial coherence is used to accept an establishment as a PE despite its lack of the "fixed" requirement. This is a convincing argument on how to understand the idea of a "coherent whole", and it leads to the conclusion

[461] Para. 5.4 of the commentary to Article 5 of the OECD MTC.
[462] That the consultant at least has some space at his disposal at the various offices seems to be implied.
[463] In the examples, the OECD mentions branches as well. At a first reading it may seem that whether or not the work is performed in one or more branches of a company would affect the outcome. However, in my opinion, this is just ambiguously worded by the OECD and not intended to be a decisive fact. The key fact of the example is that the business is conducted at several different locations, not that the locations belong to different branches.
[464] Schaffner, J, *How Fixed Is a Permanent Establishment?*, p. 256.

that if it is not a single project, i.e. a commercial whole, it cannot amount to a PE. Schaffner continues by suggesting that the specific geographical point or geographical coherence is linked with the permanence and disposal tests.[465] According to him, somewhat cautiously, a place of business can lack the connection to a specific geographical point and still constitute a PE provided that the other two tests are "passed with clear success" and that the various locations are commercially coherent. This interpretation is appealing, but in my opinion Schaffner takes it too far as his interpretation more or less removes the geographical component of "fixed" and replaces it with permanence and disposal. I can agree with the sentiment that if certain aspects of the PE are "passed with clear success" one can sometimes set the bar slightly lower for other conditions. This, however, does not imply completely removing the bar, in this case the geographical component of fixed. Consequently, I do not agree with the second part of Schaffner's reasoning described above.

Based on the above, the commercial aspect can to some degree compensate for a lack of a fixed geographical nexus but not the other way around. This is clearly manifested in the two variants of the OECD's "painter example" described above.[466] One cannot really imagine it any other way. For instance, it is unthinkable that two commercially unrelated companies occupying different offices in the same building should be considered together in the PE assessment. Geographical coherence can never compensate for a lack of commercial coherence.

Based on this it makes sense to start with commercial coherence. The main feature of commercial coherence is that the assessed activities can be considered part of a single project. In situations with service providers, the number of contracts and clients should be the starting point. One contract or several contracts for one client imply commercial coherence. In a Swedish case, one contract to renovate an unspecified number of apartments for two related companies was considered to be one project and, thus, commercially coherent.[467] This is not decisive, however, as one can imagine large enterprises having

[465] Schaffner, J, *How Fixed Is a Permanent Establishment?*, p. 262.
[466] Para. 5.3 of the commentary to Article 5 of the OECD MTC.
[467] Kammarrätten i Göteborg, no. 3734-15, June 23 2016. This case concerned the construction clause.

different management and lines of business. Thus, several contracts with the same enterprise can be considered unrelated, which would mean no commercial coherence. With that said, it should not be possible to use a number of related persons to avoid having activities considered a commercial whole. If contracts are artificially split up into several contracts between related persons in order to avoid having a PE, the business operations can still be seen as constituting a coherent commercial whole. This is the case from the perspectives of both buyer and seller.

Reimer lists a number of factors that can help determine commercial coherence. These are that it is in the nature of the business to move, identity of customers, identity of staff and equipment, how complex and large the equipment or facilities are and, finally, homogeneous or similar terms of trade.[468] It is not possible to formulate a complete list of factors to consider, nor the individual importance of the different factors. Thus, Reimer's list of factors is a good starting point in this assessment. In addition to this, in the case of a foreign service provider, it is necessary to make this assessment from the client's perspective.[469] One could possibly seek some guidance from the concept of "complementing functions part of a cohesive business operation". In the future this may be even more fruitful as this concept is, through the BEPS project, proposed to be introduced in the actual treaty text, which may produce more guidance from the commentary and case law.[470]

In summary, the commercial coherence should be determined on a case-by-case basis, taking into account the specific facts and circumstances, in particular the circumstances listed above, of the specific case.

Moving on to the "geographical coherence", one can mention that this is not an absolute condition that can be clearly defined. Just as with the commercial coherence this must be assessed with the nature

[468] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 56, 140 and 146. For similar, but not as comprehensive, factors to assess see Skaar, A, *Permanent Establishment*, p. 151 and 363-373. Skaar discusses this under the construction clause, which means that not everything may be immediately relevant for the fixed place of business PE. Also see Schaffner, J, *How Fixed Is a Permanent Establishment?*, p. 170.
[469] Schaffner, J, *How Fixed Is a Permanent Establishment?*, p. 169.
[470] See section 6.5.3.

of the business in mind. In the commentary, a couple of examples of geographical coherence are mentioned. These examples are a large mine, a building for a painter, a building in the form of an "office hotel" for a consultancy business, various offices at the same location for a consultant, and a street or outdoor market for a trader.[471] One can note that these examples represent business operations that, by their nature, move around. This further stresses the importance of taking the nature of the business into account when determining whether activities can be considered geographically coherent. Furthermore, all of these examples concern places of business that each in themselves are connected to a specific geographical point. There is a difference between a ship that is never connected to the seabed and a food truck that parks different places at a market.[472] The difference is that the food truck is connected to a geographical point at each location while the ship is not. Here one can note that it was proposed in the 2012 OECD report that a ship operated in a restricted area could, "depending on the circumstances", be considered a commercially and geographically coherent whole.[473] This example is introduced in the proposed 2017 update of the OECD MTC.[474] However, this statement does not seem to be in accordance with how the PE concept has been understood in this respect even though it seems correct from a policy perspective.[475] If the proposed update to the OECD MTC is accepted, however, it is likely that this interpretation will become more common.

The Norwegian *Alaska*[476] case can illustrate this. In this case three Norwegian fishermen were working on fishing boats off Alaska. These fishermen had a stake in the catch and earned a percentage of the profit. The Norwegian Supreme Court held that the boats themselves

[471] Para. 5.2-5.4 of the commentary to Article 5 of the OECD MTC.
[472] Skaar, A, *Permanent Establishment*, p. 150 and Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 57.
[473] OECD, *OECD Model Tax Convention: Revised Proposals concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, 2012, p. 11-12.
[474] Para. 26 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[475] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 58-59.
[476] Høyesterett, Rt. 1984 p. 99.

could not be considered fixed places of business because they lacked the geographical connection. Consequently, no PE existed.

The examples provided by the OECD also seem to express the notion that geographical coherence requires a defined area of some sort. In the examples these defined areas are a building, a mine, a street and a market. By contrast, in the example with different buildings, the geographical coherence was not present.[477] As mentioned above, the examples relate to businesses that naturally move around. Thus, one could argue that the defined area should relate to the nature of the business, e.g. a defined area of natural resources such as an oil or ore field. Without the need of such a defined area, as Skaar puts it, "the PE principle may for practical purposes be reduced to source-state taxation with a 'duration test'."[478]

The notion of a defined area can be found in case law. In a Swedish case, the Administrative Court of Appeals held that the area was not sufficiently defined and could not be considered geographically coherent in light of the enterprise's business.[479] In this case the court concluded that the enterprise had a "strong connection" to an area within a Swedish city, but that was not sufficient to consider that area a fixed place of business. Similarly, in a Norwegian Supreme Court case where a foreign consultant worked at different locations and offices in two different cities, it was held that the geographical connection was missing.[480] Additionally, the court discussed the question of whether on-shore and off-shore business was comparable when it comes to a commercially and geographically coherent whole but found, with a reference to Skaar, that it was questionable. This last remark once again stresses the important connection with the nature of the business, i.e. off-shore business is of a different nature than office work.

[477] Para. 5.4 of the commentary to Article 5 of the OECD MTC.
[478] Skaar, A, *Permanent Establishment*, p. 128. Similarly, see Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 59.
[479] Kammarrätten i Göteborg, no. 4739-4742-10, December 28 2012.
[480] Høyesterett, Rt. 1994 p. 752. For a comment on this case see Skaar, A, "More Catholic than the Pope? A Norwegian Supreme Court decision on permanent establishment and the 183-day rule", *British Tax Review*, no. 6 1997, p. 494-517.

The development of the "commercially and geographically coherent whole" notion seems to have its root in mobile business practices that have a considerable potential for tax revenue.[481] For instance, one can see this as the commentary to the construction clause was the first part of the PE concept to incorporate the "commercially and geographically coherent whole". A further indication of this is that the OECD put emphasis on "the nature of the business" as moving. Thus, it would seem that the function of this notion originally was to include in the PE concept certain types of businesses that generally lacked a sufficient connection to a specific geographical point because those businesses moved around. In a sense one could characterize these businesses as "permanent" within a country's territory. One can add that these types of business have the potential to generate substantial tax revenue, e.g. it is not surprising that the off-shore oil industry was included whereas traveling salesmen and circuses were not. Consequently, one could argue that this idea was established as a way to uphold the PE concept's relevance by applying it to important, from a tax revenue perspective, situations not previously covered.

Considering this, we revisit the examples provided by the OECD in the commentary. In the light of my interpretation regarding the original intent, it is surprising that the OECD uses a painter and consultant who train personnel as examples.[482] Neither of these businesses seems to me to typically be "moving". Nor do they typically represent a substantial source of tax revenue, at least if they are not conducted from a traditional place of business such as their own office. From my point of view, these situations are not why a concept such as a geographically and commercially coherent whole is warranted. Furthermore, both examples deal with service providers. Thus, it would make more sense to deal with these situations within the concept of service PE instead of "shoehorning" it in under the fixed place of business PE. These examples seem to be more or less precisely the situations the service PE is supposed to "solve". To me, it is not a good solution to both introduce a new rule and at the same time include similar situations in the old rules as this only leads to a more complicated fixed place of business PE. This may lead tax agencies to treat foreign ser-

[481] Skaar, A, *Permanent Establishment*, p. 128 and 151.
[482] Para. 5.3 and 5.4 of the commentary to Article 5 of the OECD MTC.

vice providers as having PEs because of a geographically and commercially coherent whole.[483]

In conclusion, it is argued that the geographical coherence assessment must start with the nature of the business. Furthermore, the assessed area must be sufficiently defined and connected to the nature of the business. A typical example of this is the extraction of natural resources within a defined area. The examples regarding service providers in the OECD MTC are rejected as sources of guidance when determining whether a geographically coherent whole exists as the businesses in these examples lack a connection between the nature of the business and a defined area.

4.4.3 The Temporal Aspect – "Permanence"

4.4.3.1 Introduction

The second aspect of "fixed" is that the place of business must be established with "a certain degree of permanence".[484] In the commentary this is described as "not of a purely temporary nature".[485] From the commentary it is clear that "permanence" does not mean everlasting. As Skaar puts it, "'temporary' in this context refers to a rather short period of time, while the term 'permanence' refers to a rather long duration."[486] Exactly what is a sufficiently long duration is difficult to define. There is a lack of consistency on this requirement between countries.[487] However, the OECD concludes that, in practice, durations of less than six months have normally not been considered sufficient.

Before discussing what duration is required, it is necessary to determine what it is referring to. Permanence is a part of the notion of a "fixed place of business". The location of a place of business, such as a building, can be assumed to fulfill this requirement in almost all situ-

[483] From personal experience I know that the Swedish tax agency has had some interest in this question. This experience comes from giving lectures at the Swedish tax agency.
[484] Para. 2 of the commentary to Article 5 of the OECD MTC.
[485] Para. 6 of the commentary to Article 5 of the OECD MTC.
[486] Skaar, A, *Permanent Establishment*, p. 210.
[487] Para. 6 of the commentary to Article 5 of the OECD MTC and Sasseville, J, and Skaar, A, *Is there a permanent establishment?*, p. 29-30.

ations. Thus, if "permanence" were referring to the location of a place of business it would be a rather pointless test as it would almost always be fulfilled. This means that, to make sense, the test must refer to something else. A location, such as a building, is not a place of business on its own. It becomes a place of business when a person uses it for its business. The conclusion of this must be that "permanence" relates to the enterprise's use of a location and not to the location itself.[488]

There are several interesting questions to discuss in relation to the permanence test. An initial question is whether there is a connection between the permanence test and the explicit duration of twelve months in the construction clause (section 4.4.3.2). Depending on the answer to the first question, the question of how a sufficient duration is determined is discussed (section 4.4.3.3). After this, the specific situation of recurring activities is discussed (section 4.4.3.4).

4.4.3.2 A Connection with the Construction Clause?

In the construction clause it is explicitly stated that a minimum duration of twelve months is required for a PE to exist. It has been suggested that one could have guidance from the construction clause when interpreting "permanence" under the fixed place of business rule. It can be noted that it is quite common for countries to use a shorter duration than twelve months in their treaties.[489] Thus, if there is a connection, the meaning of permanence can differ depending on the time limit chosen in the construction clause.

There is no mention of this in the commentary. The absence of this discussion clearly indicates that there is no such connection, at least not a formal one. If the permanence assessment in the fixed place of business rule is intended to follow the time threshold in the construction clause, then surely this would have been mentioned. Instead, the OECD mentions that countries usually consider a fixed place of business PE to exist if it has lasted longer than six months.[490]

[488] Skaar, A, *Permanent Establishment*, p. 209; Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 28 and Huston, J and Williams, L, *Permanent Establishments*, p. 13.
[489] See for instance Sweden's treaties with Albania, Argentina, Chile, India, China, Malta and Portugal, all of which have a six-month threshold.
[490] Para. 6 of the commentary to Article 5 of the OECD MTC.

This remark is clearly at odds with the twelve-month threshold in the construction clause. Thus, the conclusion must be that it is not intended to apply the time threshold in the construction clause under the fixed place of business rule.[491]

4.4.3.3 Permanence

As previously mentioned, it is stated in the commentary that a duration of less than six months is rarely considered sufficient but that a duration longer than six months is often considered sufficient. This is a good starting point when analyzing permanence as it seems that six months is a sort of threshold in practice. Similarly, Skaar had already concluded in 1991 that the permanence condition was somewhere between six and eighteen months and that the trend was to move to a shorter duration.[492] I would argue for an even narrower span. It is difficult to argue why a taxpayer who has been present through an establishment for the entire taxable year should not be taxed in the state of establishment. Consequently, it can be argued that permanence requires a duration of between six and twelve months.[493]

Reimer argues that permanence should be understood as normally requiring six months. This is based on the structure of the OECD MTC and domestic rules to determine tax liability.[494] As examples of this, he uses the concept of residence and the 183-day rule in Article 15. Additionally, he echoes the statement of the OECD that countries seem to have settled on a six-month threshold in practice. These are convincing arguments, and the notion that six months is normally sufficient has support in literature and in country practice.[495] Additionally,

[491] For the same conclusion see Skaar, A, *Permanent Establishment*, p. 216-217 and Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 28.

[492] Skaar, A, *Permanent Establishment*, p. 226.

[493] Similarly, Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 28 and Huston, J and Williams, L, *Permanent Establishments*, p. 13.

[494] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 66.

[495] Sasseville, J, and Skaar, A, *Is there a permanent establishment?*, p. 29-30; Schaffner, J, *How Fixed Is a Permanent Establishment?*, p. 151-152; Perdelwitz, A, "A Certain Degree of Permanence – Between Temporary and Everlasting Business Activities", *Taxation of Business Profits in the 21st Century – Selected Issues*

it seems that the OECD is reinforcing this in the proposed new commentary, where it is stated in an example that a company has a PE regardless of the fact that the "presence lasts less than six months".[496] Thus, it can be concluded that an establishment can normally be considered "permanent" with a duration of six months.

Regarding the related person PE situation, one can note that related persons may try to avoid the permanence requirement by having several related persons performing activities over a shorter time than six months. As has been previously argued, related persons cannot artificially fragment their operations in order to avoid having a PE. Just as with the geographical aspect of "fixed", when applying the temporal aspect, i.e. permanence, one should aggregate the time spent by the different related persons involved in this fragmentation. This is explicitly stated in the commentary with a reference to the notion of a commercially and geographically coherent whole.[497] For a discussion about the commercially and geographically coherent whole, see section 4.4.2.

4.4.3.4 Recurring Activities and "One Shot" Operations

In the previous section it was concluded that six months is normally a sufficient duration to meet the permanence condition. As this is the normal way, there are exceptions to it, i.e. situations where less than six months is enough. Two exceptions are mentioned in the commentary: recurring activities and "one shot" operations.[498] Recurring activities are rather self-explanatory. One shot activities, however, need

under Tax Treaties, ed. Gutiérrez, C, and Perdelwitz, A, p. 54; Tittle, M, *Permanent Establishment in the United States*, p. 69; Williams, R, *Fundamentals of Permanent Establishments*, p. 24-26; Nørgaard Laursen, A, *Fast driftsted*, p. 113; Skaar, A, et al, *Norsk skatteavtalerett*, p. 153; Mehta, A, *Permanent Establishment in International Taxation*, p. 71; Karundia, A, *Law and Practice Relating to Permanent Establishment*, p. 93 and Pijl, H, "The Concept of Permanent Establishment and the Proposed Changes to the OECD Commentary with Special Reference to Dutch Case Law", *Bulletin for International Fiscal Documentation*, no. 9 2002, p. 557. This is also stated in the Swedish case Kammarrätten i Stockholm, no. 2276-15, October 24 2016.

[496] Para. 29 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

[497] Para. 6.2 of the commentary to Article 5 of the OECD MTC.

[498] Para. 6 of the commentary to Article 5 of the OECD MTC.

some explaining. By "one shot activities" I mean activities that are carried out for a short period of time but exclusively in the state of establishment. In the following, these two exceptions are discussed.

Starting with the *recurring activities*, it is stated in the commentary that recurring activities over a number of years should be considered together when assessing the permanence. In the proposed new commentary an example of this is included.[499] In this example an enterprise is conducting a drilling operation in the Arctic region. Because of weather conditions, the enterprise can only conduct this business for three months a year, but it is expected to go on for five years. The presented conclusion is that in such a situation the permanence condition can be fulfilled.

After the example, the OECD stresses that the short periods are because of the nature of the business. To some degree, one can agree with this as one could argue that deviation from the regular requirement should be attributable to some sort of special circumstances.[500] Given the rather short duration that is normally required, there is definitely an argument to be made for limiting this approach to situations where the even shorter duration is because of the nature of the business. Typically, this is of a seasonal nature as described in the example. However, it can be argued that after a sufficiently long period of recurring activities, the "regular" permanence test is fulfilled.[501] This means that recurring activities may cause the permanence test to be fulfilled regardless of the reasons behind them. In general, the longer the period is and the more times it is repeated, the more likely it is that the place of business can be considered permanent.[502] Consequently, one can argue for the exclusion of too insignificant periods of time.

[499] Para. 29 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

[500] One can compare this to the commercially and geographically coherent whole discussed under the geographical aspect of "fixed".

[501] Similarly, Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 83-85.

[502] Skaar, A, *Permanent Establishment*, p. 225; Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 85 and 88 and Perdelwitz, A, "A Certain Degree of Permanence – Between Temporary and Everlasting Business Activities", *Taxation of Business Profits in the 21st Century – Selected Issues under Tax Treaties*, ed. Gutiérrez, C, and Perdelwitz, A, p. 42.

Exactly where to draw the line is not possible to say, but periods of less than one to two months are difficult to consider "permanent".[503]

In the Swedish case *Dunlop Tech*[504], the Administrative Court of Appeals concluded that the company Dunlop Tech had a PE in Sweden. Dunlop Tech had, for four years, three to four months a year, conducted winter testing of its products in the northern parts of Sweden. This was sufficient to fulfill the permanence requirement according to the court. It can be noted that the Swedish tax agency seemed to argue for an automatic approach where three months for three consecutive years always satisfies the permanence test. The court, however, neither confirmed nor denied this notion.

In conclusion, it can be said that the permanence test is fulfilled if the recurring activities clearly pass the six-month threshold in a few years. The notion advocated by the Swedish tax agency in the Dunlop Tech case seems like a good starting point, i.e. three months for three consecutive years. If the six-month threshold is not passed within three years it is not justified to consider it permanent.[505] An exception to this is when the activities are recurring for many years. For instance, one could consider two months every year for ten years as permanent. Regarding related persons, the reasoning under the "normal" permanence assessment is of course applicable here as well.

Moving on to the *"one shot" operations*, they are described in the commentary as exclusively carried out in the state of establishment.[506] In the proposed new commentary, this is further clarified with an example.[507] In the example a documentary is being filmed during four months in a remote part of the state of establishment. An individual, not resident in the state of establishment, uses her parent's house to provide catering services to the film crew. After these four months the business is terminated. According to the proposed commentary, the permanence test is fulfilled because all business activities take place in the state of establishment for the business's entire existence. Conse-

[503] Skaar, A, *Permanent Establishment*, p. 225.
[504] Kammarrätten i Stockholm, no. 2276-15, October 24 2016.
[505] Similarly, Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 88.
[506] Para. 6 of the commentary to Article 5 of the OECD MTC.
[507] Para. 30 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

quently, it is established that if the individual had a catering business in the state of residence, the permanence test would not be met.

It is difficult to consider this example to be in accordance with the notion of permanence.[508] The practical implications also seem rather small. Perhaps one can consider it justifiable to tax business operations in the state of establishment if such operations are very extensive and by nature limited to a short period of time. An example of this could be large sports events such as the Olympics or the World Cup in football. However, the multinational enterprises would be excluded anyway as they already conduct their business in other countries. Thus, the practical relevance is small in this situation as well. Furthermore, it breaches the notion of neutrality as identical establishments are treated differently depending on activities outside the state of establishment.

Based on the above, this exception and the example in the proposed new commentary cannot be accepted. The view that activities taking place exclusively in the state of establishment warrant a shorter duration under permanence is not possible under the PE concept. For instance, why should this only be limited to the permanence requirement? Why not the geographical aspect of "fixed" as well? The same arguments are present if a business is not geographically fixed, i.e. a stronger connection the state of establishment. In essence, this is source taxation, which is not in accordance with the PE concept.

4.4.4 Conclusion

When it comes to the "fixed" condition and the related person PE situation, it can be concluded that the most relevant question concerns when it is suitable to aggregate the activities of several related persons by applying an economic approach. The conclusion is that this should be done when related persons fragment their operations in order to avoid having a PE. This assessment is made within the notion of a "commercially and geographically coherent whole" under both the geographical and temporal aspects of "fixed".

[508] Perdelwitz, A, "A Certain Degree of Permanence – Between Temporary and Everlasting Business Activities", *Taxation of Business Profits in the 21st Century – Selected Issues under Tax Treaties*, ed. Gutiérrez, C, and Perdelwitz, A, p. 54. For a different opinion see Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 92.

4.5 At the Disposal

4.5.1 In General

There are no specific legal or formal requirements on the enterprise's control of its place of business. It does not matter if an enterprise owns, rents or otherwise has disposal over its place of business. This means that even the illegal use of an office could constitute a PE. It is sufficient that the enterprise has the place of business at its disposal.[509] The question of "disposal" is interesting in the related person PE situation. This is because it is not uncommon for employees of one company to be present at the facilities of another related company. Also, as previously discussed, the home of a related person can be considered a fixed place of business PE of a foreign enterprise.[510]

What does "at its disposal" mean, then? The OECD states that "the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise."[511]

To illustrate this, the OECD provides four examples. The *first* example is that of a salesman who regularly visits the office of a major customer.[512] In this situation the salesman does not have the customer's office at his disposal and, consequently, no fixed place of business PE exists.[513] No specific explanation as to why the office is not at the disposal of the salesman is provided in the commentary. This is likely because it is obvious that a salesman typically does not have his customer's office at his disposal. Why is such an obvious example needed, then? As Skaar points out, the example is needed because without the need for a legal right, the condition of "at the disposal" is what prevents a PE in the example.[514]

[509] Para. 4-4.1 of the commentary to Article 5 of the OECD MTC.
[510] See section 4.2.2.
[511] Para. 4.2 of the commentary to Article 5 of the OECD MTC.
[512] Para. 4.2 of the commentary to Article 5 of the OECD MTC.
[513] This part of the example is slightly modified in the proposed new commentary in that the word "fixed" is removed before "place of business". Para. 14 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[514] Skaar, A, "OECDs 2003 kommentarer om fast driftsted i modellavtalen", *Skatterett*, no. 2 2003, p. 148.

The *second* example is actually one that concerns the related person PE.[515] In this example, an employee of one company is using an office in the headquarters of a subsidiary in order to make sure the subsidiary complies with contractual obligations towards the first company. Here, the OECD explains that the employee is conducting the business of his employer and that the office is at his disposal, which means that a PE will exist if the permanence test is fulfilled.

Comparing the first example with the second, one can draw some conclusions. In the second example an office is reserved for the employee and it can be assumed that he has a key to the office and can come and go like the rest of the employees at that location. Furthermore, it can be assumed that the employee can keep his papers and computer at the office. By contrast, none of these assumptions seem likely in the first example. It would seem that general access and some, if limited, decision-making power regarding the place of business is enough to consider it at the enterprise's disposal.

The *third* example is of a transportation company that delivers goods at the same delivery dock at a customer's warehouse every day for several years.[516] In this situation, the OECD argues, the use of the delivery dock is so limited that it cannot be considered to be at the transportation company's disposal. This example is similar to the first one with the salesman. Analyzing both of these examples together, one can conclude that being present at customers' facilities does not normally imply disposal.

The *fourth*, and final example, is the infamous "painter example".[517] In the example, a painter works three days a week for two years in a large office building. The work, i.e. painting, is done on behalf of the building's owner, which is also the painter's main client. According to the OECD, the painter has the building at his disposal. This example has been criticized for not making sense unless one assumes circumstances not mentioned in the example, for instance, that the painter has access to a room to store his equipment.[518] One can note that

[515] Para. 4.3 of the commentary to Article 5 of the OECD MTC.
[516] Para. 4.4 of the commentary to Article 5 of the OECD MTC.
[517] Para. 4.5 of the commentary to Article 5 of the OECD MTC.
[518] Nitikman, J, "The Painter and the PE", *Canadian Tax Journal*, no. 2 2009, p. 213-258; Lüdicke, J, "Recent Commentary Changes concerning the Definition of Permanent Establishment", *Bulletin for International Fiscal Documentation*,

Germany has made an observation to this example and seems to be of the opinion that the painter is merely present without a right of disposal.[519] However, to me, this critique seems to mainly address a different point than "at the disposal", namely, that the building in the example is the "object" of business and not a place of business *through* which the business of the enterprise is conducted.[520] To avoid this critique, the OECD could have settled with stating that the building was at the disposal of the painter and not that it constituted a PE.

Assessing the example from the point of providing guidance on the question of "disposal", it is hard to argue with the outcome. As Skaar points out, one can assume that the client has given the painter a right of disposal over the workplace when entering into this agreement.[521]

Analyzing all four of the examples provided by the OECD, it is difficult to draw any clear conclusions. The second and fourth examples seem to me to actually be based on a legal right, which of course is a strong indication of disposal. On the other hand, the first example clearly lacks any legal right to use the office. It would have been interesting to have an example where disposal was at hand in a situation where a legal right cannot be assumed.

Interestingly, this was discussed in the 2012 report.[522] Part of this discussion has been incorporated in the 2017 draft of an updated version of the OECD MTC. In the draft version of the commentary it is stated that "disposal" is a combination of performing activities from a specific place and the frequency or the length of time the place is

no. 5 2004, p. 191 and Popa, O, "At the Disposal of – The Way towards a Broader Concept", *Taxation of Business Profits in the 21st Century – Selected Issues under Tax Treaties*, ed. Gutiérrez, C, and Perdelwitz, A, p. 21-24.

[519] Para. 45.7 of the commentary to Article 5 of the OECD MTC.

[520] As explained by Caridi, A, "Proposed Changes to the OECD Commentary on Article 5: Part 1 – The Physical PE Notion", *European Taxation*, no. 1 2003, p. 11-12. Also see Lüdicke, J, "Recent Commentary Changes concerning the Definition of Permanent Establishment", *Bulletin for International Fiscal Documentation*, no. 5 2004, p. 191 and Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 104.

[521] Skaar, A, "OECDs 2003 kommentarer om fast driftsted i modellavtalen", *Skatterett*, no. 2 2003, p. 149.

[522] OECD, *OECD Model Tax Convention: Revised Proposals concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, 2012, p. 9-11 and 15-17.

used.[523] This merely seems to be a clarification of the present opinion as it is in line with the examples where the length of time a place is used is expressly mentioned.

The proposal for a new commentary regarding the disposal of home offices, however, is much more interesting. There it is stated that a home office that is "used on a continuous basis for carrying on business activities for an enterprise" can be at the disposal of that enterprise provided that it is clear that the enterprise has required the individual to work from home.[524] This could be manifested by the enterprise not providing an office when it is clear that the activities performed require an office.[525] According to the OECD, a clear example of this is a consultant performing most of her business activities from her temporary home in the state of establishment.[526] By contrast, the OECD continues, a situation with a cross-border worker who, by his own choice, performs most of his work from home instead of at his provided office is an example where the home is not at the disposal of the foreign enterprise. In essence, the OECD seems to be of the opinion that it should either be explicitly stated that a home office should be used or it should be clear from the facts and circumstances that both parties presume that a home office should be used. It can be noted that the Swedish tax agency has made a statement expressing a similar opinion regarding home offices and "disposal".[527]

The proposed new commentary seems not to try to change the notion of "disposal" but rather to clarify its application with the addition of some general reasoning to complement the examples. Still, it is not entirely clear how "at its disposal" should be understood and we must proceed to analyze it further.

[523] Para. 12 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[524] Para. 18 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[525] Para. 18 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[526] Para. 19 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[527] Skatteverkets ställningstaganden, 2015-03-16, Dnr 131 160469-15/111.

4.5.2 De Facto Use or Something More?

A central question about the condition of "disposal" is whether such a condition even exists. Reading the commentary, it seems that the OECD is of the opinion that such a condition exists, even more so in light of the proposed new commentary. Nevertheless, the commentary is ambiguous and it is not easy to reconcile "illegal use" with the requirement of disposal. According to Skaar, the OECD has effectively removed this requirement, even if they do not understand it, he adds.[528] Thus, the question is whether it is sufficient for an enterprise to perform its business from a specific place to have it at its disposal or if something more is required. This is discussed in the following.

We begin with the idea that the actual use of a place is sufficient to consider it to be at the disposal of the enterprise. In essence, this approach effectively removes the point and meaning of requiring "disposal". The reason is that a PE, according to the fixed place of business rule, can never exist without activities performed from a place of business. With this view, if activities are performed from the place of business, then the enterprise has that place at its disposal. This means that the "disposal" test becomes pointless. The effect of this approach to the related person PE situation is that if one concludes that a related person conducts another related person's business, it is assumed that the second person has disposal over the first person's facilities where such activities take place.

The other view is that "at the disposal" requires something more than just using a place of business. Nitikman presents this argument in an article aptly titled "The Painter and the PE",[529] i.e. that "at the disposal" implies an additional test that an establishment must pass in order to constitute a PE. His position is based on the commentary and case law, which indicate an additional requirement. However, as

[528] Skaar, A, "OECDs 2003 kommentarer om fast driftsted i modellavtalen", *Skatterett*, no. 2 2003, p. 152. For similar opinions see Arnold, B, "Threshold Requirements for Taxing Business Profits under Tax Treaties", *Bulletin for International Fiscal Documentation*, no. 10 2003, p. 479 and Pijl, H, Morgan Stanley: Issues regarding Permanent Establishments and Profit Attribution in Light of the OECD View", *Bulletin for International Taxation*, no. 5 2008, p. 178-179.

[529] Nitikman, J, "The Painter and the PE", *Canadian Tax Journal*, no. 2 2009, p. 213-258.

we will see, case law may not be clear and coherent enough to lead to this conclusion.

As previously discussed, home offices or other places used by a related person have been one of the most common situations as in recent Swedish case law. This can be said to have started, in the sense of being established practice, with the Supreme Administrative Court case of *X AS*.[530] In this case it was clear that virtually all core business activities were being performed by the foreign company's Swedish owner.[531] It was also clear that these activities, at least partly, were performed at said owner's home. The Supreme Administrative Court mentions "at the disposal" by quoting the commentary but does not discuss the question. However, from the facts of the case it seems rather clear that the foreign company had its owner's home at its disposal in much the same way as in the proposed new example in the commentary, of the consultant who conducted her business from home. Additionally, this situation represented the foreign company's regular business organization, and the activities would fulfill the OECD notion of not being intermittent or incidental. Thus, this case seems to me to be correct in finding a PE at the owner's home.

However, this case has been used as a precedent in a number of cases where it is not as clear whether activities are performed in the place available to the related person. In short, these cases can be said to apply an assumption that if a related person has a place available to him in Sweden and the facts of the case make it likely that said person performs activities belonging to the foreign enterprise, the foreign enterprise has a fixed place of business PE in Sweden.[532] This case law, as opposed to the *X AS* case, seems not to include any particular re-

[530] RÅ 2009 ref. 91.

[531] As this was an advance ruling, the facts and circumstances were provided by the taxpayer.

[532] Kammarrätten i Göteborg, no. 622-626-17, August 29 2017; Kammarrätten i Göteborg, no. 2821-2823-16, December 15 2016; Kammarrätten i Stockholm, no. 1183-1186-15, February 23 2016; Kammarrätten i Sundsvall, no. 425-428-13, February 19 2014; Kammarrätten i Göteborg, no. 6941-6945-12, June 18 2013; Kammarrätten i Göteborg, no. 2692-11, January 1 2013; Kammarrätten i Göteborg, no. 3464-3465-09, December 15 2011; Kammarrätten i Jönköping, no. 2181-2185-09, December 1 2010 and Kammarrätten i Stockholm, no. 1580-1581-08, July 19 2010.

quirement of having a place of business at the foreign enterprise's "disposal". It would seem that it is enough to actually use the place.

There is, however, one Swedish case that explicitly deals with this question.[533] This is the *Digital Envoy*[534] case. In this case, a foreign company had an employee resident in Sweden. The County Court concluded, and the Administrative Court of Appeals agreed, that the foreign enterprise had the home office of its Swedish employee at its disposal. This was based on the fact that it was stated in the employment contract that he should work from home, that the enterprise would not provide an office, but that the employee did need an office in which to perform the work. One can note that this case is in line with the proposed new commentary discussion about home offices.[535]

This question has also been dealt with in other countries. In a case from the United States, an author's home was considered to constitute a fixed place of business.[536] The deciding factors seem to have been that the author converted part of his home to an office, claimed deductions for the home office in his tax returns and conducted his business as an author from the office.

In two Canadian cases, *American Income Life Insurance*[537] and *Knights of Columbus*,[538] the question of home office as a fixed place of business was discussed. In these cases, examples of factors to assess when deciding if a home office is at the disposal of an enterprise are listed. These factors are if the enterprise pays for the home office, if the enterprise requires a home office to be used and if the enterprise requires certain equipment at the home office. In a situation where these factors are fulfilled, it is not necessary for the enterprise to have a key

533 With the exception of an advance ruling, dnr 127-14/D, which was later rejected by the Supreme Administrative Court as it believed the circumstances were not sufficiently clear to decide the case.

534 Kammarrätten i Stockholm no. 6856-14, December 14 2015.

535 Para. 18 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

536 Georges Simenon v. Commissioner of Internal Revenue, 44 TC 820, September 29 1965.

537 American Income Life Insurance Company v. Her Majesty the Queen, 2008 CarswellNat 1512, 2008 TCC 306.

538 Knights of Columbus v. Her Majesty the Queen, 2008 CarswellNat 1507, 2008 TCC 307.

to the office, according to these cases. Again, this reasoning follows that provided by the OECD.

In the Indian case regarding *Ericsson*[539] it was concluded that having employees present at facilities belonging to a subsidiary did not mean that the foreign company had that place at its disposal. This was because one could not assume "disposal" based on the fact that a foreign company sometimes used the premises of its Indian subsidiary. This fact did not imply that "whenever any employee of the assessee visited India, he could straightaway walk into the office of ECI [the Indian subsidiary, my remark] and occupy a space or a table." Based on this, the court concluded that Ericsson did not have a place of business at its disposal in India. This ruling suggests that something in addition to just using a place of business is required to have it at ones "disposal".

In the same ruling, but regarding a different taxpayer, namely *Motorola*, it was concluded that the employees of the foreign company present in India were working for both the local and foreign company. Based on this it could be presumed that they had access to the premises in such a way that the foreign company could be seen as having the premises at its disposal. Thus, it was not possible to separate the employees' two roles when determining if the foreign enterprise had the premises at their disposal. In this context, one can also refer back to the cases *MML*[540] and *Rolls Royce*,[541] where the respective courts concluded that the employees of a related company were de facto employees of the other companies. In the *MML* case the same conclusion was drawn regarded the premises.

In another Indian case, *Galileo*,[542] the question was whether computers placed in premises belonging to clients could constitute a fixed place of business PE. Galileo was a company from the United States that operated a booking system for airline tickets. The computers in India were located at various travel agents, who could use them to re-

539 Ericsson Radio Systems AB, Motorola Inc. and Nokia Networks OY v. Deputy Commissioner of Income Tax, 95 ITD 269.
540 Kammarrätten i Stockholm, no. 7453-02, May 31 2005.
541 Rolls Royce Plc v. Deputy Director of Income Tax , ITA Nos. 1496 to 1501/DEL 2007.
542 Galileo International Inc v. Deputy Commissioner of Income Tax, ITA 851-856/2008 and ITA 859-860/2008.

serve tickets for their customers. The court concluded that Galileo exercised "complete control over the computers", which meant that the company had the space these computers occupied at its disposal. This seems to have been based on the fact that the computers required authorization by Galileo (or its Indian agent). Additionally, the computers were not allowed to be moved, not even within the same office.

One can note that this case is not in line with the previously mentioned *Ericsson* case. Galileo could not access the premises belonging to its customers as it pleased. On the other hand, the PE-constituting elements, in this case the computers, were constantly present at those premises. This was not the case in *Ericsson*, where the employees were not constantly present. On the whole, the conclusion regarding "disposal" in the *Galileo* case seems questionable, especially the phrase "complete control". Clearly one can be said to have "disposal" through another person, but such a situation is more likely if said person acts as an agent, not as a customer.

To some extent, this case is situated between the salesman and painter examples provided by the OECD.[543] One can question whether it matters if an enterprise has access to a certain amount of space through employees or equipment. Access through employees definitely seems more convincing as that implies the ability to come and go (sometimes with restrictions). Equipment located at premises the enterprise does not have access to, either by itself or through agents, seems to represent the notion of de facto use rather than "disposal".

What can one conclude based on the above-presented case law and the reasoning provided by the OECD, then? The immediate conclusion is that when "at the disposal" is explicitly discussed, it seems that something more than mere use is implied. On the other hand, there are examples of situations that have been deemed to constitute PEs where the "disposal" is clearly questionable. The overall conclusion is that, just as with the commentary to the OECD MTC, it is difficult to draw a general conclusion on what "at the disposal" means. Nevertheless, both the commentary and case law make it clear that mere presence at a location is not necessarily enough.

[543] Para. 4.2 and 4.5 of the commentary to Article 5 of the OECD MTC.

However, as Reimer points out, "at the disposal" seems to be a relative standard.[544] This means that the level of control over a place of business required for that place to be considered at the disposal of the enterprise is, to some degree, dependent on what control is needed for that specific type of business. An extreme version of this relative standard is basically the same as de facto use, as if a place of business is being used for business activities it is clear that the enterprise has sufficient control to perform said activities. Such an extreme version of the relative standard is not in line with the commentary, nor with case law. Nevertheless, "at the disposal" does represent a more limited version of a relative standard. This is because businesses are different and one cannot produce a test that applies to all types without excluding, or including, unwanted situations in the concept of "disposal". Thus, the control required must, at the very least, always mean the ability to conduct the specific business from that place of business.

Based on the above, it is not possible to exactly draw a line between de facto use and "disposal".[545] This does not mean that one cannot further narrow it down. Reimer argues that a place is at the disposal of an enterprise if the enterprise has access to it any time it wants, that the place is used on behalf of more than one client and that the place can be used for administration and similar internal affairs.[546] Baker expresses a similar notion and states that "at the disposal" means that an enterprise has "some right to use the premises for the purpose of its business and not solely for the purposes of the project undertaken on behalf of the owner of the premises."[547] One can note, however, that neither of these two lines of reasoning is in line with the painter example. Nevertheless, they are still useful when assessing a specific case.

From a practical perspective, the scope of the business operation may help determine this question. If the business operations are rela-

[544] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 103-104.
[545] Similarly see Nitikman, J, "The Painter and the PE", *Canadian Tax Journal*, no. 2 2009, p. 257.
[546] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 109.
[547] Baker, P, *Double Taxation Conventions*, 5B.10, September 2002 update.

tively extensive, it is more likely that an enterprise has the place at its disposal. For instance, it is a difference between having a contract to do paint jobs in a building a few times a year and painting in a building every day during a few years. In the second situation one can assume more access and control than in the first.

4.5.3 Concluding Remark

In the previous sections it was concluded that there is a tension within the notion of "disposal". This tension can be described as whether "disposal" requires de facto use or something more. The conclusion was that it is likely that something more is required but that it is not possible to exactly define what that is. What can be said is that "disposal" must be assessed in the specific case, and the amount of control required is to some degree dependent on the needs of the specific type of business. One can also argue that at a certain level of activity it can be assumed that an enterprise has the place of business "at its disposal". For instance, in a situation where personnel routinely carry out substantial business activities from a place of business belonging to a related person, one can assume that the place of business is at the disposal of the first enterprise even if said personnel do not have complete access.

Furthermore, a good indicator of "disposal" is if the place of business is used for the business in general and not only on behalf of the owner of the premises. Additionally, if an enterprise pays for the premises and requires certain equipment to be at the premises, the enterprise can have the place at its disposal through an agent such as an employee working there. This is the case even if the enterprise itself has no physical access to the premises.

Finally, the question of "disposal" is important from a principle point of view, especially in the context of related persons. Why this is important can be illustrated with an example. If we assume that "at the disposal" has no meaning and that de facto use is all that is required, what would be the consequences? The immediate consequence would be that any place where business activities are performed will constitute a PE, in principle,[548] if it is sufficiently fixed and the excep-

[548] In practice it would be difficult to prove that a PE exists in many of these situations.

tion in Article 5(4) is not applicable. This would, for instance, mean that it is likely that the homes of high-level executives would constitute fixed places of business PEs for their employers. A CEO is likely to do part of his job at home, making phone calls, making business decisions, answering e-mails and so on. This can be the case for any job where the employees are required to be "on call" to make decisions.

Although one can surely argue that the business of an enterprise is partly conducted from its CEO's home, this is not the same as saying that the home of a CEO should, in the normal situation, constitute a PE. Having the homes of employees and related persons constitute PEs in general is not advisable from a policy perspective. First of all, this is a situation where it is difficult to prove that a PE exists. Instead, it would likely be based on an assumption. This makes the PE concept more complicated and it decreases legal certainty for taxpayers and tax agencies alike. Second, given that the existence of a PE is based on an assumption of certain activities taking place at the home of the employee, how should the attribution of profits to that PE be made? It seems rather difficult to attribute profits to such a PE according to the present regulation. Again, the assessment will be based on assumptions.

Finally, one can argue that having a PE should mean a substantial right to taxation in the state of establishment. This is because the existence of a PE creates costs in the form of increased compliance and administration for the taxpayer and both contracting states. Creating an obstacle to international trade without any substantial shift in how taxation is divided is the opposite of what tax treaties are about. An example of this is the *Digital Envoy*[549] case discussed in the previous section. To recapitulate, in this case the home office of an employee was considered a fixed place of business PE for his foreign employer. The outcome of this case was not that any profit should be attributed to the PE. As it seems, this was not even argued for by the tax agency.[550] Instead, the case revolved around a certain payroll tax that should be paid if the foreign enterprise had a PE in Sweden. The ac-

[549] Kammarrätten i Stockholm, no. 6856-14, December 14 2015.

[550] Although this is not specified one could speculate that this was because the costs incurred at the PE, i.e. the employee's salary, were considered equal to the attributed profits. In essence, a PE with no taxable income.

tual result of the case was that the foreign company had to pay 23946 Swedish kronor[551] in payroll tax. From a policy perspective, it does not seem suitable to recognize PEs without a possibility of substantial taxation.

Based on all of the above, it is preferable to require something more than a de facto use of a place of business to consider it to be at the disposal of the foreign enterprise. Thus, the proposed addition to the commentary regarding home offices is a welcome, and proper, clarification that the fact that business activities are performed at a particular place does not necessarily mean that such a place is at the disposal of the enterprise.

4.6 Through

In addition to the previously discussed conditions for a fixed place of business PE, the business of the enterprise must be carried out, in whole or in part, "through" the fixed place of business. To some extent there is an overlap with the "at the disposal" test and carrying on business "through" the fixed place of business. However, this is not always the case as a legal right, such as ownership, will typically meet the disposal test without answering whether the business is carried on from the place of business. Similarly, there is some overlap with the question of whether a place of business even exists. Regardless of these possible overlaps, it is necessary to discuss this condition separately.[552]

In the commentary it is stated that "through" should be understood in a wide sense, including "any situation where business activities are carried on at a particular location that is at the disposal of the enterprise".[553]

[551] Roughly 2500 euro with the exchange rate on October 20 2017.
[552] See Reimer, who argues that there are three aspects of "through", Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 119-124.
[553] Para. 4.6 of the commentary to Article 5 of the OECD MTC.

Reimer describes this condition as using the place of business "as an instrument (equalling or resembling an operating asset)".[554] This means that the fixed place of business should serve the business and that not all activities must necessarily be performed in the fixed place of business.[555] Conversely, the place of business cannot be the object of the business, e.g. one does not carry out one's business through leased-out equipment or a stock of goods.[556]

Comparing the notion of "through" expressed in the commentary, it is seemingly at odds with the above description. This is especially true in the light of the previously discussed "painter example", where a painter had a PE by virtue of performing his most important activity in a building.[557] Given the impact of the OECD MTC and its commentary and the general trend of lowering the PE threshold, it seems likely that the interpretation advocated in the commentary will gradually become the dominant one. Nevertheless, it can still be argued that in order to achieve this, the wording of the MTC should be changed to reflect that mere presence is enough.[558]

4.7 Conclusion

This chapter has dealt with the study's second research question in relation to the fixed place of business rule. In other words, this chapter has dealt with the application of the fixed place of business rule in the

[554] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 124.
[555] Skaar, A, *Permanent Establishment*, p. 333 and Nitikman, J, "The Meaning of 'Permanent Establishment' in the 1981 U.S. Model Income Tax Treaty: Part 1", *The International Tax Journal*, no. 2 1989, p. 164.
[556] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 30-30a and para. 8 of the commentary to Article 5 of the OECD MTC. Also see the United States case Elizabeth Herbert v. Commissioner of Internal Revenue, 30 TC 26. Differently, the Swedish case RÅ 1991 not. 228.
[557] Para. 4.5 of the commentary to Article 5 of the OECD MTC.
[558] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 128-129 and Lüdicke, J, "Recent Commentary Changes concerning the Definition of Permanent Establishment", *Bulletin for International Fiscal Documentation*, no. 5 2004, p. 191.

related person PE situation. Two main questions relevant to related persons in this context have been identified.

The first question is *whose business is being conducted*? This is a fundamental question when it comes to related persons and the fixed place of business rule, indeed, the entire PE concept. This question may influence all of the conditions of the fixed place of business rule, although indirectly. It is recommended to start with this question, in situations where this can be questioned, as the rest of the assessment will depend on its answer. Once this question is answered it does not have any more influence on the PE assessment. In essence, this question serves the function of deciding what subject the PE assessment is made for, or, in the case of one of the related persons being a resident in the state of establishment, whether a PE assessment is needed at all.

The second question is whether the activities of several related persons should be *aggregated* in a substance-over-form approach. This is mainly interesting when determining if a place of business is "fixed", but it also has some relevance when answering the question of whose business is being conducted. However, in both of these situations, the aggregation of activities serves to prevent the artificial split-up of activities and controlling elements between related persons. In situations where no such split-up is at hand, this question is not relevant.

5 Article 5(5-6) – The Agency Clause and Related Persons

5.1 Introduction

The commentary to the agency clause begins with a statement that "[i]t is a generally accepted principle that an enterprise should be treated as having a permanent establishment in a State if there is under certain conditions a person acting for it".[559] The agency clause does not require any fixed place of business and is an extension compared to the fixed place of business rule. Because of this, the agency PE is sometimes referred to as a deemed PE, presumably because a *real* PE requires a fixed place of business.[560] The agency PE can be justified as an anti-avoidance rule or as a different way of testing whether a sufficient economic connection exists.[561] The OECD seems to favor the latter;[562] in my view, however, both lines of reasoning overlap. Without the agency PE, it would be possible for certain types of businesses to conduct extensive business activities, organized to avoid a PE,

[559] Para. 31 of the commentary to Article 5 of the OECD MTC. Skaar provides an example of the general acceptance as sometimes the clause has been applied even though not included in the treaty. Skaar, A, *Permanent Establishment*, p. 463.

[560] See for instance para. 31 of the commentary to Article 5 of the OECD MTC; Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 136 and Skaar, A, *Permanent Establishment*, p. 463. This view of the agency PE can be questioned. As has been argued previously, the PE concept is not just a set of paragraphs. Instead, the PE concept expresses a situation where a foreign enterprise has sufficient connection to the state of establishment to be taxed there. A fixed place of business is not required to conduct extensive business in a foreign jurisdiction. The agency clause has its own separate conditions. Thus, the agency PE qualifies as its own separate connection test and, consequently, there is no need to call it a deemed PE.

[561] Skaar, A, *Permanent Establishment*, p. 463 and Vann, R, "Travellers, Tax Policy and Agency Permanent Establishments", *British Tax Review*, no. 6 2010, p. 540.

[562] Para. 32 of the commentary to Article 5 of the OECD MTC.

without becoming subject to taxation in the state of establishment. Extensive business activities can also be seen as a sufficient economic connection to warrant taxation in the state of establishment according to the notion of source within the PE concept. Therefore, it is not necessary to treat these objectives separately as they are inherently intertwined.

The agency PE has traditionally been the focus when studying and discussing the related person PE. This is mainly because it is, in general, easier to reconcile the related company clause with agencies than the fixed place of business rule. Treating a related person as an agency PE conforms to the general principle of separate entities in the related company clause as the agency clause requires two subjects, the agent and the principal. One can say that it is immediately apparent that the related person PE is encompassed by the agency clause in comparison to the fixed place of business rule. Another reason for this focus is that it is a common practice to establish a subsidiary in a foreign jurisdiction as an extension of the group's business.

As discussed in chapter 3, the general idea in the MTCs is to treat related persons the same way as unrelated persons. The agency clause is partly based on legal control. Naturally this creates a tension between the related company clause and the agency clause. The crucial question for this study is where to draw the line between control that can constitute a PE and that which cannot. However, control is not the only aspect that separates the related person from the unrelated agent. It could for instance be questioned whether it is possible for a wholly owned subsidiary to be considered economically independent. Regardless of whether the subsidiary bears the risk of the transactions, the parent will still always bear part of the risk from an economic point of view.

The general structure and idea behind the agency clause is the same in both the OECD and UN MTCs. However, in detail, the agency clause differs substantially between the two MTCs. The UN MTC has three major differences which, seemingly, widen the scope of the agency PE. These differences concern the number of principals, delivery from a stock of goods and insurance agents. As two of the differences in the UN MTC, the stock of goods test and insurance agents, have no counterpart in the OECD MTC and can be said to be alien to the agency clause in a general sense, these specific rules are not discussed.

The study of the agency clause is, in this chapter, divided into four parts. These parts can be characterized as (1) general questions, (2) authority to conclude contracts and (3) the dependency assessment. Finally, (4) the proposed changes to the agency clause in the context of the BEPS project are studied. Throughout the chapter, a related person PE focus is upheld, although it is necessary to discuss aspects not immediately relevant to the related person PE. First, three general questions concerning the agency clause are discussed (section 5.2). Second, the requirement to have an authority to conclude contracts is discussed (section 5.3). Third, the dependency assessment is studied (section 5.4). Fourth, the proposed changes in the BEPS project are dealt with (section 5.5). The chapter is wrapped up with some general conclusions (section 5.6).

5.2 General Aspects

5.2.1 Who Can Be an Agent?

Both MTCs state that a *person* acting on behalf of an enterprise can constitute a PE provided that the other conditions are fulfilled. This expresses two main criteria: the agent must be a person and must act on behalf of an enterprise.

Starting with the term *person*, it is a term defined in the treaty. Article 3(1)a defines a person as an individual, a company or any other body of persons. Furthermore, the term *company* is defined in Article 3(1)b and includes any body corporate or any entity treated as such for tax purposes. According to the OECD, the term "person" should be interpreted widely.[563] Relevant for this study is that both individual shareholders (individuals) and related companies (companies) are persons and can constitute agents. Partnerships are also persons, because they are regarded either as companies or as other bodies of persons.[564]

The condition of acting on behalf of an enterprise is connected to aspects discussed in later sections. One question is discussed in

[563] Para. 2 of the commentary to Article 3 of the OECD MTC.

[564] However, see Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 324 and the Swedish case HFD 2014 ref. 71.

this section, however. The wording of the agency clause is generally understood as requiring a relationship between two parties, the enterprise (principal) and the agent, which means that an entrepreneur cannot be an agent of himself.[565] As the entrepreneur and enterprise are one, this situation falls outside the scope of the study and is not discussed further. As the PE concept and tax law in general treat both individuals and companies as separate legal entities, the personal scope is not a major issue in this study.[566] Shareholders, executives and related companies are seen as separate subjects, and, thus, can act on behalf of a related principal.

5.2.2 What Connection to the State of Establishment Is Required?

According to the agency clause in the OECD MTC, an agency PE can exist if an agent "exercises, in a Contracting State [the state of establishment, my remark] an authority to conclude contracts". The same idea is expressed in the UN MTC with a slightly different wording. From this a few conclusions can be drawn. First, it is not necessary for the agent to operate from a fixed place of business or be a resident

[565] OECD, *2002 Reports Related to the Model Tax Convention*, p. 102; Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 137b; Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 322; Skaar, A, *Permanent Establishment*, p. 487; Huston, J and Williams, L, *Permanent Establishments*, p. 124-126; Sasseville, J, and Skaar, A, *Is there a permanent establishment?*, p. 50; Pleijsier, A, "The Agency Permanent Establishment: The Current Definition – Part One", *Intertax*, no. 5 2001, p. 169 and Schaffner, J, *How Fixed Is a Permanent Establishment?*, p. 220. It can be noted that older rulings from the United States point in another direction. Huston and Williams, Pleijsier and Skaar discuss these rulings but reject the result. Skaar, however, finds it reasonable from a *de lege ferenda* point of view. Interestingly, the Swedish tax agency is of the opinion that the OECD MTC does not require the agent and principal to be two separate subjects, Skatteverkets ställningstaganden, 2013-04-24, Dnr 131 253696-13/111. Their reasoning is based on a comparison between the wording in the Swedish domestic PE provision and the MTC. In the domestic law a *fullmakt* to conclude contracts for the principal is required whereas the MTC is phrased to require an *authority*. The fullmakt requires two parties, the agent and the principal. By contrast, the Swedish tax agency argues, an entrepreneur has the authority to conclude contracts binding on him.

[566] See chapter 3.

in the state of establishment.[567] Second, the connection required is the activity to conclude contracts on behalf of a foreign enterprise within the state of establishment. However, it is not clear from the phrasing of the article exactly how this connection should be understood. To some extent this is connected to the fact that the authority to conclude contracts must be exercised "habitually". In the commentary this is explained as meaning that the economic presence "should be more than merely transitory" and the authority should be used "repeatedly and not merely in isolated cases" in order for a PE to exist.[568] The question of what should be considered "habitual" is studied later in this chapter and is not further discussed here.[569] Instead, the question is whether something more than habitually concluding contracts is required to establish a sufficient connection, i.e. if concluding many contracts in a short period of time is enough.

It is sometimes suggested that the permanence requirement in the fixed place of business rule should be used in the agency clause as well. Skaar argues that if the agency clause does not have a specific permanence rule, the notion of permanence in the fixed place of business rule should be applied.[570] He continues to conclude that the permanence test and habitually concluding contracts are two separate tests that both need to be fulfilled.[571] A "permanent abode" in the state of establishment is generally sufficient to satisfy the permanence

[567] Para. 32 of the commentary to Article 5 of the OECD MTC. It can be noted that Vann, R, "Travellers, Tax Policy and Agency Permanent Establishments", *British Tax Review*, no. 6 2010, p. 538-553, argues, from a policy point of view, that the agent should operate from a fixed place of business to be considered a PE. He also points out some inconsistencies in the OECD materials, for instance para. 42.13 of the commentary to Article 5 of the OECD MTC, where it seems that a fixed place of business is required. Whether this is an inconsistency, however, is questionable as the service PE does not require an authority to conclude contracts and, thus, deals with other types of services than those encompassed by the agency clause.

[568] Para. 32 and 33.1 of the commentary to Article 5 of the OECD MTC.

[569] See section 5.3.3.

[570] Skaar, A, *Permanent Establishment*, p. 469. Similarly, Petruzzi, R, "The Dependent Agent Permanent Establishment as an Extension of the Permanent Establishment Concept of Article 5(1) of the OECD Model Convention", *Dependent Agents as Permanent Establishments*, ed. Lang et al, p. 42.

[571] Skaar, A, *Permanent Establishment*, p. 525-526.

test, i.e. the territorial connection required, according to Skaar.[572] If this is correct, it would mean, in general, that the agent needs to be present for at least six months in the state of establishment *and* habitually conclude contracts.

Vogel is of a slightly different opinion. He seems to consider the habitual test to be a specific rule on permanence and that recourse to the fixed place of business rule should only be made "[i]n cases of doubt".[573] Thus, he seems to argue that a certain permanence aspect is included in the word "habitually". Vogel focuses on the activity and authorization. Consequently, the agent does not need to be physically present in the state of establishment outside the activities connected to the conclusion of contracts. Instead, permanence should be understood as the time the agent is engaged by the enterprise to conclude contracts. With this view there is no additional connection required besides the habitual conclusion of contracts. It can be noted that Huston and Williams share this opinion.[574]

Reimer argues that the term "habitually" should be understood as a "combination of time and frequency".[575] Furthermore, he thinks that the permanence test of the fixed place of business rule, which he interprets to mean six months, should be carried over to the agency clause to improve legal certainty. He shares Vogel's view that permanence is related to the function of an agent and not to any physical presence.

Two main questions emerge from the different interpretations referred to above: whether permanence should be understood as physical presence or the agency relationship and the impact of the permanence test of the fixed place of business rule on the agency clause. Regarding the first question, the difference between the fixed place of business rule and the agency clause must be pointed out. The fixed

[572] Skaar, A, *Permanent Establishment*, p. 485 and Skaar, A, et al, *Norsk skatteavtalerett*, p. 181.
[573] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 142.
[574] Huston, J and Williams, L, *Permanent Establishments*, p. 82. Also see Williams, R, *Fundamentals of Permanent Establishments*, p. 128.
[575] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 336. Similarly, Pleijsier, A, "The Agency Permanent Establishment: The Current Definition – Part One", *Intertax*, no. 5 2001, p. 178.

place of business rule is based on a fixed physical presence, whereas the agency clause is based on the activity of concluding contracts within the state of establishment. With this difference in mind, the idea that permanence refers to the agency relationship, i.e. agent activities and length of engagement, seems more in line with the structure of Article 5. Furthermore, the OECD states that whether an agency PE exists should be assessed by only considering the agency clause, and the question of permanence is dealt with through the use of the word "habitually".[576] The OECD also indicates that in practice the "habitual" requirement "will usually be sufficient for him [the agent, my remark] to have a taxable presence" in the state of establishment. This indicates that the OECD is of the opinion that a permanent abode is not necessary.

Based on the above there are compelling arguments to interpret the agency clause to not require any specific connection to the state of establishment besides the condition to use the authority to conclude contracts habitually. As this shifts the question towards what "habitually" means, the second question is not discussed in this section. We will come back to this question later, when the meaning of "habitually" is studied.

Finally, the implications of the discussion above on the related person PE need to be mentioned. In many cases a subsidiary is located in the state of establishment and, consequently, the question of whether the agent needs a physical presence would not affect these situations. However, it is possible for a related person situated in a third state to create an agency PE by concluding contracts in the state of establishment.

5.2.3 Which Activities Are Covered?

Before proceeding to the agency clause's different conditions, a short presentation of the main difference in principle between the fixed place of business PE and the agency PE is made. While the fixed place of business rule requires both a fixed place and business activities, the agency clause only requires business activities. However, not just any business activity is sufficient. The agency clause specifies the activity as concluding contracts. Thus, an agent who acts on behalf of a for-

[576] OECD, *2002 Reports Related to the Model Tax Convention*, p. 102-103.

eign principal but does not conclude contracts cannot constitute an agency PE.[577] However, a formalistic approach to this activity should not be applied. It follows from the commentary that negotiations, for instance, may lead to an authority to conclude contracts.[578]

It should be noted that if an agency PE exists, all activities performed by the agent on behalf of the foreign enterprise are connected to the PE, not only the PE-constituting ones.

Finally, not all contracts have relevance under the agency clause. Typically, but not exclusively, the contracts relevant under the agency clause relate to the sale of goods or services.[579] The agent must conclude contracts that would not be excluded by Article 5(4) had the principal himself concluded the same contracts from a fixed place of business. In other words, the exception for preparatory and auxiliary activities in Article 5(4) applies to the agency clause and, a bit simplified, it can be stated that the contracts must be considered a core business activity to matter under the agency clause. The exceptions in Article 5(4) are discussed in chapter 6.

5.3 The Authority to Conclude Contracts

5.3.1 Introduction

According to Article 5(5), an agent who habitually concludes contracts in the name of its principal may constitute a PE. From this passage three different conditions can be identified. These conditions are: (1) an authority to conclude contracts, (2) the habitual use of the authority to conclude contracts, and (3) the contracts being "in the name of"

[577] Para. 32 of the commentary to Article 5 of the OECD MTC.
[578] Para. 33 of the commentary to Article 5 of the OECD MTC.
[579] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 327 and Pleijsier, A, "The Agency Permanent Establishment: The Current Definition – Part One", *Intertax*, no. 5 2001, p. 172-177. It has been argued that it is only sales activities that are included under the agency clause. See OECD, *OECD Model Tax Convention: Revised Proposals concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, 2012, p. 36 and Storck, A and Schmidjell-Dommes, S, "Acting on Behalf of an Enterprise under Article 5(5) of the OECD Model Convention", *Dependent Agents as Permanent Establishments*, ed. Lang et al, p. 58-59.

the principal. It is necessary to point out that all of these conditions need to be met for an agency PE to exist.[580] The meaning of these conditions is discussed in this section.

5.3.2 Authority to Conclude Contracts

5.3.2.1 Introduction

The authority to conclude contracts is not defined in the OECD MTC. Thus, domestic private law will have some influence on the application of Article 5(5) by way of Article 3(2). As discussed previously, the context of the treaty might limit the influence of domestic law. As private law regarding contracts varies between countries[581] and is beyond the objective of this study, it is not further discussed. Instead, the impact of the OECD MTC's context, as well as the PE concept in general, either limiting or expanding, on the domestic regulation is the focus.

As a starting point, if the agent has an authority to conclude contracts according to the domestic law, it is likely that the same is true under the treaty. However, as stated above, the PE concept may limit or expand the domestic notion of what an authority to conclude contracts is. Initially, one can note that it seems like the OECD advocates a kind of substance-over-form approach when it comes to the authority to conclude contracts. For instance, an agent who "solicits and receives (but does not formally finalise) orders" can have an actual authority to conclude contracts provided his actions are routinely approved.[582] Similarly, it is stated in the commentary that an agent who "negotiates all elements and details of a contract in a way binding" on the principal can have an authority to conclude contracts regardless of where the contract is actually signed.[583] Based on the two examples provided by the OECD, two interesting aspects can be identified.

[580] See for instance the Swedish case Kammarrätten i Stockholm, no. 6479-12, September 9 2013, where a formal authority to conclude contracts existed but was not habitually used.

[581] The most discussed difference is how civil law and common law countries deal with commissionaire agents and undisclosed agents. This is discussed in section 5.3.4.

[582] Para. 32.1 of the commentary to Article 5 of the OECD MTC.

[583] Para. 33 of the commentary to Article 5 of the OECD MTC.

These are: pass-through arrangements similar to the first example and negotiations and similar activities. This is discussed in the following sections.

5.3.2.2 The Signing of Contracts

Starting with the pass-through arrangements where the contracts are signed outside the state of establishment, it seems like this example is targeting a situation with "routine" contracts, e.g. sale of goods or services, with little or no negotiation. Vogel argues that the actual behavior and not only the formal signing must be considered. Furthermore, he argues that the authority to conclude contracts might be wider according to the PE concept than in domestic law and, consequently, that the PE concept expresses the substance-over-form principle.[584] Whether or not the agent binds its principal according to domestic law does not seem to matter with this line of reasoning.[585]

An indication of an agent's authority to conclude contracts is if the principal regularly approves and accepts the result of the agent's actions.[586] This is because the agent in these situations has made the actual decision, not the principal.[587] Reimer argues that it is required that the agent's actions are followed in "the overwhelming majority of cases."[588] However, it has been argued that whether an agent possesses an authority to conclude contracts must be assessed with the present economic situation in mind. Vogel exemplifies this with major contracts where the principal has an interest in maintaining the right to conclude contracts himself.[589] The result of this is that even if the

[584] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 140. Similarly, see Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 328.

[585] Note that this only applies to the authority to conclude contracts. The ultimate result must still be that the principal is legally bound by the contracts in question. See section 5.3.4 for further discussion about this.

[586] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 330.

[587] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 141.

[588] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 330.

[589] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 140. Similarly, see Skaar, A, *Permanent Establishment*, p. 469, who argues

principal accepts all of the agent's actions in a specific timeframe, an agency PE may still be denied if the facts support sound business reasons for the principal to maintain an exclusive right to conclude contracts. In other words, the acceptance of the agent's actions does not automatically mean that the principal has surrendered the actual decision making. Furthermore, different types of contracts may in some situations need to be assessed separately. For example, consider an agent who solicits and receives 100 orders on behalf of a foreign principal. Half of these orders concern sales with fairly standardized terms and conditions. All of these sales orders are routinely approved, and signed, by the principal. The other half of orders concern products custom made and tailored for the specific client's needs. Of these orders, 25 are approved while the remaining 25 are rejected. In this situation, the rejections of half of the custom orders should not affect the fact that 100 percent of the standard orders are approved. Consequently, it is argued that an agency PE may exist in this situation because an agent does not need to have a general authority to represent the principal in all matters.[590]

An interesting ruling dealing with this question is the Canadian case *Knights of Columbus*.[591] The facts of the case were as follows. Knights of Columbus, established in the United States, issued life insurance in Canada through field agents. These agents met with potential clients and received insurance applications. The agents advised the potential clients and collected the initial premiums but were not allowed to alter any provisions in the insurance agreement. Furthermore, the agents were not allowed to bind the Knights of Columbus. All insurance agreements were to be approved and signed by the principal in the United States. Between 90 and 92 percent of the applications were approved.

The tax agency's position was that the agents had the authority to conclude contracts because of the high rate of routinely approved ap-

that if the signing is a material right to disapprove of the contracts, no agency PE will exist.

[590] Williams, R, *Fundamentals of Permanent Establishments*, p. 145-146.

[591] Knights of Columbus v. Her Majesty the Queen, 2008 CarswellNat 1507, 2008 TCC 307. While the referenced part of the ruling is well reasoned it can be noted that in an *obiter dictum* the judge misunderstands how paragraphs 4 and 5 in Article 5 relates to each other.

plications. The court, however, found that "[t]here is nothing routine about the complex, detailed medical inquiries that form part of the application process". In other words, a medical assessment of the applicant was made by the principal. Consequently, the agents did not have the authority to conclude contracts.

This case supports the argument that it is not enough that the principal approves of the agent's actions if it can be established that the material right of approval is held by the principal. If a specific skill is needed, and the agent lacks that skill, it is likely that the actual power to decide whether a contract should be accepted lies with the principal.

Thus, it can be concluded that the actual signing of contracts is not a necessary element in the agency PE. Instead, the crucial element is whether the signing by someone other than the agent constitutes an actual acceptance of the agent's result with a material right to disapprove the contract.[592] By contrast, if the agent does sign contracts it is typically not necessary that he has negotiated the terms.[593] For instance, the signing of standardized contracts without any negotiations can be seen as an "authority to conclude contracts", as the Knights of Columbus case discussed above shows.

However, what if a local agent negotiates the terms of the contracts and, subsequently, the contracts are formally signed by a regional agent situated in another country?[594] In which country does an agency PE exist? Or might it exist in both? Skaar argues cautiously that the agency PE should be recognized in the country where the major part of the business activities take place, most likely where the negotiations take place. From a policy perspective, this seems to be the correct solution and it is in line with the notions of source, neutrality and equity. It can hardly be said that the signing agents in the example "involve the enterprise to a particular extent in business activities in the State concerned."[595] In conclusion, there is no difference in principle between a principal signing contracts in the state of residence and an agent signing them in a third state, provided that the signing is

[592] Skaar, A, *Permanent Establishment*, p. 489.
[593] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 141.
[594] This example is used by Skaar, A, *Permanent Establishment*, p. 494.
[595] Para. 32 of the commentary to Article 5 of the OECD MTC.

merely a formality. Consequently, in a situation such as the one in the example above, the agency PE should be recognized only in the state where the negotiations take place. Next, the relevance of negotiations is discussed.

5.3.2.3 Negotiations and Similar Activities

Negotiations have been discussed and debated quite a lot during the past decade. The question of whether negotiations are a PE-constituting activity is well illustrated in the Italian case *Philip Morris*,[596] which also was the cause of the debate. The facts of the case were as follows. The Italian company Intertaba, part of the Philip Morris group, was manufacturing cigarette filters. Intertaba also performed various services on behalf of foreign group companies without receiving remuneration. The service deemed most important by the Italian Supreme Court concerned the supervision of a contract between non-resident group companies and the Italian tobacco administration. Furthermore, representatives from Intertaba had participated in the negotiation of the contract it supervised.

The Supreme Court argued, with reference to the commentary,[597] that the authority to conclude contracts includes all the agent's activities that contribute to the conclusion of contracts. Furthermore, the participation in the conclusion on contracts could in principle only cover one stage of the process, i.e. only negotiation, and still constitute an authority to conclude contracts. Surprisingly, an authority to negotiate terms of the contract was not deemed necessary, which means that being present at a negotiation could be a PE-constituting activity. Finally, the court concluded that the authority to conclude contracts must be assessed with substance-over-form in mind. This seems to be based on the commentary,[598] academic literature[599] and the need to prevent tax avoidance.

The first thing to note about this judgment is that it is quite policy oriented in nature. The Supreme Court actually stated five principles, two of which I described above, and sent the case back to the regional

[596] Corte Suprema di Cassazione, No. 3368, March 7 2002 from 4 *ITLR*, p. 926 (unofficial translation to English).
[597] Para. 33 of the commentary to Article 5 of the OECD MTC.
[598] Para. 33 of the commentary to Article 5 of the OECD MTC.
[599] Not further specified by the court.

court to reassess the PE question based on these principles. This ruling has been much debated and criticized.[600] One can even say that the OECD participated in this criticism as they reacted by changing the commentary to explicitly state that the fact "that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient."[601] Thus, according to the OECD it seems like all elements and details of a contract need to be negotiated by the agent to be a PE-constituting activity.[602] In this respect, the UN expresses a more nuanced opinion and states that it is sufficient if the agent has "negotiated all the essential elements of the contract".[603] It does not seem appropriate to apply a literal interpretation of "all elements and details". A literal approach would be wide open to abuse as no PE would be found if the foreign principal retained the right to negotiate some minor aspect on its own. Such an outcome is not in accordance with the structure of the agency clause and the PE concept in general. Indeed, the OECD commentary still expresses a substance-over-form approach and all must be understood as the *essential* elements of a contract.[604]

[600] See for instance Gazzo, M, "Permanent Establishments through Related Corporations", *Bulletin for International Fiscal Documentation*, no. 6 2003, 257-264 and Trutalli, F, "Independent Legal Entities or Permanent Establishments?", *European Taxation*, no. 8 2002, p. 364-370. The case has also received some praise, albeit mostly from a principle point of view, Sheppard, L, "Revenge of the Source Countries?", *Tax Notes International*, March 28 2005, p. 1130-1131.

[601] Para. 33 of the commentary to Article 5 of the OECD MTC.

[602] The problems with this formulation were discussed in OECD, *2002 Reports Related to the Model Tax Convention*, p. 104-105. However, no solution was presented.

[603] Para. 24 of the commentary to Article 5 of the UN MTC.

[604] OECD stressed the importance of stopping abusive arrangements in relation to the question on negotiations in *2002 Reports Related to the Model Tax Convention*, p. 104. Similarly, see Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 330, "the main features of the contract". Pleijsier, A, is of the opinion that an agent with "extensive powers to negotiate" may constitute a PE, "The Agency Permanent Establishment: The Current Definition – Part One", *Intertax*, no. 5 2001, p. 172. For a general substance-over-form argument, see Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 140. Slightly different, see Skaar, A, *Permanent Establishment*, p. 492.

Turning back to the *Philip Morris* decision, it is the conclusion of the Supreme Court that mere participation in negotiations can be enough to establish a PE, which deserves to be criticized.[605] One can compare this case to an Indian case where it was held that mere presence at meetings where negotiations, among other things, took place did not equal an authority to conclude contracts.[606] The substance-over-form approach, including the statement that all activities contributing to the conclusion of contracts are relevant, is in my opinion well founded and in accordance with the PE concept with support in the commentary as well as in literature. Additionally, there is further support for the substance-over-form approach in case law.[607]

5.3.3 The Meaning of "Habitually"

An authority to conclude contracts in the name of an enterprise is not in itself sufficient to constitute a PE. In Article 5(5) it is stated that such an authority should be habitually exercised. This requirement serves to establish a sufficient connection between the foreign enterprise and the state of establishment. In the commentary this is further elaborated as "repeatedly and not merely in isolated cases"[608] and "more than merely transitory".[609] In addition to this, what is to be considered habitual should be decided on a case-by-case basis, considering both the "nature of the contract and the business of the principal."[610] For instance, an enterprise that concludes relatively few but nonetheless complex and economically important contracts will require fewer contracts to consider it frequent enough compared to an enterprise whose business it is to conclude a large number of contracts. As was discussed in the previous section, negotiations and simi-

[605] This is from an agency PE perspective. The Supreme Court's reasoning regarding the fixed place of business rule is not discussed in this section.
[606] Rolls Royce Plc v. Assistant Director of Income Tax, ITA no. 282/DEL/2005. Also see Mehta, A, "Dependent Agency Permanent Establishments – Judicial Developments in India", *Bulletin for International Taxation*, no. 10 2011, p. 565-566.
[607] Conseil d´Etat, RJF 10/03, No. 1147, June 20 2003 from 5 *ITLR*, p. 1023 (unofficial translation to English).
[608] Para. 32 of the commentary to Article 5 of the OECD MTC.
[609] Para. 33.1 of the commentary to Article 5 of the OECD MTC.
[610] Para. 33.1 of the commentary to Article 5 of the OECD MTC.

lar activities may be PE-constituting activities and must be considered under the habitual assessment as well.

Because of the varying needs of different businesses it is not possible to formulate an exact meaning of "habitually". What can be said, however, is that a single contract is not enough as that is the very definition of isolated.[611] It must here be reiterated that it is the conclusion of contracts that is the PE-constituting activity and not the underlying business operations. Thus, one contract to perform services for 12 months will not constitute an agency PE.[612]

There is sparse case law on how "habitually" should be understood. A Norwegian ruling dealt with the, more or less, automatic renewal of a contract once a year for three years.[613] The Supreme Court concluded that this was not enough to be considered habitual. The important circumstance seems to have been the "automatic" renewal as, depending on the circumstances, it is less likely that the authority to conclude contracts has been used in such situations. By contrast, true renegotiations may result in a PE.[614]

In a Swedish case,[615] an enterprise in the construction industry had an agency PE in Sweden because a shareholder, i.e. a related person, had concluded four verbal agreements in a year. It can be noted that it was not specified in the ruling when the contracts were concluded during the year.

An interesting question is whether there is any connection between the fixed place of business rule and the agency clause, specifically the temporal aspects of "fixed". Skaar argues that apart from habitualness, which he sees as a frequency test, the agency PE also consists of the same permanency assessment as the fixed place of business rule.[616] This permanence is related to the agency relationship itself and not to the agent's activities. Reimer is of the same opinion, although he does not use the same conceptual framework and considers habitualness as

[611] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 142 and Skaar, A, *Permanent Establishment*, p. 527.
[612] For a further discussion about consultancy and service companies see Skaar, A, *Permanent Establishment*, p. 527.
[613] The case is usually labeled *Alphawell*, Høyesterett, Rt. 1994 p. 752.
[614] Skaar, A, et al, *Norsk skatteavtalerett*, p. 188.
[615] Kammarrätten i Göteborg, no. 1835-1836-16, November 6 2017.
[616] Skaar, A, *Permanent Establishment*, p. 469 and 525 -526.

including both a time and frequency component.[617] Vogel did not see the same strong connection and stated that in cases of doubt, recourse can be had to the permanence test of the fixed place of business rule.[618] The view that the agency PE is subordinated to the fixed place of business rule and should be considered *lex specialis* only where it expressly overrides that rule is not shared in this study.[619] The reason for this is that the agency PE is a separate connection test with its own conditions and internal logic.[620] Furthermore, even if one agreed on the subordination of the agency clause, the requirement to habitually conclude contracts should be considered to replace the permanence requirement in the fixed place of business rule. Consequently, the notion of a formal connection between habitualness and permanence is rejected.

However, to do something "habitually" means to do it regularly.[621] From a linguistic point of view, to do something regularly implies both a certain length of time and frequency.[622] For instance, concluding 50 contracts in one day and then never again can hardly be considered regularly. Similarly, concluding two contracts over three years cannot normally be regarded as regular. Thus, the interpretation advocated by Vogel is the one preferred as it is most in line with the agency clause and the PE concept in general. In practice, however, it is likely that there is little difference between the three opinions referred to.

When it comes to the related person agent, would it matter if a foreign enterprise was represented by several related agents, i.e. would habitualness be decided for each agent separately? The short answer is no, it would not matter. As has been argued previously, one cannot ar-

[617] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 334 and 336..
[618] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 142.
[619] See Skaar's reasoning, Skaar, A, *Permanent Establishment*, p. 469-470.
[620] For a similar view see Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 311.
[621] In the *Oxford English Dictionary* "habitual" is defined as something "done regularly and in a way that is difficult to stop". The regularity is also shown in the Swedish translation of habitual, which is translated as "regelmässigt".
[622] See Nitikman, J, "The Meaning of 'Permanent Establishment' in the 1981 U.S. Model Income Tax Treaty: Part 2", *The International Tax Journal*, no. 3 1989, p. 263.

tificially split up activities between related persons in order to avoid a PE. In such situations a substance-over-form approach should be applied. Furthermore, the same can be said about unrelated agents. An enterprise cannot avoid having a PE by using several unrelated agents. It is habitual representation on a general level that should be assessed and not the agents on a specific level.[623]

In summary, it is not possible to formulate an exact rule on what should be considered habitual. Instead, this must be decided on a case-by-case basis. One single contract, however, is never enough. Lastly, "habitually" should be understood to encompass both a time and frequency requirement.

5.3.4 The Meaning of "In the Name of"

5.3.4.1 Introduction

The authority to conclude contracts should not only be exercised habitually, but also the contracts need to be "in the name of" the principal. This is perhaps the most debated and discussed aspect of the authority to conclude contracts in recent times, i.e. the meaning of the somewhat ambiguous phrase "in the name of". The reason for this can be traced to differences in agency law between civil and common law countries. Furthermore, the use of the commissionaire agent to avoid having a PE has increasingly put this question on the agenda. As this practice has been fairly common among multinational groups, this question is of particular relevance to the related person PE.

To clarify the meaning of "in the name of", the OECD updated the commentary in 1994 to state that the contracts did not need to be literally in the name of the principal as long as they were binding the principal.[624] This, however, spawned new uncertainties about whether "binding" should be understood as legally binding or if it is sufficient that the principal is bound economically. Several countries' tax agencies have argued that "in the name of" should be understood as eco-

[623] Skaar, A, *Permanent Establishment*, p. 481-484 and Pistone, P and Ruiz Jiménez, C A, "Habitual Exercise of Authority to Conclude Contracts under Article 5(5) of the OECD Model Convention", *Dependent Agents as Permanent Establishments*, ed. Lang et al, p. 155.

[624] In 2003 this update was placed in para. 32.1 of the commentary to Article 5 of the OECD MTC.

nomically binding, presumably to prevent the use of a stripped local subsidiary acting as a commissionaire for a foreign related person in order to avoid having a PE. There have recently been a number of cases regarding this decided by supreme courts in Europe.[625]

Furthermore, the OECD is examining the interpretation of "in the name of" and the use of commissionaire arrangements to artificially avoid PE status.[626] Indeed, this has resulted in a proposed new agency clause that encompasses the notion of economically binding contracts.[627] Thus, it can be concluded that the phrase "in the name of" is interesting both from a legal interpretation and a policy point of view. In addition to this, it is highly relevant for the related person PE.

Below, the basic issue is described and discussed (section 5.3.4.2). After that, the question of whether contracts should be legally or economically binding is studied through case law (section 5.3.4.3). Finally, a conclusion is presented and the policy aspects are analyzed (section 5.3.4.4).

5.3.4.2 The Problem

The main problem is the wording "in the name of" and its different implications in civil and common law.[628] This difference comes from

[625] These cases are *Zimmer*, *Dell Norway*, *Dell Spain* and *Boston Scientific*. See section 5.3.4.3 for a discussion of these cases.

[626] OECD, *OECD Model Tax Convention: Revised Proposals concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, 2012, p. 33-35 and *Addressing Base Erosion and Profit Shifting*, Action 7.

[627] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 16-17 and the 2017 draft update to the OECD MTC.

[628] The two classic articles dealing with this problem are Avery Jones, J and Ward, D, "Agents as permanent establishments under the OECD Model Tax Convention", *British Tax Review*, no. 5 1993, p. 341-383 and Robert, S, "The Agency Element of Permanent Establishment: The OECD Commentaries from the Civil Law View (Part One and Two)", *Intertax*, no. 9-10 1993, p. 396-420 and 488-508. A more recent study can be found in Pijl, H, "Agency Permanent Establishments: *in the name of* and the Relationship between Article 5(5) and (6) – Part 1 and 2", *Bulletin for International Taxation*, no. 1-2 2013, p. 3-25 and 62-97. Additionally, Avery Jones has written more on this topic in recent years. See Avery Jones, J, "The Origins of Articles 5(5) and 5(6) of the Model", *Dependent Agents as Permanent Establishments*, ed. Lang et al; Avery Jones, J and Lüdicke, J, "The Origins of Article 5(5) and 5(6) of the OECD

different solutions on agency law between civil and common law countries. Simply put, an agent will generally bind an undisclosed principal in common law, whereas an undisclosed principal will not be bound in civil law.[629] In a situation with an undisclosed principal, the agent will contract in its own name. Based on the general solutions presented above, the agency PE question may have different answers in civil and common law. In a civil law country the principal is not bound by the contract, only the agent is. Thus, in civil law the phrase "in the name of" corresponds to contracts that legally bind the principal. By contrast, the phrase has no immediate meaning in common law as, in general, whose name the contract is in is not that important in deciding who is bound by it.[630] This means that, as a starting point, the phrase "in the name of" is unproblematic from a civil law perspective but might cause problems for the common law lawyer.[631]

A literal interpretation of the phrase by a body of appeal commissioners in the United Kingdom seems to have prompted an observation by the United Kingdom.[632] This, in turn, led to the clarification, previously mentioned, by the OECD in 1994, which stated that it is not necessary for the contracts to be literally in the name of the principal as long as they are binding on him.[633] This commentary update is clearly aimed at common law jurisdictions as a contract in the agent's name would not be legally binding on the principal in civil law. However, this spawned a discussion about whether "binding"

Model", *World Tax Journal*, no. 3 2014, p. 203-241 and Avery Jones, J, "Dell Products: A view from the UK*", Høyt Skattet – Festskrift til Frederik Zimmer*, ed. Banoun, Gjems-Onstad, Skaar.

[629] For an extensive analysis of the differences, see Avery Jones, J and Ward, D, "Agents as permanent establishments under the OECD Model Tax Convention", *British Tax Review*, no. 5 1993, p. 341-383.

[630] Avery Jones, J and Ward, D, "Agents as permanent establishments under the OECD Model Tax Convention", *British Tax Review*, no. 5 1993, p. 352.

[631] Pijl, H, "Agency Permanent Establishments: *in the name of* and the Relationship between Article 5(5) and (6) – Part 1", *Bulletin for International Taxation*, no. 1 2013, p. 5-6.

[632] Avery Jones, J and Ward, D, "Agents as permanent establishments under the OECD Model Tax Convention", *British Tax Review*, no. 5 1993, p. 351 and Pijl, H, "Agency Permanent Establishments: *in the name of* and the Relationship between Article 5(5) and (6) – Part 1", *Bulletin for International Taxation*, no. 1 2013, p. 83-84.

[633] Para. 32.1 of the commentary to Article 5 of the OECD MTC.

should be understood as legally binding or economically binding. As it is clear that legal binding is sufficient, this discussion mainly affects civil law jurisdictions because there a contract typically must be in the name of the principal to bind him. Thus, the update that clarified the application of the agency clause from a common law perspective unfortunately created an ambiguity for the civil law reader, i.e. contracts not in the name of the principal are not legally binding on him, and so "binding" in the commentary must refer to something else. To add to the confusion, the OECD's Working Party 1 was not able to reach a common view on the meaning of "in the name of".[634] Surprisingly, they still recommended adding an example to para. 32.1 of the commentary on Article 5. The suggested example basically states that a principal may be bound in a situation of indirect representation depending on the relevant country's domestic agency law. The surprising part is that, even though the Working Party was unable to agree on an interpretation, they were able to provide an example that points towards a "legally binding" requirement. Next, the views on the meaning of "binding" in case law are discussed below.

5.3.4.3 Case Law

There are four fairly recent cases from European supreme courts concerning typical commissionaire structures and the meaning of "in the name of". All of these cases deal with related persons and, as such, are especially interesting. These cases are described and discussed below.

The first case discussed is the French case *Zimmer.*[635] The facts of the case were as follows. Up until 1995, Zimmer Ltd, a British company, sold its products through the French related company Zimmer SAS, which acted as a distributor. On March 27 1995, the two companies concluded an agreement that converted Zimmer SAS from a distributor to a commissionaire. The French tax agency considered that the commissionaire arrangement led to Zimmer Ltd having a PE

[634] OECD, *OECD Model Tax Convention: Revised Proposals concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, 2012, p. 35.
[635] Conseil d´Etat, No. 304715, March 31 2010 from 12 *ITLR*, p. 739 (unofficial translation to English).

in France. The relevant PE provision was based on the 1963 OECD MTC and was similar to the present version.[636]

The Supreme Administrative Court started by establishing that a related company could be a PE of another related company provided that, in this case, the conditions of the agency clause were fulfilled. After this statement the court dealt with the French agency law and stated that, in principle, a commissionaire cannot be a PE of its principal. The reason for this was that the agent contracts in its own name, which does not bind the principal directly to the agent's clients. The court further stated that the commissionaire label is not an absolute protection from having a PE. If the commissionaire agreement or other factual circumstances show that the principal is legally bound, a PE may exist. This was not the case and an agency PE was denied.

Although the court did not elaborate on the subject it is clear that they interprets "in the name of" as requiring the principal to be legally bound by the contracts. It is interesting to note that this judgment seemingly differs from an earlier French case, *Interhome*, where the Supreme Administrative Court held that the power to involve a principal commercially must be assessed both in fact and in law.[637] However, no PE was found in that case as the agent's activities were outside the business proper of the principal.

The next ruling is the Norwegian case *Dell Norway*.[638] The Norwegian company Dell AS had a commissionaire agreement with Dell Products, a tax resident of Ireland, to sell Dell products in Norway. The Norwegian tax agency argued that the phrase "på vegne av"[639] in Article 5(5) in the tax treaty[640] did not require contracts that were le-

[636] See Article 4 of the treaty between France and the United Kingdom, 22 May 1968.
[637] Conseil d´Etat, RJF 10/03, No. 1147, June 20 2003 from 5 *ITLR*, p. 1023 (unofficial translation to English).
[638] Noregs Høgsterett, HR-2011-02245-A, December 2 2011.
[639] This translates to "on behalf of", my translation, but is phrased "in the name of" in the English version of the treaty. "On behalf of" is sometimes used instead of "in the name of" in treaties with common law countries. Also see Avery Jones, J and Ward, D, "Agents as permanent establishments under the OECD Model Tax Convention", *British Tax Review*, no. 5 1993, p. 352-353.
[640] See Article 5 of the tax treaty between Norway and Ireland, 22 November 2000.

gally binding on the principal. Instead, it must be understood as a functional assessment of whether the principal is bound in an economic sense.[641] This view was upheld in the first two courts and the case proceeded to the Supreme Court. The relevant provisions in the treaty followed the OECD MTC. It was also clear that Dell AS did not conclude contracts that legally bound Dell Products.

The Supreme Court concluded that a textual approach to both the Norwegian and English versions led to an interpretation that required legally binding contracts. The court then proceeded to see if other sources of law could lead to a different result. The court looked at paragraph 32.1 in the commentary to Article 5 and concluded, with reference to Avery Jones and Ward,[642] that the 1994 amendment was just to clarify the application from a common law perspective. In addition to this, the court referred to the *Zimmer* case and the fact that the Swedish tax agency accepted the same commissionaire arrangement without considering it an agency PE. Finally, the court discussed the practical problem of defining a commercially bound criterion in order to reach a common application. Based on this, the court concluded that there was no reason to depart from the result of the textual approach and, consequently, no PE was found.

The next case concerned the same multinational group, and presumably a similar structure, and is labeled *Dell Spain*.[643] The Spanish Supreme Court started by concluding that a literal interpretation of the wording of the provision implied that only legally binding contracts between the principal and customers could constitute an agency PE. The court then stated that the form of the contract was of less interest. What mattered was the functional bond, i.e. a substance-over-form approach. Consequently, the Supreme Court considered the re-

641 In the judgment this is phrased "kommittenten i realiteten er bunden av avtalen", which I interpret as a substance-over-form argument that emphasizes the commercial realities instead of whether the contract is legally binding or not.

642 Avery Jones, J and Ward, D, "Agents as permanent establishments under the OECD Model Tax Convention", *British Tax Review*, no. 5 1993, p. 341-383. The court referred to the reprint of this article in European Taxation in 1993.

643 Dell Products Ltd v General State Administration, STS 2861/2016, recurso no 2555/2015, June 20 2016, from 19 *ITLR*, p. 633 (unofficial translation to English).

lated person acting as commissionaire an agency PE of the foreign company. Additionally, the court stated that one cannot accept a literal interpretation, with specific reference to the *Zimmer* and *Dell Norway* cases, in the interest of preventing tax avoidance.

The final ruling is the Italian case *Boston Scientific*.[644] This case concerned the company BSI, resident in the Netherlands, and its subsidiary BS, resident in Italy. BS acted as a commissionaire on behalf of BSI. The Italian tax agency argued that BSI had a PE in Italy through its agent BS and that the agency clause should be interpreted according to substance-over-form. The court did not discuss the question at length but seemingly approved of the previous court's reasoning where it concluded that BS acted in its own name. The result of the case was that no agency PE existed.

In conclusion, the tax authorities in all of the referred cases argued for an economic, or factual, understanding of binding, presumably because they deemed the arrangements abusive. This view was rejected in three of the cases and instead the courts interpreted "in the name of" as requiring the principal to be legally bound by the contracts. In the fourth case, i.e. *Dell Spain*, the economic view of the tax agency prevailed. This was clearly influenced by an interest in preventing tax avoidance.

5.3.4.4 Conclusion

As a starting point, when "in the name of" is explicitly discussed, the general opinion expressed in literature seems to understand the phrase as legally binding.[645] The general arguments for this are based around

[644] Corte Suprema di Cassazione, no. 3769, March 9 2012, from 14 *ITLR*, p.1060 (unofficial translation to English).

[645] See Avery Jones, J and Ward, D, "Agents as permanent establishments under the OECD Model Tax Convention", *British Tax Review*, no. 5 1993, p. 352; Pijl, H, "Agency Permanent Establishments: *in the name of* and the Relationship between Article 5(5) and (6) – Part 1", *Bulletin for International Taxation*, no. 1 2013, p. 7; Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 139; Pleijsier, A, "The Agency Permanent Establishment: The Current Definition – Part One", *Intertax*, no. 5 2001, p. 177; Skaar, A, "Erosion of the Concept of Permanent Establishment: Electronic Commerce", *Intertax*, no. 5 2000, p. 193; Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 329; Williams, R, *Fundamentals of Permanent Establishments*, p. 173-174; Baker, P, *Double Taxation Conventions*, 5B.26, September 2002 update; Schaffner, J, *How Fixed Is a Perma-*

the historical development and the context of the MTC with commentary. Furthermore, the recent case law largely supports the view that "in the name of" means legally binding contracts. The *Dell Spain* case does not seem convincing as the reasoning is more or less only based on an interest in preventing tax avoidance. Additionally, it should be mentioned that the OECD deemed it necessary to change the agency clause to include economically binding contracts.[646] This proposed change would not be necessary if the present provision already included economically binding contracts.

Furthermore, most arguments for an economic understanding of binding seem to be more of *de lege ferenda* reasoning than *de lege lata*. In particular, these arguments seem to stem from the notion that commissionaire arrangements are abusive and base eroding, i.e. policy arguments.[647] However, one line of reasoning is based on the substance-over-form approach found in the commentary. It is mainly the discussion on the 1994 clarification,[648] "actual authority"[649] and the relevance

nent Establishment?, p. 225; Mehta, A, *Permanent Establishment in International Taxation*, p. 407; Nørgaard Laursen, A, *Fast driftsted*, p. 175; Obuoforibo, B, "In the Name of Clarity: Defining a Dependent Agent Permanent Establishment", *Taxation of Business Profits in the 21st Century – Selected Issues under Tax Treaties*, ed. Gutiérrez, C, and Perdelwitz, A, p. 76-77; Monsenego, J, "Agency Permanent Establishment and Commissionaire Structures", *International Transfer Pricing Journal*, no. 6 2010, p. 444-445; Kroppen, H-K and Hüffmeier, S, "The German Commissionaire as a Permanent Establishment Under the OECD Model Treaty", *Intertax*, no. 4 1996, p. 135; Leegaard, T, "Supreme Court Holds That Commissionaire Structure Does Not Amount to a Permanent Establishment", *European Taxation*, no. 6 2012, p. 320; Persico, G, "Agency Permanent Establishment under Article 5 of the OECD Model Convention", *Intertax*, no. 2 2000, p. 78-82 and Daxkobler, K, "Authority to Conclude Contracts in the Name of the Enterprise", *Dependent Agents as Permanent Establishments*, ed. Lang et al, p. 120. For a different view, see Karundia, A, *Law and Practice Relating to Permanent Establishment*, p. 286-287.

[646] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 16-17 and the 2017 draft update to the OECD MTC.

[647] See for instance the *Dell Norway* case where the Norwegian tax authority argued that the objective to stop tax avoidance led to an interpretation of economic binding as the opposite led to a situation where taxation can be avoided on a formality.

[648] Para. 32.1 of the commentary to Article 5 of the OECD MTC (first sentence).

of negotiations without the actual signing of contracts[650] that are brought up as arguments for an economic view of "in the name of". These arguments are not convincing.

First, a literal reading of the first sentence in paragraph 32.1 of the commentary to Article 5 can, as previously mentioned, give the impression that a legal binding is not necessary. However, such an interpretation completely disregards the history and context in which that sentence was added. This method of interpretation cannot be accepted as one basically has to ignore relevant circumstances in order to reach the conclusion that an economic binding is sufficient.

Second, the authority to conclude contracts in the name of the enterprise contains three different conditions: (1) an authority to conclude contracts, (2) the habitual us of said authority, and (3) contracts concluded "in the name" of the principal. Hence, the authority to conclude contracts must be separated from the question of who is bound by the contracts. The "actual authority" and the relevance of who signs a contract, and where it is signed, discussed in the commentary, refer to when a contract is deemed concluded and not whose name it is in. In the commentary it is phrased as an "actual authority to conclude contracts".[651] The same conclusion is reached by the OECD's Working Party 1 and the Norwegian Supreme Court in the *Dell Norway* case.[652] Similarly, that an agent negotiating can sometimes be "said to exercise this authority"[653] even if the contracts are signed abroad clearly refers to what activity is required to deem a contract concluded. Thus, the substance-over-form approach recognized in the commentary is meant to be applied to the authority to conclude contracts, not the entire agency PE assessment.

The arguments to understand "in the name of" as legally binding are convincing. Furthermore, the reasoning that an economic binding is sufficient does not have any support *de lege lata*. With the various Supreme Courts' decisions in *Zimmer*, *Dell Norway* and *Boston Scientific*,

649 Para. 32.1 of the commentary to Article 5 of the OECD MTC.
650 Para. 33 of the commentary to Article 5 of the OECD MTC.
651 Para. 32.1 of the commentary to Article 5 of the OECD MTC.
652 OECD, *OECD Model Tax Convention: Revised Proposals concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, 2012, p. 35. Also see Skaar, A, *Permanent Establishment*, p. 487.
653 Para. 33 of the commentary to Article 5 of the OECD MTC.

it seems that the matter is fairly settled. The Spanish case law, however, may still cause some issues and confusion in the future. One can hope that countries wanting to treat commissionaire agents as PEs adopt the new proposed version of the agency clause to include economically binding contracts.

5.4 Dependent Agents

5.4.1 Introduction

Even if an agent has an authority to conclude contracts, and uses it habitually, it is not enough to constitute a PE for the principal. In addition to this the agent needs to be dependent on the principal. This follows from Article 5(6) of the OECD MTC, which states that an agent of independent status should not constitute a PE, provided that it acts in its ordinary course of business. According to the OECD it "stands to reason that such an [independent, my remark] agent, representing a separate enterprise, cannot constitute a permanent establishment of the foreign enterprise".[654] Nevertheless, the OECD continues, Article 5(6) is included to clarify and put emphasis on this assumption. It is doubtful that this is merely a clarification as it seems clear that independent agents can be within the wording of Article 5(5). This "clarification" only makes sense if one sees it as clarifying the policy behind the agency clause. It can be noted that the exclusion of independent agents is included already in the first draft convention by the League of Nations in 1927.[655] This assumption is based on the notion that an independent agent conducts its own business, and not the principal's business. Consequently, a foreign enterprise with an independent agent does not have a sufficiently strong connection to the state of establishment to be taxed.

The independence envisioned under the agency clause is absolute. This means that the agent must be independent both from an economic and legal point of view.[656] As mentioned previously, this notion

[654] Para. 36 of the commentary to Article 5 of the OECD MTC.
[655] League of Nations, *Double Taxation and Tax Evasion*, Committee of Technical Experts, Article 5, (1927).
[656] Para. 37 of the commentary to Article 5 of the OECD MTC.

of independence does not easily apply to the related person PE as a subsidiary, for instance, is legally dependent on its parent. Nevertheless, as discussed in section 4.2.2, the dependency assessment under the agency clause is of general interest in the PE concept as guidance when determining whose business is being conducted.

It can be noted that it has been proposed, within the BEPS project, that a person that acts almost exclusively on behalf of closely related enterprises cannot be considered independent.[657] This proposal is also part of the 2017 draft update to the OECD MTC.

The discussion about the dependency assessment is structured as follows. Initially, the general question of the relationship between Articles 5(5) and 5(6) is discussed (section 5.4.2). There are three points to assess under Article 5(6): legal and economic dependence (section 5.4.3), and the "ordinary course of business" (section 5.4.4).

5.4.2 The Relationship between Articles 5(5) and 5(6)

The relationship between Articles 5(5) and 5(6) has been the focus of some debate. Generally, three different theories on this relationship have been presented. These theories are: (1) that Article 5(6) is an exception to 5(5),[658] (2) that Articles 5(5) and 5(6) are independent rules,[659] and (3) that Articles 5(5) and 5(6) are integrated to form one rule.[660] These three theories are discussed below in the order listed here.

The first view discussed is that paragraph 6 acts as an exception to the rule in paragraph 5. This system is described and advocated by Avery Jones and Ward in an article from 1993.[661] The arguments for

[657] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 16-17.

[658] Avery Jones, J and Ward, D, "Agents as permanent establishments under the OECD Model Tax Convention", *British Tax Review*, no. 5 1993, p. 341-383.

[659] Roberts, S, "The Agency Element of Permanent Establishment: The OECD Commentaries from the Civil Law View (Part One and Two)", *Intertax*, no. 9-10 1993, p. 396-420 and 488-508.

[660] Pijl, H, "Agency Permanent Establishments: *in the name of* and the Relationship between Article 5(5) and (6) – Part 1 and 2", *Bulletin for International Taxation*, no. 1-2 2013, p. 3-25 and 62-97.

[661] Avery Jones, J and Ward, D, "Agents as permanent establishments under the OECD Model Tax Convention", *British Tax Review*, no. 5 1993, p. 341-

this are twofold. First, in paragraph 5 it is stated that a person "other than an agent of independent status to whom paragraph 6 applies" falls within the paragraph. Therefore the wording of the MTC is indicating that paragraph 6 is an exception to paragraph 5.[662] Second, the context, especially the historical development and differences between civil and common law, supports the view that paragraph 6 is an exception.[663]

The second view, developed by Roberts, is that the two paragraphs represent two separate rules. In Roberts's view, a dependent agent who does not conclude contracts binding on its principal will still constitute a PE, according to paragraph 6, if "he habitually transacts business in the host country".[664] Thus, an agency PE could, with this view, be created either by paragraph 5 or 6. Roberts arrives at this conclusion by using the *ejusdem generis* principle, which states that when a general term follows an enumeration, said general term must be understood to include only things similar to the enumeration.[665] Applied to Article 5(6), this means that "any other agent of an independent status" is to be interpreted in the light of the preceding terms "broker" and "general commission agent". Roberts concluded that neither the broker nor the general commission agent concludes contracts binding on their principals. Based on this, he argues that "any other agent of an independent status" should be understood as an agent that

383; Avery Jones, J, "The Origins of Articles 5(5) and 5(6) of the Model", *Dependent Agents as Permanent Establishments*, ed. Lang et al; Avery Jones, J and Lüdicke, J, "The Origins of Article 5(5) and 5(6) of the OECD Model", *World Tax Journal*, no. 3 2014, p. 203-241 and Avery Jones, J, "Dell Products: A view from the UK*", Høyt Skattet – Festskrift til Frederik Zimmer*, ed. Banoun, Gjems-Onstad, Skaar.

662 Avery Jones, J and Ward, D, "Agents as permanent establishments under the OECD Model Tax Convention", *British Tax Review*, no. 5 1993, p. 375.

663 Avery Jones, J and Ward, D, "Agents as permanent establishments under the OECD Model Tax Convention", *British Tax Review*, no. 5 1993, p. 354-360, 374-375 and 378-379.

664 Roberts, S, "The Agency Element of Permanent Establishment: The OECD Commentaries from the Civil Law View (Part One)", *Intertax*, no. 9 1993, p. 399.

665 Roberts, S, "The Agency Element of Permanent Establishment: The OECD Commentaries from the Civil Law View (Part One)", *Intertax*, no. 9 1993, p. 400.

does not conclude contracts binding on their foreign principals.[666] Thus, as paragraph 6 only deals with agents that do not bind their principals, it should be seen as a separate rule.

Third, and finally, is a model that treats Articles 5(5) and 5(6) as one integrated rule. This model is described by Pijl[667] and credited, by the same author, to Professor Klaus Vogel.[668] This view is, in essence, that the dependency assessment in Article 5(6) should be made first, and as an integrated part of Article 5(5).[669] The argument for his model is based on the wording of the first sentence in Article 5(5). The relevant part reads "where a person – other than an agent of an independent status to whom paragraph 6 applies". According to Pijl, this means that one should first assess whether the agent is a *person*, then move on to Article 5(6) and determine whether the agent is independent or dependent.[670] If the agent is dependent, one continues with assessing the rest of the conditions in Article 5(5). To support this grammatical argument, Pijl references historical material and literature

[666] Roberts, S, "The Agency Element of Permanent Establishment: The OECD Commentaries from the Civil Law View (Part One)", *Intertax*, no. 9 1993, p. 400. Similarly, see Nitikman, J, "The Meaning of 'Permanent Establishment' in the 1981 U.S. Model Income Tax Treaty: Part 2", *The International Tax Journal*, no. 3 1989, p. 258-259.

[667] It should be noted that this model has been brought forward before Pijl. However, Pijl's articles provide a more comprehensive study. See Kroppen H-K and Hüffmeier, S, "The German Commissionaire as a Permanent Establishment Under the OECD Model Treaty", *Intertax*, no. 4 1996, p. 133-136, and Persico, G, "Agency Permanent Establishment under Article 5 of the OECD Model Convention", *Intertax*, no. 2 2000, p. 66-82.

[668] Regarding Vogel see Pijl, H, "Agency Permanent Establishments: *in the name of* and the Relationship between Article 5(5) and (6) – Part 1 and 2", *Bulletin for International Taxation*, no. 1-2 2013, p. 5 and 94. However, the references provided by Pijl do not, to this author, seem conclusive enough to support this.

[669] Pijl, H, "Agency Permanent Establishments: *in the name of* and the Relationship between Article 5(5) and (6) – Part 2", *Bulletin for International Taxation*, no. 2 2013, p. 85.

[670] Pijl, H, "Agency Permanent Establishments: *in the name of* and the Relationship between Article 5(5) and (6) – Part 2", *Bulletin for International Taxation*, no. 2 2013, p. 85.

where the dependency assessment is discussed before the agent's activities.[671]

Roberts's model of separate rules has not received support in literature and is clearly not in line with the PE concept, the OECD MTC and the commentary. Interestingly, in the *Philip Morris* case the Italian Supreme Court seems to share Roberts's view, at least partly, as it stated that if the conditions in Article 5(5) are fulfilled, the agent cannot be independent.[672] This implies that Articles 5(5) and 5(6) are separate rules. However, as already mentioned, there is no support for this view. Thus, this model can be seen as an anomaly and is not further discussed.

This leaves us with the question of whether the exception or integration model best reflects the relationship between the agency clause's two paragraphs. Initially, it should be mentioned that the practical outcome of both these models is the same, and the question can thus be classified as a theoretical one. The difference between the models, apart from what has already been discussed, is that Avery Jones and Ward's model may lead to misunderstandings when interpreting the agency clause. According to Avery Jones and Ward, paragraph 5 is based on civil law whereas paragraph 6 is based on common law. The misunderstandings can occur when civil law lawyers interpret paragraph 6 and when common law lawyers interpret paragraph 5. The authors argue that paragraph 5 and 6 do not make sense when read from a common law and civil law perspective respectively. The risk of misunderstandings can nowadays be questioned given how debated this issue has been. The integration model does not suffer from the problem of misunderstandings, and Pijl rejects the idea that the paragraphs are based on separate legal traditions.[673]

[671] Pijl, H, "Agency Permanent Establishments: *in the name of* and the Relationship between Article 5(5) and (6) – Part 1 and 2", *Bulletin for International Taxation*, no. 1-2 2013, p. 22, 23 and 64. It should be noted that Pijl is cautious when using the historical material, not treating it as proof but rather as an argument.

[672] Corte Suprema di Cassazione, No. 3368, March 7 2002, from 4 *ITLR*, p. 926 (unofficial translation to English).

[673] Pijl, H, "Agency Permanent Establishments: *in the name of* and the Relationship between Article 5(5) and (6) – Part 2", *Bulletin for International Taxation*, no. 2 2013, p. 93.

Initially, it can be mentioned that both Avery Jones and Ward and Pijl make convincing arguments in their respective articles. Given that there is no difference in practice between the two models, I have not delved deeply into the historical material and, hence, cannot take a position on who is right in that respect. However, I do believe that Pijl takes his grammatical argument too far. I agree with him that paragraphs 5 and 6 are part of the same integrated rule, which I call the agency clause, the same way I consider the fixed place of business rule and the exceptions for preparatory and auxiliary activities to be integrated with each other. Nevertheless, one could definitely read paragraph 5 as the main rule and paragraph 6 as the exception, and to some extent the two could be read as different rules, although I am not certain that Avery Jones and Ward would agree with the last statement.

In conclusion, the main difference between the two discussed models is the historical explanation and context. Besides this, I believe the differences are rather small.[674]

5.4.3 Legal and Economic Dependence

5.4.3.1 Dependence in General

In this section the assessment to determine whether an agent is legally or economically dependent is discussed. In general terms, an *independent* agent can be described as governed by the principal's desired result but free to organize his own business in order to reach said result.[675]

[674] As indicated by Avery Jones, J, "The Origins of Articles 5(5) and 5(6) of the Model", *Dependent Agents as Permanent Establishments*, ed. Lang et al, p. 2 in note 1.

[675] Para. 38.3 of the commentary to Article 5 of the OECD MTC. The same opinion is stated in the United States case Donroy Ltd v. United States, 9 AFTR 2d 1129 (301 F. 2d 200), "[a]n independent agent, or independent contractor, generally means one who, exercising an independent employment, contracts to do a piece of work according to his own methods and without being subject to the control of the employer except as to the result of the work." Similarly, in Taisei Fire and Marine Ins. Co., Ltd., et al v. Commissioner of Internal Revenue, 104 TC 535, "even an independent agent only has authority to perform specific duties for the principal. It is freedom in the manner by which the agent performs such duties that distinguishes him as independent."

Conversely, a dependent agent's business is to some degree controlled by the principal. Another way to describe this distinction is that if the agent's business is merged with the principal's, the agent is dependent, i.e. if the agent conducts the principal's business, not his own, he is dependent.[676] The OECD lists three criteria to assess dependence: (1) detailed instructions or comprehensive control,[677] (2) entrepreneurial risk[678] and (3) number of principals.[679] It is somewhat difficult to separate the legal and economic aspects of dependence as some circumstances may be relevant to both. Thus, the different criteria are discussed without necessarily referring to legal or economic dependence.[680]

One could argue that in certain related person situations, e.g. a parent-subsidiary relation, the agent will always be legally and economically dependent. However, this argument is explicitly rejected by the OECD, which states that control as a shareholder is not relevant when determining legal dependence.[681] In the same statement, this approach is said to be consistent with Article 5(7) and the neutrality notion expressed there. As discussed previously, "not relevant" should be understood in the light of Article 5(7) and the phrase "of itself".[682] Interestingly, the OECD does not mention economic dependence in this context. Companies in the same group can be seen as one economic unit. However, it follows from Article 5(7) that related companies are to be seen as separate entities.[683] Consequently, the dependency assessment should, in principle, not differ between related and unrelated persons. The situation with related persons, however, requires special attention as they usually have a common strategy and the pos-

[676] Skaar, A, *Permanent Establishment*, p. 513 and Huston, J and Williams, L, *Permanent Establishments*, p. 128. Differently, Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 340.
[677] Para. 38 of the commentary to Article 5 of the OECD MTC.
[678] Para. 38 of the commentary to Article 5 of the OECD MTC.
[679] Para. 38.6 of the commentary to Article 5 of the OECD MTC.
[680] The same approach is used in the commentary where dependency is mainly discussed in general without specific references to legal and economic aspects.
[681] Para. 38.1 of the commentary to Article 5 of the OECD MTC.
[682] See section 3.5.3.2.
[683] Para. 40 of the commentary to Article 5 of the OECD MTC.

sibility to exercise informal control. It cannot be ruled out that certain aspects have more or less weight in the related person PE situation.

The starting point to determine legal dependence is the obligations the agent has towards the principal. If the agent is "subject to detailed instructions or to comprehensive control", it is dependent.[684] The fact that an agent has to follow instructions is, however, inherent in the agent-principal relationship. After all, the agent is working for the principal. In the commentary, it is stated that limitations of the agent's authority should not influence whether an agent is dependent or not.[685] In other words, dependency should be assessed within the boundaries of the agent's authorization according to the OECD. This means that instructions and control must exceed the levels inherent in an agency relationship.[686]

Vogel makes this distinction by using the terms "materially" and "personally" dependent.[687] Material dependence coincides with what the OECD labels the limits of the agent's authority and is not sufficient to constitute a PE. Personal dependency, on the other hand, is a relationship similar to that of an employee in relation to his employer and implies comprehensive control. Consequently, with this view an employee is always dependent.[688] There are two main characteristics, relevant for this discussion, in an employer-employee situation. First, the employer instructs the employee not only on what to do but also how to do it. Second, the employer bears the economic risk and receives the profits whereas the employee receives a salary. These two characteristics are also expressed in the commentary as "subject to detailed instructions or to comprehensive control" and who bears the "entrepreneurial risk".[689] The third characteristic, number of principals, can also be linked to an employment situation as an employee usually only has one principal. Thus, it may be helpful to compare the

[684] Para. 38 of the commentary to Article 5 of the OECD MTC.
[685] Para. 38.4 of the commentary to Article 5 of the OECD MTC.
[686] Skaar, A, *Permanent Establishment*, p. 513.
[687] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 169.
[688] A similar view is expressed in the commentary, para. 10 of the commentary to Article 5 of the OECD MTC. Also see Skaar, A, *Permanent Establishment*, p. 504.
[689] Para. 38 of the commentary to Article 5 of the OECD MTC. Also see Huston, J and Williams, L, *Permanent Establishments,* p. 131.

agency agreement with how an employee would be treated in a similar situation. These three criteria are discussed in the following sections. It should be mentioned that the question of dependence was also discussed in the context of whose business is being conducted, see section 4.2.2. To some degree, the discussion in these two sections should be seen as complementing each other.

5.4.3.2 Control and Instructions

In this section the threshold for control and instructions is discussed. Certain control is inherent both in the agency situation and between related persons. As mentioned previously, control is a central aspect in the related persons PE situation and, thus, an important aspect to achieve the study's objective.[690] As already established, "normal" control and instructions in both of these situations refer to policy and results. By contrast, control of the day-to-day business may lead to a PE. It seems that the "normal control" in Article 5(7) and the control inherent in any agency relationship are quite similar.[691] Because of this similarity it is argued that, in principle, no aspect of control should be excluded from the PE assessment.[692] However, such control that a principal would typically exercise over an independent agent is, of itself, not sufficient.[693] Such control can be detailed regarding the result.[694] However, if those instructions in reality mean that the agent's freedom to organize his business is limited, the independence can be questioned.

Let us move on to the specifics, i.e. the meaning of comprehensive control and detailed instructions. As a starting point I will discuss a

[690] See section 1.4.2.2.
[691] See section 3.5.3 for further discussion.
[692] Possibly different, Huston, J and Williams, L, *Permanent Establishments*, p. 131, argue that it should not be considered. This position, however, is not elaborated and it is not clear to me if they arrive at this conclusion based on principle or practical considerations.
[693] In a Swedish case from the Board of Advance Rulings, dnr 42-07/D, a Swedish company was going to manage the investments of a foreign company in the same group. The investment management was to be conducted on the same terms as was normal between unrelated parties. The board held that the Swedish company acted as an independent agent in its ordinary course of business and did not constitute a PE.
[694] Huston, J and Williams, L, *Permanent Establishments*, p. 132.

case from the United States, namely, the *Taisei Fire* case.[695] The facts were as follows. Four Japanese insurance companies had an unrelated United States company, Fortress Re Inc, as an agent in the United States. Fortress had the authority to conclude reinsurance contracts on behalf of the four companies, which was regularly done. Fortress was limited by a "net acceptance limit", a limit to the liability it could accept for each company. It was found that Fortress had "total control" over its day-to-day business. The court noted that Fortress was used as an agent because it had a "good relationship with reinsurance brokers, [had] access to good business, and [had] a profitable business strategy." In the three years in question, Fortress earned about 27.5 million U.S. dollars from management fees and commissions. It was undisputed that Fortress had an authority to conclude contracts binding on its clients and acted in its ordinary course of business. Thus the only question was whether Fortress was an independent agent or not.

The court started by concluding that the relevant treaty provisions were "duplicated" from the 1963 OECD MTC. The court continued with an interesting question that deserves to be mentioned. In the commentary to the 1963 OECD MTC, it was stated that dependent agents had to be *both* legally and economically dependent to constitute PEs.[696] The court referred to literature, the fact that the 1963 commentary was referring to League of Nations material (which required *both* legal and economic independence) and that the OECD changed the commentary to the 1977 MTC. The conclusion from this was that the intended meaning of the 1963 commentary was to have an "or", instead of "and", between legal and economic. Consequently, even though the tax treaty had been ratified in 1971, the commentary to the 1977 OECD MTC could be used for interpretation as it represented the intended meaning.

The Commissioner argued that the gross acceptance limit and net premium income limit restricted Fortress's action in a way that it should be considered dependent. However, the court found that Fortress set the gross acceptance limits itself as part of its business strategy. Furthermore, Fortress refused to put a gross acceptance limit in its management agreements as that would have limited its flexibility. The

[695] Taisei Fire and Marine Ins. Co., Ltd., et al v. Commissioner of Internal Revenue, 104 TC 535.
[696] Para. 15 of the commentary to Article 5 of the 1963 OECD MTC.

court also noted that even if a customer wanted to decrease its net premium income from the United States, Fortress would not change its business practice. Based on the above, the court concluded that "Fortress had complete discretion over the details of its work. As an entity, Fortress was subject to no external control."

That Fortress was a legally independent agent seems pretty clear. Why is this case interesting, then? To begin with, this ruling suggests that even if an agent is free to organize its day-to-day business, other limitations relating to the agent's result may still be relevant. Another interesting aspect is that the court is focused on Fortress's business strategy and operations when assessing dependence. An agent that sets its own business strategy and even refuses to change it to accommodate its principals is a strong indication of independence. Some sort of general formula to apply and solve the problem is explicitly rejected.[697] Both of these points support my view that facts should not be ruled out beforehand according to some general principle or idea. The dependency assessment, and the rest of the PE concept, must be made on a case-by-case basis, taking into account whatever is deemed necessary in a specific case to assess each condition.

5.4.3.3 Entrepreneurial Risk

Another important criterion mentioned in the commentary is if the agent assumes any entrepreneurial risk.[698] To determine this, the economic relationship between the agent and principal must be scrutinized.[699] Thus, remuneration, who pays the agents' expenses and who owns the assets used by the agent are important factors to look at. As a starting point, an independent agent can be assumed to receive part of the profit, bear part of the risk and be responsible for its own expenses and assets. Consequently, an agent that is completely shielded from losses is most likely dependent.

[697] "It is obvious that the tests of 'comprehensive control' and 'entrepreneurial risk' […] involve an intensely factual inquiry, which does not lend itself to the articulation of a '*definite statement that would produce a talisman for the solution of concrete cases*.' [my emphasis]" The court cites the italic part from Commissioner of Internal Revenue v. Duberstein, 363 U.S. 278.

[698] Para. 38 of the commentary to Article 5 of the OECD MTC.

[699] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 170.

Returning to the *Taisie Fire*[700] case, the Commissioner argued that Fortress was dependent because its "expenses were covered by a management fee" and that it received its business because of its clients' creditworthiness. The court dismissed both of these arguments. The court concluded that even though the management fee effectively covered Fortress's expenses, this did not mean that they did not bear any risk. According to the court, Fortress was not guaranteed a profit. Fortress's profits were dependent on whether they could generate enough business. Furthermore, Fortress's clients could terminate the contract with six months' notice, leaving Fortress to find a new client. It was also noted that such management fees were normal in this line of business. Regarding the second argument, the court stated that because of Fortress's good reputation, it could attract other clients if needed, and that hundreds of other insurance companies would serve just as well as the four Japanese companies. Finally, the court noted that Fortress's profits were significant and that the remuneration received was "not the kind of sum paid to a subservient company." Consequently, Fortress was an economically independent agent.

Two main arguments can be identified in this ruling. First, the agent was remunerated in a way that is common in this line of business and on an arm's-length basis. Second, the management fee was based on fixed percentages on premiums and required Fortress to attract enough business to not operate at a loss.[701] The fact that the remuneration effectively covered the agent's expenses did not matter as that was a consequence of the agent's capability to conduct good business.[702]

Arm's-length remuneration was also considered in the *Interhome*[703] case. In this case a French subsidiary was acting as an agent for its Swiss parent. The agent, however, received insufficient commission and operated at a loss, which was solved by regular balancing pay-

[700] Taisei Fire and Marine Ins. Co., Ltd., et al v. Commissioner of Internal Revenue, 104 TC 535. For a background and facts of the case see the previous section.

[701] The same argument is brought forward by Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 347.

[702] Also see the Canadian case American Income Life Insurance Company v. Her Majesty the Queen, 2008 CarswellNat 1512, 2008 TCC 306.

[703] Conseil d´Etat, RJF 10/03, No. 1147, June 20 2003, from 5 *ITLR*, p. 1023 (unofficial translation to English).

ments by the parent. Based on this, and the fact that the agent acted exclusively for its parent, the French Supreme Administrative Court concluded that the agent was dependent. The court's reasoning in this case is brief and it is more or less just concluded that the subsidiary was dependent based on the facts presented. Furthermore, it is not clear how low the commission was, but in my opinion the court's phrasing implies a conscious strategy regarding the commission and balancing payments. Regardless, it illustrates that an agent who receives inadequate remuneration paired with balancing payments runs the risk of being dependent. It can be argued that the agent did not bear any real entrepreneurial risk as the parent company consistently made balancing payments. Thus, it seems that, regardless of the agent's performance, it was in practice shielded from losses and, at the same time, it could not make any profit. Based on this, it seems obvious that Interhome was economically dependent as in practice it received a fixed remuneration and did not bear any risk, i.e. the principal just paid the agent's expenses. Thus the relationship between Interhome and its principal was similar to one where a parent company conducts its business itself, through employees.

The situation in *Interhome* is unique to related persons. Unrelated persons would never have a similar arrangement. It can be assumed that this difference exists because of the control inherent in the related person PE situation. The result of splitting remuneration in commission and shareholder contributions is that the agent is consistently operating at a loss, i.e. it has no taxable income. If no PE existed, the foreign company would not be taxed in the state of establishment either. This would create a possibility to shift income from the state of establishment to the principal's state of residence. This problem could to some extent be remedied by transfer pricing to make sure that the subsidiary at least makes a small profit. However, as argued previously, this is not sufficient as with an unrelated agent, both the agent and the PE would be taxed. Thus, the conclusion on dependency in *Interhome* is correct from both a law and a policy perspective. What are the implications of the points discussed here, then?

First, it must be reiterated that a feature of an independent agent is to assume risk, which means that they may sometimes operate at a loss, for example, in a start-up phase or during a recession. This means that just because an agent operates at a loss it should not automatically be considered dependent. However, there is a difference

between an unrelated agent operating at a loss and receiving shareholder contributions and a related one that receives the same contribution from its principal. In the former situation it is still the agent, through its shareholders, that bears the risk of losses. By contrast, in the latter case the risk is borne by the principal.

But what if the agent and principal are sister companies and the contribution comes from their parent company? Can it still be said in this situation that the agent does not bear any risk and is dependent? I would say yes. In the commentary it is stated that a pool of principals can be seen as together controlling the agent.[704] In this example, however, the parent is not acting as a principal. Given that the principal and the parent are group companies that are pursuing a common strategy, it is reasonable to aggregate the parent's actions with the principal's. It should be noted that this does not imply that the agent is a multiple PE.

But what if the agent, instead of receiving contributions, performs another business activity to cover the losses from the agency arrangement, for example, manufacturing and selling goods? As we can see, it is possible to vary this example quite a lot. From an economic point of view, however, we are just changing cash flows within the same box. It is not possible to produce a general formula for how these situations should be solved. It must be decided on a case-by-case basis while considering the financial situation between all involved related persons. One thing can be said, an agency agreement between related persons that deviates from what is normal between unrelated persons is a strong indication of dependence. The reason for this is that it indicates that the business interests of the agent and principal have merged, i.e. it can be questioned whether the agent conducts its own business. In Article 5(7) of the UN MTC, this is explicitly stated in the case of exclusive agents. However, as argued above, this is relevant under treaties based on the OECD MTC as well.[705]

5.4.3.4 Number of Principals

The last criterion mentioned in the commentary is the number of principals. If the agent's activities are performed almost wholly for

[704] Para. 38.6 of the commentary to Article 5 of the OECD MTC.
[705] The same opinion is expressed by Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 347.

one principal, a common situation for a related person acting as an agent, it is less likely that the agent is independent.[706] However, this criterion is less important than the two previous ones and should not lead to dependence on its own.[707] In the UN MTC, the number of principals is mentioned in the article itself, in contrast to the OECD version where it is mentioned in the commentary. Article 5(7) of the UN MTC states that an exclusive, or almost exclusive, agent cannot be independent if the agency agreement also departs from what would be normal between unrelated persons. It is clear from the commentary to the UN MTC that the number of principals alone is not sufficient to be dependent.[708] Nevertheless, if both these criteria are fulfilled, an agent would be automatically treated as dependent under the UN MTC. Such automatic dependence is not the case under the OECD MTC, although, as argued in the previous section, it is a strong indication of dependence. The difference between the two models is therefore minor.[709]

Interestingly, in the ongoing BEPS project and the 2017 draft update of the OECD MTC, the proposal on changing the agency clause contains an even stricter phrasing. In the proposal, the relevant part of Article 5(6) reads as follows: "Where, however, a person acts exclusively or almost exclusively on behalf of one enterprise or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprises."[710]

As the number of principals is not sufficient in itself, the difficult aspect of this criterion is how "wholly" and "almost wholly" should be interpreted. In the commentary, the length of time during which

[706] Para. 38.6 of the commentary to Article 5 of the OECD MTC.
[707] Para. 38.6 of the commentary to Article 5 of the OECD MTC; Huston, J and Williams, L, *Permanent Establishments* p. 135 and Fuentes Hernándes, D, "Agents of an Independent Character under Article 5(6) of the OECD Model Convention", *Dependent Agents as Permanent Establishments*, ed. Lang et al, p. 178.
[708] Para. 33 of the commentary to Article 5 of the UN MTC.
[709] A bit more cautiously expressed by Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 347.
[710] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 16.

there is a low number of principals should be considered.[711] For instance, if an agent has two large clients and ten small ones, the fact that one of the large clients terminates the agency agreement should not mean that the agent is considered to be almost wholly acting on behalf of the remaining large client. In this situation, some time would need to pass before the number of principals would be relevant. The exact duration needed cannot be defined and must be decided on a case-by-case basis. An important factor to determine this is whether the agent is actively seeking new clients or not.[712]

This was mentioned in the United States case *Inverworld*.[713] This was not a tax treaty case, but the domestic legislation was similar to the OECD model regarding independent agents. The United States company (Inc) acted as an agent for a group company (Ltd) based on the Cayman Islands. It was concluded that Inc acted almost exclusively for Ltd. During the five years that were assessed, between 92 and 99 percent of Inc's gross revenue was derived from the services performed for Ltd. It was also noted that Inc did not market its services and, thus, did not try to attract any other clients. Based on this, the court concluded that Inc was not an independent agent.

Another fact that lessens the impact of having one dominant principal is if the agent has substantial business activity of its own.[714] A subsidiary having substantial business activity and at the same time acting as an agent on behalf of its parent is less likely to be dependent than a subsidiary whose only business is to act as an agent on behalf of its parent. One can compare this with the Indian case *Galileo*.[715] In this case the court concluded that it was enough that the unrelated agent acted exclusively for one principal in a specific line of business. As such, it did not matter that the agent had a "full fledge travel agency business" besides acting for the principal in question. The conclusion was that the agent was economically dependent. The last part about being "economically dependent" seems somewhat questionable

[711] Para. 38.6 of the commentary to Article 5 of the OECD MTC.
[712] Huston, J and Williams, L, *Permanent Establishments*, p. 135.
[713] Inverworld Inc, v. Commissioner of Internal Revenue, 71 TCM 3231.
[714] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 170.
[715] Galileo International Inc v. Deputy Commissioner of Income Tax, ITA 851-856/2008 and ITA 859-860/2008.

based on the number of principals alone. The principle expressed, i.e. that being an exclusive agent in one line of business out of several, however, is valid, although, as stated above, the argument of "number of principals" is considerably weaker in such situations.

A question that is especially interesting in the related person PE situation is in which situations several clients should be seen as one. For instance, should an agent with ten clients, none of which are predominant but all of them group companies, be considered to act almost wholly on behalf of one principal? According to the OECD, the fact that a number of principals "act in concert to control the acts of the agent" may lead to the agent being dependent.[716] Naturally, this does not mean that related persons are automatically seen as one principal. However, a situation where an agent acts almost wholly on behalf of related persons warrants special attention to whether those principals together control the agent.

In summary, the number of principals is not decisive in the dependency assessment. It mainly functions to strengthen or weaken other arguments for dependence. If the agent has a substantial business activity besides acting as an agent or actively tries to attract new clients, the impact of acting almost wholly on behalf of one principal is lessened.

5.4.4 Ordinary Course of Business

An agent that fulfills all conditions in Article 5(5) but is considered legally and economically independent according to the previous discussion can still be an agency PE. It is not sufficient to be independent; the independent agent must also act in its ordinary course of business to avoid PE status. At a first glance, this might seem strange. Should the PE depend on how the agent conducts his "other" business and not on the activities performed on behalf of the principal? If this was the case then it would indeed be strange.[717] However, as will be demonstrated below, this is not the case.

According to Skaar, the reasoning behind this condition is that an independent agent conducts his own business, but if he is acting outside his ordinary course of business it is less likely that he conducts his

[716] Para. 38.6 of the commentary to Article 5 of the OECD MTC.
[717] Skaar, A, *Permanent Establishment*, p. 516.

own business activities.[718] The same argument is brought forward in the commentary, where it is stated that an agent is not acting in his ordinary course of business in relation to activities which economically belongs to the principal.[719] This is similar to the general dependency assessment discussed above, where a dependent agent's business was merged with the principal's, i.e. the dependent agent conducts the principal's business and not his own.[720] Based on this similarity, one could see the ordinary course of business test as an extension of the dependency assessment discussed previously rather than a completely separate test. Consequently, this test should not completely override the result of legal and economic independence but rather complement it.[721]

In the commentary, it is stated that normally one should compare the agent's activities with "activities customary to the agent's trade".[722] However, this statement is elaborated to allow, in certain situations, complementary or alternative tests. One "certain situation" is mentioned and concerns activities not related to a common trade.[723] In the report leading up to this statement one additional situation is mentioned.[724] This situation is when the agent and principal are affiliated. In this situation it is suggested that one may assess the activities of the corporate group instead of the agent. I see two results of this approach. First, if the activity is ordinary for the group but alien for the agent, it would still be within the agent's ordinary course of business as it is ordinary for the group. Second, if the activity is alien for the group but ordinary for the agent, e.g. the only activity the agent performs, it would be seen as outside the ordinary course of business.

[718] Skaar, A, *Permanent Establishment*, p. 515-516.
[719] Para. 38.7 of the commentary to Article 5 of the OECD MTC.
[720] See section 5.4.3.1, specifically note 675 and 676 with accompanying text.
[721] Skaar, A, *Permanent Establishment*, p. 516. Skaar uses the expression "contradict" instead of "completely override". Contradict is slightly stronger and implies that the ordinary course of business test should be moved to the general dependency assessment; otherwise it would be without use.
[722] Para. 38.8 of the commentary to Article 5 of the OECD MTC.
[723] For an interesting case dealing with such a situation see the German case BFHE Bd. 139 (1984) 411, cited through Skaar, A, *Permanent Establishment*, p. 519-521.
[724] OECD, *2002 Reports Related to the Model Tax Convention*, p. 112.

Both of these results seem strange and contradict the notion that related and unrelated persons should be assessed the same way. This approach also conflicts somewhat with the principle that related persons are separate entities when it comes to taxation. Furthermore, it is difficult to see how this approach would help determine whether the business activity economically belongs to the agent or principal. Consequently, this approach does not seem appropriate. Based on the above, the starting point is the agent's line of business, but the facts of the specific case determine how one approaches this question, at least according to the OECD.

The OECD tries to elaborate on the ordinary course of business test further with an example. However, no further lucidity is achieved, quite the opposite actually.[725] The example is found in the commentary.[726] In this example, a commission agent sells goods on behalf of an enterprise but in his own name, i.e. not binding the principal given the terminology used by the OECD. In addition to this, the agent habitually concludes contracts binding on the enterprise. The OECD's conclusion is that the agent is a PE "since he is thus acting outside the ordinary course of his own business (namely that of a commission agent)". This example is poorly drafted, and as such misleading, as it seems to imply a mechanical approach to the ordinary course of business test. The fact that a commission agent also habitually contracts in the name of its principal is not of itself evidence that the agent performs activities that economically belong to the principal.[727] This example does not really give any guidance at all on how to interpret an agent's ordinary course of business. Instead, it seems to clarify that an agent cannot "hide" behind a commissionaire status while at the same

[725] For a similar opinion see Staringer, C and Vallada, F, "Acting in the ordinary course of business under Article 5(6) of the OECD Model Convention", *Dependent Agents as Permanent Establishments*, ed. Lang et al, p. 194.

[726] Para. 38.7 of the commentary to Article 5 of the OECD MTC. It can be noted that this example is removed in the proposed new commentary. Instead, two new examples are introduced. These examples are clearer and they clarify that an agent can have more than one line of business and that the lines of business that are not connected to the agency should not be considered. Para. 110 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

[727] The same conclusion is reached by Skaar, A, *Permanent Establishment*, p. 515.

time performing other actions, something that hardly needed to be clarified as the foremost reason the commissionaire is not a PE is that it does not bind the principal, not that it is independent.[728] In the context of related persons, it can often be the case that the commissionaire is dependent but does not constitute a PE because it does not bind the principal. Thus, the example expresses a clarification, unnecessary in my mind, that it is not enough to label an agent as a typical type of independent agent, the agent also has to act according to that label to be considered independent.

Pijl finds one additional meaning in the example. The description of the commissionaire's actions is preceded by the phrase "for example". This indicates that it is not only the described situation that is covered. According to Pijl, the phrase "ordinary course of business" replaced the older wording of "bonafide".[729] Based on this he concludes that "ordinary course of business" includes a general notion of independence.

How should the ordinary course of business be determined, then? Skaar uses three criteria to assess this: (1) ordinary in the agent's own business, (2) ordinary in the agent's particular line of business and (3) the activities are performed in an independent way.[730] These criteria are used as a starting point in the following analysis.

The first question is whether one should look at the agent's own business or the agent's line of business in general. As mentioned previously, the OECD favors the custom in the relevant line of business, with recourse to the agent's own business as a secondary test depending on situation. The notion that the agent's line of business is the

[728] See the *Zimmer* case, Conseil d´Etat, No. 304715, March 31 2010, from 12 *ITLR*, p. 739 (unofficial translation to English), where the court stated that the facts of the case must decide if the principal is bound, not how the agency agreement is labeled by the parties. Also see Pijl, H, "Agency Permanent Establishments: *in the name of* and the Relationship between Article 5(5) and (6) – Part 2", *Bulletin for International Taxation*, no. 2 2013, p. 91, who reaches the same conclusion.

[729] Pijl, H, "Agency Permanent Establishments: *in the name of* and the Relationship between Article 5(5) and (6) – Part 1 and 2", *Bulletin for International Taxation*, no. 1-2 2013, p. 17 and 91.

[730] Skaar, A, *Permanent Establishment*, p. 521-522.

most important aspect seems to have some support in literature.[731] On the other hand, the idea to look at the agent's own business also has some support.[732] However, even if the agent's own business is considered relevant by some authors, the argument is that it is not the only criterion but rather a combination of the agent's own business and the custom in the particular line of business. Nevertheless, there is no consensus on how the ordinary course of business should be interpreted. By contrast, the view that only the agent's own business should be assessed has rather weak support in literature.[733] This is logical as this view would create a situation where two principals with identical businesses could be treated differently depending on the practice of their agents. The conclusion is that assessing only the agent's own business is not in line with the agency clause, nor is it appropriate from a policy perspective.

Two cases from the German Supreme Court are commonly cited when discussing this question. The first is the *Insurance*[734] case. The court stated that the ordinary course of business could not be assessed by looking at the agent's other activities. Instead, it was concluded that the agent's ordinary course of business should be decided on the basis of the general custom in the relevant line of business.

The other case is *Container*.[735] In this case a German agent leased out containers on behalf of its United States principal. The agent was considered independent and the question was whether it acted in its ordinary course of business or not. At that time it was unusual for

[731] Pleijsier, A, "The Agency Permanent Establishment: The Current Definition – Part One", *Intertax*, no. 5 2001, p. 181-182 and Staringer, C and Vallada, F, "Acting in the ordinary course of business under Article 5(6) of the OECD Model Convention", *Dependent Agents as Permanent Establishments*, ed. Lang et al, p. 204.

[732] Skaar, A, *Permanent Establishment*, p. 519; Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 172; Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 352 and Huston, J and Williams, L, *Permanent Establishments*, p. 137.

[733] For an example of this view see Roberts, S, "The Agency Element of Permanent Establishment: The OECD Commentaries from the Civil Law View (Part Two)", *Intertax*, no. 10 1993, p. 488-489.

[734] BFH in BStBl 1975 II 626, cited through Skaar, A, *Permanent Establishment*, p. 517.

[735] BFH in BFHE Bd. 139 (1984) 411, cited through Skaar, A, *Permanent Establishment*, p. 519-521.

agents in Germany to participate in this kind of business. The court stated that just because the activity was unusual in general did not automatically mean that it was outside the ordinary course of business. The reason for this was that it was a marginal market that required considerable financial resources and innovation. The court then stated that unusual activities could still be considered to be within the ordinary course of business if it could be said that those activities would be ordinary in the future. As no objective criteria could be used, the court focused on the agent's own business, and it was concluded that leasing out containers was in the ordinary course of the agent's business.

These two cases imply that the starting point is what is ordinary in the specific line of business. An agent can have more than one line of business.[736] Therefore, if the agent operates in several lines of business it must be decided which line of business the assessed activities originate from. However, even if the agent's activities cannot be said to be ordinary with reference to a specific line of business, it could still be within the ordinary course of business if one adopts a broader approach. This is in line with the current reasoning in the commentary.[737] Skaar interprets *Container* as decided on "the general conditions for agency PE."[738] Another interpretation is that the German Supreme Court just applied a broader approach to what is ordinary in a specific line of business.[739] How should this be decided, then? Naturally, predicting the future behavior of agents is a difficult task. Hence, it is better to focus this assessment on what is already known. It is submitted that the agent's own activities and the general criteria for dependence are better suited to determine this. Assume that an agent is performing

[736] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 350.

[737] Para. 38.8 of the commentary to Article 5 of the OECD MTC.

[738] Skaar, A, *Permanent Establishment*, p. 521.

[739] Staringer, C and Vallada, F, "Acting in the ordinary course of business under Article 5(6) of the OECD Model Convention", *Dependent Agents as Permanent Establishments*, ed. Lang et al, p. 203-204. It can be noted, however, that the authors suggest that one should assess "what would be the reasonable role of independent agents" in situations where no comparable data exists. Exactly how this is to be done is not mentioned, but it seems quite similar in practice to Skaar's idea of recourse to the general criteria. How would one assess this otherwise?

unusual activities. If those activities are the entire business of the agent, performed for various clients none of which are predominant, and are performed in an independent way, it seems unreasonable to consider the agent dependent and constituting a PE. Exactly how these criteria should be weighed cannot be predetermined but must be decided on a case-by-case basis.

In conclusion, the ordinary course of business should be decided primarily on what is ordinary in a particular line of business. If this is fulfilled, one does not need to proceed further. By contrast, if the agent's activities cannot be said to be ordinary in this line of business, a broader approach needs to be adopted. This broader approach should assess whether there are reasons to still consider the activities ordinary. To answer this question one should look at the totality of the agent's activities and the general criteria for independence.

Given this conclusion, one can question the status as a stand-alone test. In my opinion, it would be better to remove this reference from the actual article and instead include it in the commentary as one aspect among others to assess dependence in general.

5.5 The Proposed New Agency Clause in the BEPS Project

The proposed new agency clause has changes in both paragraphs 5(5) and 5(6), i.e. both in the authority to conclude contracts in the name of the principal and the dependency assessment. The changes to the present Article 5(5) mainly concern the change from the requirement to contract "in the name of", i.e. legally binding the principal, to economically bind the principal. The change to Article 5(6) mainly deals with related persons and basically means that an agent acting almost exclusively on behalf of related persons will always be considered dependent. In the following, the proposed changes are discussed with a focus on the related person PE situation.

Starting with the changes in Article 5(5), it can initially be concluded that there are no direct implications for related persons. However, as discussed previously, the commissionaire structure is often used by multinational groups and, thus, the proposed changes have indirect relevance for the related person PE. The first change is that the "au-

thority to conclude contracts" is supplemented with "plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise". This change seems to me, to a large extent, to introduce what was previously stated in the commentary in the actual article.[740] However, just by moving something from the commentary to the article will enhance the moved aspect. Furthermore, as Reimer points out, a "principal role" can only be played by either the agent or the principal.[741] It is not unlikely that "principal role" will be interpreted more broadly to include more than negotiating all essential elements of a contract.[742] Especially since the traditional "authority to conclude contracts" is still part of the agency clause, it can be argued that "principal role" aims at other situations. To some degree it seems that the proposed change aims to split the current "authority to conclude contracts" into two parts, a more formal one, the present wording, and a substance-over-form one, the principal role. In my opinion, if one wanted to enhance the substance-over-form approach to the conclusion of contracts it would have been better to delete the previous condition and just include the "principal role" as the new condition.

Let us move on to the next proposed change, which is to include contracts that economically bind the principal. Just as with the previously discussed change, the present wording is kept with some additions. Thus, it is still sufficient to contract "in the name of" the principal. Additionally, contracts that involve the principal selling, letting or performing services are included in situations where the principal is

[740] For instance, compare para. 32.1 of the commentary to Article 5 of the OECD MTC with para. 89 of the commentary to Article 5 of the 2017 draft of the OECD MTC. Also see para. 88-90 of the commentary to Article 5 of the 2017 draft of the OECD MTC and Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 367-368.

[741] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 366.

[742] For instance, Plejsier argues that a sales agent will always play the principal role. Pleijsier, A, "The Artificial Avoidance of Permanent Establishment Status: A Reaction to the BEPS Action 7 Final Report", *International Transfer Pricing Journal*, no. 6 2016, p. 443.

not legally bound by the contract. That commissionaires are covered by this is specifically stated in the proposed new commentary.[743]

A question relevant to related persons that can be asked in this context is what happens if the principal subcontracts the performance of services to a related person other than the agent?[744] If the subcontractor acts independently, can it be said that it conducts the business of the principal in the sense that it is still the principal that provides the services? Conversely, can it be said that the agent is acting on behalf of the subcontractor and, thus, creating an agency PE for him?[745] It is not immediately clear to me how these questions should be answered. However, if this is an artificial split-up of activities in order to avoid having a PE, I would suggest applying substance-over-form to the situation.

The proposed change of Article 5(6) is specifically aimed at the related person PE situation. In the proposed new Article 5(6) it is stated that if the agent acts almost exclusively on behalf of one or more closely related enterprises, that agent shall be considered dependent with respect to those enterprises. A 90 percent test is implied in the commentary to determine whether an agent acts almost exclusively on behalf of closely related enterprises.[746] In the proposed new Article 5(8), "closely related enterprise" is defined. This definition is somewhat unclear. First, it is stated that if one person has control over the other, or if they are under common control, they are closely related. In the proposed commentary this control is explained as something similar to the control one would have from possessing more than 50 percent of the beneficial interest in the enterprise.[747] Regardless of the outcome of this, persons should always be considered to have control if they directly or indirectly hold more than 50 percent of shares and votes or possess the beneficial interest to more than 50 percent.

[743] Para. 91-92 of the commentary to Article 5 of the 2017 draft of the OECD MTC. Also see para. 93-96 of the commentary to Article 5 of the 2017 draft of the OECD MTC for a further discussion of the new criteria.
[744] Of course, this situation is relevant to an unrelated subcontractor as well.
[745] This is assuming that the same subcontractor is used repeatedly to satisfy the condition "habitual".
[746] Para. 112 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[747] Para. 120 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

The proposed dependency assessment is fairly straightforward even though there may be some issues with the first part of the definition of "closely related". Because of this, nothing more is said about the interpretation. Instead, the chosen solution is discussed from a policy perspective. Initially, it is interesting to note that the proposed dependency assessment includes an aspect of form-before-substance. A wholly owned subsidiary acting as an agent is considered dependent based on the legal form of parent-subsidiary alone. This is interesting because the discussion and conclusions throughout the study have been focused on substance-over-form. This is a departure from the notion that related persons should be treated the same way as unrelated persons and the separate entity baseline. This proposal received "strong objections" but these were ignored as there was "general support" for the changes in Working Party 1.[748] It is also a departure from what can be labeled the go-to solution, substance-over-form. Perhaps one can view this as a simplification in the sense that it is assumed that a closely related agent in most cases is dependent in substance. Given the previous discussion on this, that explanation cannot be accepted. It seems highly questionable that the vast majority of related persons are controlled in such a manner that they are dependent in the way envisioned under the PE concept, e.g. typically control the day-to-day business. It seems a bit more likely that related persons are economically dependent because the division of risk between related persons is a somewhat artificial operation. Still, the lasting impression is that this proposal is a significant weakening of the notion that related persons are separate entities. This once again shows that the PE concept is often treated as a practical rule rather than a principle one.

Finally, it may be that the view that a related person is dependent migrates into the dependency assessment under the fixed place of business rule, resulting in more related person PEs under that rule as well. On the other hand, it could be the case that the widened agency clause relieves some of the pressure on the fixed place of business rule.

[748] OECD, *BEPS Action 7: Preventing the Artificial Avoidance of PE Status*, Revised Discussion Draft, 2015, p. 12.

5.6 Conclusion

This chapter has dealt with the study's second research question in relation to the agency clause. In other words, this chapter has dealt with the application of the agency clause in the related person PE situation. Comparing this chapter to the previous one, which dealt with the fixed place of business PE, it can be concluded that the tension created by related persons is less focused on the interpretation of the rule. Instead, the focus is to a large extent on the policy level to include commissionaire agents under the agency clause. The reason for this is that the agency clause is adapted to related persons from the start. The question of whose business is being conducted is explicitly included in the rule through the dependency assessment. Despite this difference, the conclusion in this chapter is the same as in the previous chapter, namely, that there are in principle two questions that are specific to the related person PE situation. These questions are whose business is being conducted and when can one aggregate the activities of several related persons. The first question is inherent in the dependency assessment. The second question is relevant to prevent related persons to artificially split up activities between them to avoid having a PE.

6 Article 5(4) – Preparatory and Auxiliary Activities

6.1 Introduction

This chapter deals with the exception from having a PE provided that the relevant activities are specified in a list or can be considered preparatory or auxiliary. These exceptions can be found in Articles 5(4) of the OECD MTC and the UN MTC. Article 5(4) effectively functions as an exception, which means that even if all the PE conditions are fulfilled, no PE exists provided that the activities are covered by the exceptions.[749] These exceptions are applicable to all the different PEs in the OECD MTC, the fixed place of business PE, construction PE and agency PE. This is stated in Article 5(4) and, when it comes to the agency clause, a reference to the exceptions is made in Article 5(5). Naturally, the application to the construction PE is narrow as the specific listed activities are not related to construction. Nevertheless, in certain limited situations the exceptions can be relevant for the construction clause. One example is an enterprise building a warehouse that in the future will store the enterprise's goods. In this situation, the construction can be considered of a preparatory nature.

The objective of the exceptions is to simplify and raise the minimum PE threshold. The reasoning is that even though the exempted activities may constitute PEs in principle, it is difficult to attribute any profits to such PEs.[750] Another argument is that taxation of the ex-

[749] Interestingly, the Swedish government did not consider the activities in Article 5(4) as exceptions but rather as examples when the domestic PE provision was modeled after the OECD version in 1986. In their opinion, Article 5(4) served little purpose as the listed activities in many cases did not fulfill the PE conditions anyway. Thus, the Swedish domestic PE provision lacks the list of exceptions. However, this does not seem to have had any major influence on the application of the PE concept in Sweden. Prop. 1986/87:30, p. 43.

[750] Para. 23 of the commentary to Article 5 of the OECD MTC; Skaar, A, *Permanent Establishment*, p. 279; Reimer, E, *Permanent Establishments*, 5th ed, ed.

empted activities lacks legitimacy.[751] Presumably, this argument comes from the fact that the exempted activities are considered "insignificant" for the enterprise.[752] The logic behind this reasoning is now being challenged, and substantial changes are being proposed in the BEPS project. This is discussed in section 6.5.

This may lead to a situation where Article 5(4) becomes rather fragmented. On the one hand, we have the current version, which will live on in old tax treaties and most likely even in some countries' future tax treaty practices. Notably, the United States has expressed doubt about the suggested changes and did not include them in their updated MTC from 2016 as the implications of the changes were not clear.[753] On the other hand, we have the new version proposed in the BEPS project, which some countries will implement in both old[754] and future tax treaties. Additionally, the UN MTC's version is slightly different from the current OECD one. This may lead to some confusion in the future.

The outline of this chapter is as follows. Initially, the effects of the exceptions on related persons are discussed (section 6.2). After this, the specifically listed exempted activities are discussed as well as the difference between the OECD and UN MTCs (section 6.3). Then we move on to discuss the general exception of preparatory and auxiliary activities (section 6.4). Next, the new version of Article 5(4) proposed in the BEPS project is dealt with (section 6.5). Finally, some concluding remarks are presented (section 6.6).

Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 241.; Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 108 and Schaffner, J, *How Fixed Is a Permanent Establishment?*, p. 207.

[751] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5, marg. no. 108.

[752] Para. 24 of the commentary to Article 5 of the OECD MTC.

[753] The United States Treasury, *Preamble to 2016 U.S. Model Income Tax Convention*, February 17 2016, p. 9.

[754] This depends on the outcome of the multilateral instrument developed under Action 15 in the BEPS project.

6.2 The List of Exceptions and Related Persons

As will be discussed later, the most interesting aspects of the exceptions and related persons are found in the proposed new version of Article 5(4) in the context of the BEPS project. There is, however, one interesting question regarding the current version which is discussed in this section.

If one looks at the list of exceptions one can note the use of the phrases "belonging to the enterprise" and "for the enterprise". One of these phrases is present in subparagraphs a)-e), i.e. in connection with all of the exempted activities. These phrases imply that it is activities relating to the enterprise's internal operations that are covered by the exceptions. This means, for example, that storing the enterprise's own goods can be an exempted activity while performing the service of storing someone else's goods cannot. The reason is that the first activity relates to the enterprise's internal operations while the second does not.

How does this connect to the related person situation, then? As discussed previously, the OECD MTC is based on the notion of separate entities.[755] This means that providing a service for a related person cannot be exempted under Article 5(4) as the activity is not an internal operation. This is explicitly stated in the commentary.[756]

This can have the effect that an activity that would be exempted if performed by the enterprise itself falls outside the scope of Article 5(4) if performed by a related person. This is a fairly common situation as multinational groups often centralize certain support functions to one company, which then performs this function on behalf of the other companies in the group.

To some extent, this means that a multinational group in certain limited situations can choose whether an establishment is taxed in the state of establishment or not. It is doubtful that this is a serious problem in practice as multinationals are usually organized in a group, which makes this difficult to utilize on a large scale. However, if only one company needs a specific service, which is exempted, it would be

[755] See chapter 3.
[756] Para. 26 of the commentary to Article 5 of the OECD MTC.

possible to choose to establish a company or a branch depending on whether you want to be taxed in the state of establishment or not.

Another, and perhaps more serious issue, is that the notion of related persons as separate entities can be used to avoid having a PE by splitting up activities between different related persons. This is discussed later in section 6.5.3 as this situation is specifically dealt with in the BEPS project.

6.3 The List of Specific Exceptions

6.3.1 In General

Article 5(4) contains a list of specific activities that are exempted from constituting PEs on their own. These specific activities can be found in subparagraphs a)-d). As mentioned in the previous section, a common feature of these activities is that they must relate to the enterprise's own internal operations. In the following sections the specific activities that are exempted are discussed. Additionally, the combination of activities and the difference in the UN MTC is dealt with.

There is, however, a question of general interest to discuss first. This question is whether the specific listed activities are always exempted or if they are subjected to a condition of being preparatory or auxiliary. In other words, are the listed activities real exceptions or are they merely examples of activities that are commonly preparatory or auxiliary? This question has likely emerged because, if the specific activities are exceptions, then a substantial establishment that generates substantial profit would still not constitute a PE provided that the performed activity are listed in subparagraphs a)-d).

This question was discussed by the OECD in both 2002 and 2012 in reports concerning the interpretation and application of the PE concept.[757] The conclusion in both of these reports was that the specifically listed activities in subparagraphs a)-d) were not subject to the condition of being preparatory or auxiliary. This is the correct conclusion. The reason for this is the explicit inclusion of such a requirement

[757] OECD, *2002 Reports Related to the Model Tax Convention*, p. 99-100 and OECD, *OECD Model Tax Convention: Revised Proposals concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, 2012, p. 24-27.

in subparagraphs e) and f) while subparagraphs a)-d) lack such an explicit requirement.[758] Furthermore, the new version of Article 5(4) presented in the BEPS project makes it clear that the current version does not include a general requirement of activities being preparatory or auxiliary.[759] There are, however, authors arguing the opposite, i.e. that the specifically listed activities are required to be preparatory or auxiliary to be exempted.[760]

It can be noted that in 2002 a minority of the Committee on Fiscal Affairs was of the opinion that the specifically listed activities are subject to the requirement of being preparatory or auxiliary.[761] This is explored again in the BEPS project, and it is proposed that countries may adopt a version of Article 5(4) where all listed activities are subject to the condition of being preparatory or auxiliary.[762] It can be noted that, in the 2017 draft update to the OECD MTC, the BEPS proposal is the norm and the present version is included as an option in the commentary.[763] This proposal is discussed further in section 6.5.2.

6.3.2 Storage, Display or Delivery

According to Article 5(4)a in the OECD MTC, "the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise" will not constitute a PE. As was

[758] OECD, *OECD Model Tax Convention: Revised Proposals concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, 2012, p. 26; Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, marg. no. 108-109; Williams, R, *Fundamentals of Permanent Establishments*, p. 184; Nørgaard Laursen, A, *Fast driftsted*, p. 137 and Baker, P, *Double Taxation Conventions*, 5B.20, September 2002 update.

[759] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 28-29. For further discussion see section 6.5.2.

[760] Skaar, A, *Permanent Establishment*, p. 288-290; Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 252 and 276; Schaffner, J, *How Fixed Is a Permanent Establishment?*, p. 211-214 and Oberbauer, N, "The Dependent Agent PE and the Exception for Auxiliary and Other Activities under Article 5(4) of the OECD Model Convention", *Dependent Agents as Permanent Establishments*, ed. Lang et al, p. 210.

[761] OECD, *2002 Reports Related to the Model Tax Convention*, p. 99.

[762] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 28-29.

[763] Para. 78 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

concluded in the previous section, subparagraph a) does not contain a requirement of the listed activities being preparatory or auxiliary but functions as a true exception. Furthermore, it was concluded that the listed activities only concern the enterprise's internal operations, which is clear from the phrase "belonging to the enterprise".

The meaning of this exception is not further elaborated in the commentary as the only mention of it is one sentence basically just repeating the text of the article.[764] It is briefly discussed in literature.

To begin with, it is worth stressing that the word "solely" is used in the subparagraph, which makes it clear that the exception is not applicable if other activities are performed at the place of business. However, the activities of storing, displaying or delivering must be understood in a wide sense. For example, activities normally connected to the storage of goods, such as labeling and keeping inventory, should be encompassed by "storage" and do not count as separate activities.[765]

Another question is whether the exception is applicable if a combination of storage, display and delivery is performed in the same warehouse or if such a combination of activities instead falls under subparagraph f). An example would be a warehouse used both for storage and delivery, something one can assume is a common situation. The question is important as subparagraph f) is subject to the requirement that the combination be of a preparatory or auxiliary character, whereas subparagraph a) is not.

This was discussed by the OECD in the 2012 report regarding the interpretation of the PE concept. The recommendation in that report was to clarify in the commentary that any combination of storage, display and delivery in the same facility should be covered by the exception.[766] The reason was that the exception would be rather pointless, as a facility used for the delivery of goods usually means storing the goods at that facility. Similarly, storing goods is often followed by a delivery. This is the correct interpretation as the opposite conclusion

[764] Para. 22 of the commentary to Article 5 of the OECD MTC.
[765] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 267 and Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, marg. no. 210.
[766] OECD, *OECD Model Tax Convention: Revised Proposals concerning the Interpretation and Application of Article 5 (Permanent Establishment)*, 2012, p. 30-31.

would mean that the practical application of the exception, especially "delivery", would be close to meaningless. One can note that this reasoning is included in the 2017 draft update to the OECD MTC.[767] Thus, any combination of storage, display and delivery is covered by the exception as long as no other activities are performed.

6.3.3 Stock of Goods

Subparagraphs b) and c) in Article 5(4) of the OECD MTC are exceptions dealing with a stock of goods or merchandise in two different situations. Subparagraph b) exempts the "maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery" while subparagraph c) exempts the same maintenance of a stock of goods or merchandise for the sole purpose of being processed by another enterprise.

Initially, the general conclusions from the above should be mentioned. The first one is that subparagraphs b) and c) do not have a requirement that listed activities be preparatory or auxiliary. The second conclusion is that the exceptions only cover an enterprise's internal operation, which is stated with the phrase "belonging to the enterprise".

Let us start with subparagraph b), which deals with storage, display and delivery. Just as with subparagraph a), these activities should be understood as including those normally connected with the listed activities.[768] The difference between subparagraphs a) and b) is that b) only relates to the stock of goods as a PE while a) relates to the facility where the stock of goods is handled.[769] It is, however, somewhat difficult to completely separate these two subparagraphs from each other as both deal with storage, display and delivery. For instance, goods and merchandise are not places of business as those are the subject of business activities, in this situation storage, display or delivery.[770] As a place of business is required for a fixed place of business PE, a stock

[767] Para. 66 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[768] See the previous section.
[769] Para. 22 of the commentary to Article 5 of the OECD MTC.
[770] Skaar, A, *Permanent Establishment*, p. 319; Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, marg. no. 111 and Tittle, M, *Permanent Establishment in the United States*, p. 171-172.

of goods cannot be a PE on its own. Thus, subparagraph b) is more of a clarification that a stock of goods does not fulfill the conditions for a fixed place of business PE than a true exception.[771] In the Indian case *Airlines Rotables*,[772] it was concluded that a stock of consignment goods was not used to carry out the business of the foreign enterprise. Additionally, the Income Tax Appellate Tribunal stated that a stock of goods, in principle, cannot lead to a PE unless it is stored in a warehouse on behalf of someone else.

By contrast, one can note a peculiar case from Sweden concerning the individual HÅ.[773] HÅ had his tax residence in Belgium but owned real estate in the form of a building in Sweden. HÅ had sold the real estate and, according to the tax treaty between Sweden and Belgium, Sweden could only tax the capital gain provided it was connected to a PE in Sweden. The Board of Advance Rulings concluded that the real estate constituted trading stock according to Swedish domestic law and that there was nothing indicating that "trading stock" had any other meaning in the treaty. The board then proceeded to conclude that the stock of goods was not solely maintained for storage, display or delivery. Instead, it was maintained for the purpose of selling it. As the rest of the conditions of the fixed place of business PE were considered fulfilled, wrongly in my opinion, HÅ had a PE in Sweden through his stock of goods. The case was appealed and was ultimately upheld by the Supreme Administrative Court.

This ruling has several questionable conclusions. In this section, however, I will limit the discussion to the conclusion that the stock of goods was maintained for the purpose of selling it. It can immediately be concluded that if this is the correct interpretation, the holding of a trading stock would rarely be included in "solely for the purpose of storage, display or delivery". This is problematic for two reasons. First, it can be assumed that an enterprise always stores a stock of goods not for the sake of storing it but with the view to using it in some way, for instance to sell or process it. One does not store one's own assets for the *sole purpose of storing* them. Thus, the board's conclu-

[771] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, marg. no. 111.
[772] Airlines Rotables Limited v. Joint Director of Income Tax, ITA No. 3254/MUM/2006, May 21 2010.
[773] RÅ 1991 not. 228.

sion is inconsistent with reality and it greatly limits the scope of "storage".

Second, the limit of the scope of "storage" does not matter that much in the context of subparagraph b) as it was concluded above that it has only a clarifying function.[774] However, as the phrase "storage, display or delivery" is used in subparagraph a) as well and it is clear that no difference is intended, the board's conclusions can have a harmful effect. This is because a warehouse *is* a place of business and could fulfill the conditions in Article 5(1). This means that the true exception in subparagraph a) may have its scope reduced as well if the above reasoning is accepted. Based on this, the reasoning, relating to the purpose of keeping the trading stock, by the Board of Advance Rulings cannot be accepted. Perhaps, the board's reasoning can be explained by the fact that it is stated in the domestic PE provision that buildings held for resale constitute PEs. This is somewhat strange as it is recognized in the preparatory works to the domestic PE provision that the same is not necessarily true under the OECD MTC.[775]

Let us move on to subparagraph c), which deals with the maintenance of a stock of goods for the sole purpose of being processed by another enterprise. As with the previous exceptions, this one is merely described with a sentence in the commentary.[776] Furthermore, as was discussed above, a stock of goods is not a place of business and cannot constitute a PE on its own. Thus, this provision is also more of a clarification that the PE conditions are not fulfilled than a true exception.[777]

6.3.4 Purchasing Goods or Collecting Information

Subparagraph d) in Article 5(4) of the OECD MTC states that "the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise" is exempted from being a PE. Thus, this exception contains two different situations. That this is a true exception is indicated

[774] As I consider that the board erroneously concluded that the conditions in Article 5(1) were fulfilled, I disregard that part of the ruling in this discussion.
[775] Prop. 1986/87:30, p. 42-43.
[776] Para. 22 of the commentary to Article 5 of the OECD MTC.
[777] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5 marg. no. 112.

by the use of the phrase "fixed place of business", which means that the intended establishments would be PEs if Article 5(4)d did not exist. The exception is further explained in the commentary as a newspaper bureau, which is collecting information, can be exempted on the same principle as "the concept of 'mere purchase"'.[778] Thus, the OECD considers that, in principle, purchasing and collecting information are the same type of activity. For clarity, I will still discuss them separately.

Before starting to discuss the two situations, the general conclusions concerning the list of exceptions are once again presented. The conclusions were that the specifically listed activities are not subject to a requirement of being preparatory or auxiliary, and the exceptions only relate to the enterprise's internal operations.

The reason for exempting purchases is that no income is produced by a mere purchase and doing so facilitates export.[779] As Skaar puts it, "the mere purchase of goods in itself does not increase the value of the buying enterprise."[780] This is because a purchase on the market is merely an exchange of one asset (money) for another asset (goods).

The activity of "purchasing" encompasses other activities normally connected to it. Examples of such activities can be quality control and repacking.[781] In the *Fabrikant* case[782] from India it was held that an office that purchased diamonds and also performed quality control, negotiated prices, assorted and packed diamonds and handled shipping and export did not constitute a PE due to the exception of mere purchase activities. In another Indian case, *Columbia Sportswear*,[783] a foreign company set up an office in India to help coordinate purchases. The

[778] Para. 22 of the commentary to Article 5 of the OECD MTC.
[779] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5 marg. no. 114. Also see Article 7(5) of the OECD MTC as it read prior to 2010 where it was explicitly stated that no income should be attributed to a PE based on mere purchase.
[780] Skaar, A, *Permanent Establishment*, p. 313-314.
[781] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 271 and Skaar, A, *Permanent Establishment*, p. 314-315.
[782] Fabrikant and Sons Ltd. v. Assistant Director of Income Tax, ITA No. 4657 to 4660 and 3342/MUM/2007.
[783] Columbia Sportswear Company v. Director of Income Tax, W.P. No. 39548/2012 (T-IT).

office did not do any purchasing themselves. Instead, the office identified possible sellers, negotiated prices, controlled quality and compliance with established agreements and acted "as go-between" between the sellers and the company's foreign head office. The High Court concluded that all of the activities were "necessary to be performed by the petitioner – assesse before export of goods" and, consequently, that the exception corresponding to Article 5(4)d in the OECD MTC was fulfilled.

Now we proceed to discuss the exception for collecting information. As previously mentioned, the collection of information is considered by the OECD to be similar to mere purchase. One can understand this position when comparing a news agency collecting information for processing to a manufacturing company that purchases raw material for its production. In essence, both companies acquire the material needed to produce their respective products.[784]

Just as with the previously discussed exceptions, this one is limited to the sole purpose of collecting information. This means that the information cannot be analyzed or edited.[785] However, activities normally connected with collecting information can be performed and still have the exception apply. Such activities can include storage of the information, transferring the information abroad and simple systematic arrangement of information.[786] In addition to this, the conversion of information from one medium to another should be considered connected. An example of this would be information that is received in paper form being subsequently scanned or otherwise converted into a digital document.

6.3.5 The UN MTC

The list of exceptions in the UN MTC follows the OECD version with one exception. The word "delivery" is deleted from subparagraphs a) and b). The reason stated for this is that warehouses used

[784] For a different opinion see Skaar, A, *Permanent Establishment*, p. 311.
[785] Vogel, K, *Klaus Vogel on Double Taxation Conventions*, 3rd ed, Article 5 marg. no. 114; Skaar, A, *Permanent Establishment*, p. 311 and Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 275.
[786] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 272-273.

for delivery should constitute PEs provided that all other conditions are fulfilled.[787] However, the UN also notes that most tax treaties involving developing countries do in fact include "delivery" in the list of exceptions.[788] Furthermore, the UN raises the issue of attribution of income in relation to the delivery of goods. They conclude that it may be the case that "little income could properly be attributed to this activity [delivery of goods, my remark]".[789] In addition to this, the UN mentions that tax agencies may be tempted to attribute too much income in these situations, which increases the risk of litigation and inconsistent application. Because of this, the UN recommends that countries consider this before choosing to delete "delivery" or not.

The effects of not having "delivery" in subparagraphs a) and b) are rather straightforward. Under the UN MTC an enterprise that has established a warehouse from which it delivers goods will have a PE provided that all other conditions are fulfilled.

In addition to this, the "delivery agent" may constitute a PE. The "delivery agent" is included in the agency clause in Article 5(5)b. Simply put, this means that an agent who "habitually maintains" a stock of goods "from which he regularly delivers" said goods may constitute an agency PE in the same way as if he had an authority to conclude contracts.

In conclusion, it can be said that the differences between the OECD and UN MTCs are minor. As it seems that the UN MTC will be amended to include the requirement of all listed activities being preparatory or auxiliary to qualify as an exception,[790] just as the OECD MTC will be accordance with the BEPS proposal, the difference may be insignificant in the future.

[787] Para. 17 of the commentary to Article 5 of the UN MTC.
[788] Para. 20 of the commentary to Article 5 of the UN MTC.
[789] Para. 21 of the commentary to Article 5 of the UN MTC.
[790] Arnold, B, "The UN Committee of Experts and the UN Model: Recent Developments", *Bulletin for International Taxation*, no. 3/4 2017, p. 134.

6.4 Preparatory and Auxiliary Activities

6.4.1 Introduction

The final two subparagraphs, e) and f), in Article 5 of the OECD MTC state that activities not listed are still exempted provided that they are preparatory or auxiliary (e) and that any combination of activities in subparagraphs a)-e) are exempted provided that the overall character is preparatory or auxiliary. This makes it clear that the exception is not limited to the specifically listed activities. Indeed, any activity, or combination of activities, that can be considered preparatory or auxiliary is exempted from constituting a PE. Thus, subparagraphs e) and f) function as a general exception for preparatory and auxiliary activities. What characterizes a preparatory or auxiliary activity, then? This question is discussed in the following sections. As these two types are quite different they will be discussed in separate sections starting with auxiliary activities (section 6.4.2) followed by the preparatory activities (section 6.4.3).

6.4.2 Auxiliary Activities

As already mentioned, there is a general exception in the PE concept of an activity, or a combination of activities, of an auxiliary character. The question is how one determines if an activity has an auxiliary character. According to the OECD it is "often difficult" to determine whether an activity is auxiliary or not.[791] The reason this is a difficult assessment is that enterprises are different, which means that a detailed study of the specific enterprise's business operations must be conducted in order to determine whether an activity is auxiliary or not. The OECD stipulates that the "decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole."[792]

If an activity is not auxiliary it is a core business activity. Two fairly clear types of core business activities are mentioned in the commentary.[793] The *first* one is an activity that coincides with the general purpose of the enterprise. This is rather straight-forward and basically

[791] Para. 24 of the commentary to Article 5 of the OECD MTC.
[792] Para. 24 of the commentary to Article 5 of the OECD MTC.
[793] Para. 24 of the commentary to Article 5 of the OECD MTC.

means that the starting point when assessing activities under subparagraphs e) and f) is the enterprise's own business. It is not possible to determine what is essential and significant without an object of reference.

Nevertheless, the *second* type of activity is an activity that is generally a core business activity for all enterprises regardless of their specific business. This activity is to manage one's own business. This also includes managing the business of related persons. According to the OECD, managing the whole, or just a part, of the enterprise's business is an essential activity and can never be considered an auxiliary activity.

A third type of activity can be mentioned as well. This is not a core business activity but rather the opposite. This category consists of activities similar to the ones listed in subparagraphs a)-d). The specifically listed activities are useful as they are generally considered to be auxiliary activities. Thus, these activities can be used as a reference when determining if an activity is of an auxiliary character.[794]

So we have some guidance from the OECD on what an essential and significant activity is. The phrase "essential and significant" implies that this assessment has two sides, i.e. a qualitative and a quantitative side.[795] Reimer describes auxiliary activities as activities with no "more than a marginal relevance within the enterprise's overall business plan."[796] He continues by clarifying that it is not the place of business's share of the profit that should determine this.[797] Instead, he argues, it is the type and intensity of the activity compared to the enterprise's business as a whole that should determine whether an activi-

[794] See for instance the *Knights of Columbus* case, where the combination of storage, collection of information, supply of information and *similar* activities were considered to have an auxiliary character, Knights of Columbus v. Her Majesty the Queen, 2008 CarswellNat 1507, 2008 TCC 307.
[795] Skaar, A, *Permanent Establishment*, p. 283-284.
[796] Reimer, E, *Permanent Establishments*, 5th ed, ed. Reimer, E, Schmid, S and Orell, M, Part 2 marg.no. 281.
[797] Also see van Raad, K, "The 1977 OECD Model Convention and Commentary – Selected suggestions for amendment of the Articles 7 and 5", *Intertax*, no. 11 1991, p. 502.

ty is considered auxiliary or not.[798] This is a good starting point when assessing an activity under Article 5(4).

Skaar argues that there is no underlying principle and that this assessment is a compromise between different legal traditions.[799] I agree with this notion even if I think it is somewhat harshly put. Yes, based on the commentary there is no specific test to apply when assessing whether an activity is auxiliary. This means that what is considered an auxiliary activity must be decided on a case-by-case basis. It is also likely that there will be some variation between countries as national courts may develop different case law. Thus, to further clarify what is an auxiliary activity it is useful to study case law as a specific situation is needed to discuss this condition.

In this context a Swedish case can be mentioned. The case concerned the company *Dunlop Tech*.[800] Dunlop Tech was a German company and its main business was to develop software to measure tire pressure in cars. The company conducted winter testing in Sweden to gather raw data, which then was to be analyzed in Germany. The Swedish tax agency, however, considered that Dunlop Tech was not only gathering raw data. Specifically, they argued that the winter testing was quality control of the software as the customers' cars were used for the testing.

The Administrative Court of Appeals agreed and considered that the winter testing was essential in the process of developing the software and, consequently, an important part of the company's ability to produce income. In closing, the court stressed the fact that the testing was conducted on the customers' cars, which enabled quality control

[798] One can note that Reimer argues for a test in two parts. The first part is a relative test depending on the specific enterprise's business. This is what is described in the text. The second part is an absolute test, which means that above a certain threshold, an activity that is auxiliary from the enterprise's perspective should still constitute a PE because of its size. As an example he mentions a place of business with valuable assets and a considerable number of employees and which has its own administration. He further specifies this absolute condition as met if the place of business is economically viable on its own. One can certainly agree with Reimer that from a policy perspective such a fixed place of business should constitute a PE. However, I do not find any further support of this view within the current PE concept.

[799] Skaar, A, *Permanent Establishment*, p. 324-325.

[800] Kammarrätten i Göteborg, no. 2276-15, October 24 2016.

and car-specific adaptations. Based on all of the above, the court concluded that Dunlop Tech's activities in Sweden were the core business and not merely auxiliary. The important aspect of this case seems to be that the testing was essential in producing Dunlop Tech's products paired with the close connection with its customers as the testing was conducted on their cars.

In another Swedish case the Administrative Court of Appeals found that a company that was in the business of hiring out staff to other companies was conducting its core business in Sweden.[801] The activities performed in Sweden were marketing, the handling of complaints, various other contacts with clients and the supply of staff to clients. The court argued that even though part of the business in Sweden could be considered auxiliary, the overall character was that of the company's core business.

Finally, one can mention some additional examples of situations where there was an assessment of whether activities were auxiliary or not. It should be kept in mind, though, that this must be regarded as guidance only as an assessment of the specific situation is usually needed. Nevertheless, it may be useful to get some more examples of activities that have been considered auxiliary or not.

The Swedish Supreme Administrative Court held that an office tasked with seeking out potential clients in Sweden was not exclusively conducting auxiliary activities.[802] In a similar case, the Administrative Court of Appeals held that an individual who provided information, gathered information from interested potential clients and maintained contact with the company's present clients in Sweden was not of an auxiliary character.[803]

In another case, the Swedish Administrative Court of Appeals held that an individual who signed a contract concerning a share deposit, requested information from the Netherlands regarding a company and conducted a transfer of shares from one commission agent to another was conducting auxiliary activities that did not constitute a PE.[804]

[801] Kammarrätten i Stockholm, no. 5574-11, May 21 2012.
[802] RÅ 1998 not. 188.
[803] Kammarrätten i Stockholm, no. 6856-14, December 14 2015.
[804] Kammarrätten i Göteborg, no. 4811-07, January 23 2009.

In yet another case, it was held that an office that received orders from customers and received, stored and subsequently delivered goods did not have an auxiliary character.[805]

Having presented various examples from case law, an important question remains. Can any general conclusion be drawn based on the previous discussion and presented case law? The immediate answer is no, no general conclusion can be drawn from the above. Despite this, a few things can still be said. Comparing these cases, in relevant parts, with cases dealing with other aspects of the PE concept, one thing is clear. The general assessment of auxiliary activities is centered on the instant situation and with one exception the cases lack a substantial general reasoning regarding auxiliary activities. This exception is the comparison between the enterprise's general business and the establishment that is usually mentioned.

One could cautiously argue that the more closely an activity is linked to the sale of goods or services, the more likely it is to be a core business activity.[806] Other than this, it is difficult to discern any points of general interest to assess from these cases.

6.4.3 Preparatory Activities

The specifically activities listed in Article 5(4) are mostly auxiliary activities. Furthermore, the discussion in the commentary mainly deals with activities and situations that seem to be auxiliary. This is likely because the practical importance of the exception for auxiliary activities is more important than the one for preparatory activities. The reason for this is that the exception for preparatory activities often requires that the activities following the preparation do not amount to a PE.[807] As preparatory activities are usually followed by core business activities that lead to a PE, the scope of this exception is narrow.[808] We will return to this question later, after a discussion of the general character of a preparatory activity.

As a starting point, the OECD does not distinguish between preparatory and auxiliary activities. This means that the general approach

[805] Kammarrätten i Göteborg, no. 3464-3465-09, December 15 2011.
[806] See Nørgaard Laursen, A, *Fast driftsted*, p. 139 for a similar discussion.
[807] Para. 11 of the commentary to Article 5 of the OECD MTC and Skaar, A, *Permanent Establishment*, p. 281.
[808] Skaar, A, *Permanent Establishment*, p. 281.

to determine whether an activity is preparatory is the same as when determining whether an activity is auxiliary. As this has already been discussed above, there is no need to repeat it here. Instead, a short summary is made.

The starting point to determine whether an activity is preparatory is to compare it with the general purpose of the whole enterprise.[809] If the activity coincides with the general purpose it cannot be a preparatory activity. This means that what is a preparatory activity for one enterprise may not be considered preparatory for another enterprise with a different business purpose. Therefore, a point of reference needs to be established, which is the enterprise in question, and that each "individual case will have to be examined on its own merits."[810] An example of this is an enterprise that collects and processes information from a fixed place of business for a possible establishment of its general business, which is to sell goods, versus an enterprise whose general purpose is to perform the same activities. The first situation may be considered a preparatory activity while the latter may not.

After the point of reference is established and it is concluded that it does not coincide with the general business purpose, the difficult part of the operation to determine whether an activity is preparatory or not starts. According to the OECD, the "decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the enterprise as a whole."[811] In essence, this statement expresses both a qualitative and a quantitative assessment. In the previous section it was argued that this should be understood as assessing the type and intensity of the activity compared to the enterprise's business as a whole.

Now it is time to turn back to the narrow scope of the exception for preparatory activities and what it tells us when we try to apply this exception. The scope of the exception is narrow because subparagraph e) requires that the sole activity is preparatory, and subparagraph f) requires that the combination of activities is of a preparatory character. Furthermore, a PE exists when preparations to start a core business activity take place at a place of business if that activity is to take place at the same place of business. The preparations to set up

[809] Para. 24 of the commentary to Article 5 of the OECD MTC.
[810] Para. 24 of the commentary to Article 5 of the OECD MTC.
[811] Para. 24 of the commentary to Article 5 of the OECD MTC.

the place of business, however, should not be included in the future PE provided that the preparatory "activity differs substantially from the activity for which the place of business is to serve permanently."[812] As it is in the nature of a preparatory activity to be followed by something else, presumably core business activities, the implication of this is that, for the exception to apply, the activity usually cannot take place at the same place of business as the future PE. Additionally, it can be concluded that the activity to set up the actual place of business is in general a preparatory activity.

6.5 The New Version Proposed in the BEPS Project

6.5.1 Introduction

In the BEPS project, there are two problems identified with Article 5(4). The problems mainly refer to changes in actual business patterns that have caused the rationale behind the exceptions to no longer be true. The first problem is that some of the activities listed in Article 5(4) have changed from usually being preparatory or auxiliary to being core business activities. The reason stated for this change is that the way business is conducted has changed drastically.[813] To a large extent this is due to the "digital economy" and the new business practices in its wake. While this problem existed before the emergence of the digital economy, the scale of it has increased with the development of new technology.[814]

An example of such a new business operation is the sale of goods online. In order to provide fast delivery, a local warehouse is used to store the goods. This warehouse would not be a PE under the current rules as "storage" is specifically exempted in Article 5(4)a. However, as such business operations have become "increasingly significant

[812] Para. 11 of the commentary to Article 5 of the OECD MTC.
[813] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 10.
[814] OECD, *BEPS Action 1 Final Report: Addressing the Tax Challenges of the Digital Economy*, p. 79.

components of business in the digital economy", they can no longer be considered auxiliary.[815]

In order to secure taxation from core business activities in the country where they are performed, the OECD proposes changes to the present version of Article 5(4) to require the listed activities to be preparatory or auxiliary in order to be exempted.

The second problem is specifically connected to the related person PE situation. The problem is described as "fragmentation of activities" among related persons.[816] This fragmentation basically means that instead of conducting all activities at one place of business, a company may split functions and activities among several places of business and legal entities. In some situations the result can be that one or more of the places of business are considered to conduct only preparatory or auxiliary activities and, thus, no PE is recognized in those places of business. By contrast, had all activities been conducted at one place of business all the activities would have been included in the PE with corresponding profit attribution.

It can be noted that the problem with fragmentation may not be as prominent in the UN MTC. The UN MTC includes a provision on limited force of attraction in Article 7(1). This provision states that the state of establishment may tax profits derived from activities performed on its territory that are similar to activities performed in a PE. The need for a PE, however, still makes it possible to avoid taxation if the activities can be fragmented in such a way that no PE exists.

Although the OECD has identified the previously discussed problems that give rise to BEPS concerns, it is recognized that some countries do not share the view that the first problem is a serious issue.[817] Thus, the OECD leaves it to countries to decide whether to adopt either or both suggestions.[818] As mentioned previously, the 2017 draft update of the OECD MTC includes the BEPS proposals in the actual

[815] OECD, *BEPS Action 1 Final Report: Addressing the Tax Challenges of the Digital Economy*, p. 88.
[816] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 10 and 28.
[817] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 28 and 38.
[818] The option to adopt neither suggestion is of course also possible.

treaty text while the present version is mentioned in the commentary as an alternative option.[819]

The following sections deal in detail with the new provisions proposed in the BEPS project. The first proposal, concerning the list of activities, is discussed in section 6.5.2. The second proposal, i.e. the anti-fragmentation rule, is discussed in section 6.5.3. Finally, general conclusions regarding the changes proposed in the BEPS project are presented in section 6.5.4.

6.5.2 The "New" List of Examples

The first proposed change is related to the first problem discussed in the previous section, i.e. the emergence of new business practices. As mentioned above, the reasoning behind the proposed change to the list of exceptions in Article 5(4) is that business operations have evolved, and activities once considered suitable to exempt are nowadays sometimes considered core business activities that should constitute PEs.

The actual changes in Article 5(4) are rather small, although with considerable consequences. The proposal removes any mention of preparatory and auxiliary activities in subparagraphs 5(4)e and 5(4)f. As it is those passages that imply that the listed activities are real exceptions and not only examples, that means that the provision transforms from a list of exceptions into a list of examples.[820] Furthermore, an addition is made at the end of the list where it is clarified that the listed activities, either one or several combined, are only exempt if they can be considered preparatory or auxiliary. Basically, this means that one must always assess whether an activity, or a combination of activities, is preparatory or auxiliary, even if said activity is mentioned in the list. This leads to the conclusion that the list in Article 5(4) becomes more of a list of examples than true exceptions.

To understand this change one must ask what a list of examples implies for the application of the provision. Even if the mentioned activities are only examples, they will still provide guidance. These activities were once considered suitable to exempt because they were usual-

[819] Para. 78 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[820] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 28-29.

ly auxiliary with minor profit to attribute to the potential PE. As mentioned above, the main reasoning behind the change is that business practices have changed, in certain instances, which has transformed these activities from minor to major business activities.

However, not all business operations have changed drastically, and it stands to reason that for more traditional types of businesses the examples would still be considered preparatory or auxiliary. In the proposed new commentary the listed activities are referred to as "merely common examples of activities that are covered by the paragraph because they often have a preparatory or auxiliary character."[821] Thus, the OECD still generally considers the listed activities to be of an auxiliary or preparatory character. How this will be interpreted in practice remains to be seen, but it is not unlikely that some states will interpret these exceptions in a narrow sense.

To get a sense of the practical implications of this change, a study of the new examples that the OECD provides in relation to the listed activities is necessary. For activities not listed, no real change seems to be intended. Nevertheless, the new examples in the proposed commentary will of course influence the assessment of other activities as well, at least to some extent.

Starting with Article 5(4)a, which deals with facilities used solely for storage, display or delivery of the enterprise's own goods, there are two new examples and one old example that have been modified. All examples will first be described, followed by a general analysis.

The first example concerns a foreign company that sells goods online to customers in state S.[822] In state S, the company has a "very large warehouse" with a "significant number of employees". The purpose of the warehouse is to store and deliver the company's goods to customers in state S. The conclusion is that the exception in Article 4 does not apply to the warehouse. The reason is that the warehouse "represents an important asset and requires a number of employees, [and] constitute[s] an essential part of the enterprise's sale/distribution

[821] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 34 and para. 70 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[822] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 31 and para. 62 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

business". The example reflects both quantitative and qualitative aspects. The quantitative aspects are the size of the warehouse and its workforce while the qualitative assessment is the role of said warehouse in the enterprise's business.

The second example is a bonded warehouse used to store fruit in a climate-controlled environment during customs clearance.[823] Not surprisingly, this is covered by the exception in Article 5(4), as this is clearly not an essential part of the enterprise's business.

The third, and final, example concerns a company that maintains a place of business from which it delivers spare parts to customers who have already purchased the machinery now in need of the spare parts.[824] This activity is covered by Article 5(4), according to the OECD and, consequently, no PE exists. By contrast, the example continues, if the place of business also performs repairs or maintenance of the previously sold machinery, it would not be exempted under Article 5(4). The reason for this is that such "after-sale activities" are an "essential and significant" part of the services performed by an enterprise for its customers.

Looking at these three examples a few things can be said. To begin with, one can conclude that the examples deal with situations that seem rather unproblematic to interpret in the first place. As such, the examples do not really provide any particular guidance. The first example deals with the situation that prompted the changes to begin with, e.g. the sale of goods online. The example is made even more unproblematic by the use of phrases like "very large warehouse" and "significant number of employees". It would have been more interesting if a warehouse of a more "traditional business" such as a manufacturer or physical retail had been made an example.

The same can be said about the second example but on the other end of the spectrum, i.e. it seems rather obvious that the situation is covered by the exception in Article 5(4). If a bonded warehouse, used only to clear customs, was not considered an auxiliary activity, what

[823] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 31 and para. 63 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[824] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 31 and para. 63 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

would be? It is strange that two such "extreme" examples are provided. As mentioned above, the examples provide little guidance on how to handle difficult situations, even though one would assume that the purpose of the commentary is to provide such guidance to begin with. Why would one need explanations and clarifications focusing on the simple cases?

The final example provides some additional guidance, as a warehouse used for delivery of spare parts to goods previously sold is considered an auxiliary activity. Analyzing this example while keeping the first example in mind tells us that the delivery of spare parts relating to goods previously sold is typically not an essential part of the enterprise's sales business, i.e. the qualitative test is not fulfilled. The gap between the first and third examples, however, is wide, and one has to rely on the general discussion about preparatory and auxiliary activities, i.e. the quantitative and qualitative assessment.[825]

Subparagraphs b) and c) in Article 5(4) are not provided with any additional guidance on the question of preparatory or auxiliary activities in the proposed new commentary.[826] Subparagraph d), however, did receive three examples on how to assess when a place of business for purchase or collecting information is covered by the exception in Article 5(4). Before the examples, a more general statement on the activity of purchasing goods for the enterprise is provided in the proposed new commentary. This statement is merely a version of the already existing statement that the activities coinciding with the general purpose of the enterprise cannot be preparatory or auxiliary.[827]

Moving on to the examples, the first two examples concern places of business used for purchases. The first example is a foreign enter-

[825] See section 6.4.2.

[826] Instead, a discussion of when a place of business is at the disposal of an enterprise and the fact that Article 5(4) only deals with the enterprise's own activities is pointed out. OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 32-33 and para. 65 and 66 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

[827] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 33 and para. 68 of the commentary to Article 5 of the 2017 draft of the OECD MTC. Also see para. 24 of the commentary to Article 5 of the OECD MTC.

prise in the business of buying and selling an agricultural product.[828] To do this efficiently, the enterprise has an office in the state of establishment. The purchase office has employees performing the actual purchases. These employees have experience and special knowledge of the specific product. They visit the producers, assess quality and enter into contracts depending on the situation. It is specifically stressed that the quality assessment is a "difficult process requiring special skill and knowledge". The conclusion of the example is that the enterprise has a PE through its purchasing office. The reasoning is short and it is merely stated that the "purchasing function forms an essential and significant part of RCO's [the enterprise, my remark] overall activity."

One can compare this example with the *Fabrikant* case previously discussed to illustrate the difference between the present and proposed exception.[829] In that case an office that purchased diamonds and also performed quality control, negotiated prices, assorted and packed diamonds, and handled shipping and export did not constitute a PE as the establishment's activities were considered mere purchases and consequently exempted.

Just as with the examples discussed above, this example's conclusion is based on a qualitative and quantitative assessment. The example is centered on the qualitative aspects, however, which makes it somewhat difficult to interpret. It seems to me that the activity in the example constitutes a core business activity, for a company whose business it is to buy from producers and then resell, without any refinement of the product, to distributors, because the purpose of the fixed place of business coincides with the purpose of the enterprise as a whole. Reading the example, one might get the, in my mind wrong, idea that the determining factor is the level of difficulty related to the act of purchasing, e.g. standardized contracts with no quality assessment would not lead to a PE. Observing only the example, this is a logical conclusion as the example is focused on the skill required by the employees. It is logical to assume that when an example is used to

[828] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 33 and para. 68 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

[829] Fabrikant and Sons Ltd. v. Assistant Director of Income Tax, ITA No. 4657 to 4660 and 3342/MUM/2007. Also see section 6.3.4.

clarify something, that example is constructed to highlight what is essential in that specific PE assessment. As is often the case with the examples used by the OECD in relation to the PE concept, this one is somewhat unclear and may potentially cause more harm than good.

In my opinion, a better version of the example would have been to either remove the references to the difficulty and skill required or use an enterprise that has manufacturing as its principal purpose. In the second suggestion, I can see that the difficulty level and skill of the employees may be relevant for the PE assessment. This is because the purchasing office, in this situation, does not share the purpose of the enterprise in general, which leads to the qualitative assessment having relevance.

Finally, one can ask what this example provides that the previously discussed example with the warehouse of the e-tailer does not. Is the purchasing not as essential a part of the enterprise's business as the warehouse is for the e-tailer? I would argue that the "warehouse example" does a better job clarifying the exceptions, which is yet another argument against the first "purchasing example".

The second example regarding purchasing activities concerns a foreign enterprise that maintains an office to research the local market and lobby for changes in regulations to allow them to establish in that country.[830] While doing market research and lobbying, the employees "occasionally purchase supplies for their office". The conclusion of the example is that the place of business does not amount to a PE. All of the activities performed, i.e. purchasing, researching and lobbying, are exempted when assessed on their own. Furthermore, the overall activity is considered to be of a preparatory character.

There is not much to say about this example as it is rather clear that the purchase of office supplies in this case is an auxiliary activity. When assessing the two examples dealing with the "purchasing office", one notices that the structure is similar to the warehouse examples. That is, both sets of examples are structured with two examples situated far out on opposite sides of the scale. Just as with the warehouse examples, it would have been better to provide an example covering a situation that is more difficult to assess.

[830] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 33-34 and para. 68 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

The last example in the proposed commentary relating to subparagraph d) deals with fixed places of business that are collecting information.[831] The example is actually a description of three situations without any further discussion.

The first situation is an investment fund that sets up an office to collect information about possible investments. The second situation is an insurance company with an office that collects statistics on risk. The final situation is a newspaper with an office that collects "information on possible news stories". It is also clarified that the office is not performing any advertising activities. The conclusion for all three situations is that the specified collection of information constitutes a preparatory activity.

As the information is limited, it is difficult to reach any other conclusion than the one provided in the proposed commentary. It is important to remember that the activity of collecting information must always be assessed with the enterprise's business in mind. For example, an enterprise that is in the business of collecting information on behalf of its clients cannot be said to be performing a preparatory or auxiliary activity when collecting said information.[832]

Based on all of the above, it can be concluded that the proposed changes to Article 5(4) mainly concern business operations where the previously exempted activities in fact constituted core business activities. As such, business operations where this is not the case should, in principle, still be able to use these exceptions. Nevertheless, as discussed, this may not always be the case. In particular, the example of the agricultural purchasing office does not adhere to this notion. As the assessment of whether activities are auxiliary is intensely factual, it is difficult to completely analyze how this proposed change will affect the PE concept. However, given the examples, and my critique of them, it does not seem unlikely that it will take some time before a common understanding is established. Of course, this will create problems for both tax agencies and taxpayers in the meantime.

[831] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 34 and para. 69 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

[832] This situation is quite similar to the first warehouse example above, e.g. activities that are commonly auxiliary or preparatory are considered core business activities in certain business models.

6.5.3 The "Anti-Fragmentation Rule"

The proposed "anti-fragmentation rule" is of considerable interest for this study as it is specifically designed with related persons in mind. The main theme of this new rule is already discussed in the commentary, but that discussion is limited to fragmentation within the same enterprise.[833] This means that one out of two main additions in this new rule is to extend this reasoning to the related person situation. The other main addition is of course the inclusion of the fragmentation reasoning in the actual article and not only in the commentary. Naturally, this adds importance to the aspect of fragmentation and it can be assumed that this issue will be dealt with more often. In the proposed commentary the purpose of the new rule is stated to be to prevent an enterprise or a group from splitting a cohesive business operation into several parts in order to have one, or all, of the establishments merely conducting preparatory or auxiliary activities and, thus, avoid having one or more PEs.[834]

This new rule is suggested to be included in a new paragraph under Article 5(4), namely Article 5(4.1).[835] The proposed Article 5(4.1) reads as follows:

> *Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting state and*
>
> *a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or*
>
> *b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprise at the two places, is not of a preparatory or auxiliary character,*

[833] Para. 27.1 of the commentary to Article 5 of the OECD MTC.
[834] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 40 and para. 79 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[835] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 39.

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

It is interesting to note that the anti-fragmentation rule only applies to the fixed place of business PE, i.e. Article 5(1). This is manifested by the wording "Paragraph 4 shall not apply to a fixed place of business". Thus, this anti-fragmentation rule does not apply to the agency clause.

The new rule has three conditions, all of which need to be fulfilled. In situations with related persons a fourth condition, "closely related enterprise", applies.[836]

The first condition is that the enterprise, or closely related enterprises, has two or more fixed places of business, or share the same place of business, in the state of establishment. The second condition consists of two alternative requirements. The first requirement is that at least one place of business constitutes a PE according to Article 5. The second alternative is that the combination of activities performed at the various places of business "is not of a preparatory or auxiliary character".

The third condition is a requirement that the combination of activities performed at the assessed places of business constitutes "complementary functions that are part of a cohesive business operation".

The anti-fragmentation rule is further explained in a proposed new section of the commentary.[837] Just as with the proposed changes to the list of exceptions discussed above, the explanation is provided through examples. The first example, labeled "Example A",[838] concerns a bank, resident in state R, with several branches constituting PEs in state S. Among other things, these branches provide loans to clients in state S. In addition to these branches, the bank also has a separate office in state S. At this office, the information in the loan applications made at the different branches in state S are verified be-

[836] See section 5.5 for a discussion about the meaning of "closely related enterprise".
[837] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 40-41 and para. 79-81 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[838] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 40-41 and para. 81 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

fore the applications are analyzed by employees in state R. Finally, a decision, based on the analysis made in state R, is made in the branch to approve the loan or not.

The conclusion provided for this example is that the anti-fragmentation rule is applicable, which means that the exception in Article 5(4) does not apply for the office in state S. The rationale provided is basically just a repetition of the conditions, namely, that the branches constitute PEs and the functions performed at the office are complementary to the cohesive business operation of granting loans. No further discussion about the assessment is made in Example A.

The second example, labeled "Example B",[839] deals with company R, resident in state R, and its wholly owned subsidiary S, resident in state S. R manufactures and sells appliances. S buys goods from R and then sells them in its own store located in S. Company R has a small warehouse adjacent to S's store. Some of the larger items for sale are displayed in the store but stored in the warehouse. When such an item is sold to a customer, the employees of S go to the warehouse and retrieve the item. The ownership of the item is transferred to S when it leaves the warehouse.

The conclusion provided by the OECD is that Article 5(4.1) is applicable and, consequently, the exceptions are not. The reason for this is that R and S are "closely related enterprises". Furthermore, the store constitutes a PE for S and it is clarified that the PE definition does not require a cross-border situation. This is a useful remark as it might be easy to assume that a cross-border element is necessary given the objective of tax treaties and the PE concept. By analyzing the wording of the fixed place of business PE, however, it is clear that it can be applied to an establishment in the enterprise's state of residence. Finally, it is concluded that the warehouse and the store are complementary functions and part of a cohesive business operation.

Having described the examples, it is now time to turn back to the specific conditions of the anti-fragmentation rule for a more detailed analysis. We start with the first condition, i.e. the sharing of a place of business or the existence of two or more places of business. At a first glance, this condition seems straight-forward and easy to apply. There

[839] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 41 and para. 81 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

are, however, a few things to discuss and there may still be some ambiguity.

To begin with, the anti-fragmentation rule does not explicitly refer to the places as "places of business" but rather just "places" where business activities are carried on. A "place" where business activities are carried on is very likely a place of business. In the discussion preceding the actual rule, the term "place of business is used" instead of "place".[840] Furthermore, it is stated that this new rule is an extension of the reasoning already provided in the commentary, regarding a single enterprise, to the related person PE situation.[841] In the commentary, the term "place of business" is used.[842] Based on this, the conclusion is that the word "place" should be understood as "place of business" in this rule.

Having concluded this, a new question emerges. Does a place of business need to be "fixed" in order to be included in the assessment under the anti-fragmentation rule? Clearly, only fixed places of business are directly affected by the anti-fragmentation rule. This is logical as a place of business that is not fixed cannot constitute a PE anyway and does not need to apply the exception in Article 5(4). Instead, the question is aimed at the other places of business included in the assessment of the fixed place of business. An example can illustrate this question. A foreign enterprise has a fixed place of business and another closely related enterprise has three additional temporary offices (lasting about two months each) relating to different projects in the same country. In this example, will the three temporary offices be considered in the assessment under Article 5(4.1)b or not? The fixed place of business could, for instance, be a warehouse for spare parts and equipment used by the employees in the temporary offices performing repair services on behalf of customers. This example is similar to "Example B" discussed above, with the difference that the store in "Example B" is a fixed place of business and the temporary offices are not. This question is likely relevant in situations where a foreign

[840] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 39.
[841] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 39.
[842] Para. 27.1 of the commentary to Article 5 of the OECD MTC.

company performs services while at the same time maintaining a fixed place of business for storage or information purposes.

To begin deciphering the meaning it is prudent to start with the wording of the anti-fragmentation rule. It is only the primary location that is referred to as a "fixed place of business". The secondary locations are just labeled "place". With the widest possible interpretation, "place" is just understood as a physical space with no additional requirement. Business activities can only be performed by physical objects such as humans, computers or machinery. All physical objects occupy space, which means that "place" becomes a redundant condition as what matters is the performance of business activities within the state of establishment. Given this redundancy and my previous conclusion that "place" should be understood as "place of business", this wide interpretation cannot be accepted. The term "place of business" has been discussed previously and it was concluded that it should be understood in a wide sense with a focus on whether the place is actually used to conduct business.[843] It is clear that the mere incidental performance of business activities in a certain "place" does not mean that it is a place of business. For instance, the sidewalk does not constitute a place of business just because the CEO makes business decisions over the phone while waiting for a cab.

It is clear that something more is required, but does that mean that a place of business is enough or that the place of business should be fixed? It is difficult to see that anything in between those two options is intended. This is because such a solution would be difficult to interpret and apply in practice. It would also be contrary to the general structure of the fixed place of business rule.

Turning back to the wording of the anti-fragmentation rule, it can be concluded that the wording supports the view that only a "place of business" is required. However, there are arguments to require something more, i.e. "fixed". It can be noted that there are several examples where the meaning of the PE concept cannot be fully grasped by reading Article 5.[844] As such, the inclusion of a "fixed" requirement

[843] See section 4.3.3.

[844] One can mention the condition of having the place of business at one's disposal and the conditions to assess dependence under the agency clause as examples of this.

would be possible even though the preferred solution of course would be to include it in the anti-fragmentation rule.

The first, and most convincing, argument is that a requirement of being fixed better corresponds with the purpose of preventing fragmentation. The type of fragmentation intended to be prevented is explicitly stated to be fragmentation in order to avoid a PE through the exceptions in Article 5(4).[845] Including short-term and temporary places of business does not seem to target any specific fragmentation in order to use the exceptions in Article 5(4). Instead, it could include service providers, shorter secondments and sales agents. These situations do not seem to be abusing the exceptions. If these situations are problematic, it would be better to target them with the changes to the exceptions in 5(4) that require an activity to be preparatory or auxiliary in the specific situation. In my example above, for example, one could argue that the warehouse with spare parts and equipment is a central part of the business operation to provide fast repairs.

Furthermore, it seems that the discussion is conducted with fixed places of business in mind. There are several indications of this. The first one is that both examples in the proposed commentary only deal with fixed places of business.[846] It also seems that the discussion in the present commentary is conducted with fixed places of business in mind as the example given is storing and distributing goods from two different places that I understand as fixed places of business.[847] This example is explained by stating that "[a]n enterprise cannot fragment a cohesive operating business", which leads to the conclusion that the "real" structure would have been to store and distribute goods at the same fixed place of business. As the anti-fragmentation rule is built upon the discussion in the commentary, it seems likely that this, i.e. a requirement of "fixed", is still intended under the new rule. Addition-

[845] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 40 and para. 79 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[846] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 40-41 and para. 81 of the commentary to Article 5 of the 2017 draft of the OECD MTC.
[847] Para. 27.1 of the commentary to Article 5 of the OECD MTC.

ally, it seems that some authors have assumed that a "fixed place of business" is implied.[848]

Furthermore, there are good reasons to require a fixed place of business for the additional activities from a policy perspective. Perhaps it is more accurate to say that there are good reasons to not include temporary and moving activities in the anti-fragmentation rule. It can hardly be argued that a business operation is fragmented to avoid having a PE if parts of the activities are only performed temporarily for a brief period of time. This is because the idea of the anti-fragmentation rule, as discussed above, must be to prevent fragmentation of ongoing businesses that constitute PEs.

In addition to this, it can be argued that the inclusion of activities not performed from a fixed place of business can lead to strange results. For instance, imagine a fixed place of business that, seen on its own, only performs auxiliary activities. For instance, it can be an office of a newspaper tasked to collect information. The information is sent to the newspaper's headquarters, and every now and then the newspaper sends a journalist to the state of establishment to write an article based on the information collected. The journalists stay at different hotels and perform their work in the field and in the hotel room for a few days up to a few weeks depending on the story covered.

The office is a fixed place of business. Had the employees at the office written the articles, i.e. not only collected but also processed information, it would most likely have meant that the activities performed at the office were core business activities. Finally, the collecting and processing of information are "complementary functions that

[848] Pleijsier is explicitly referring to "[g]rouping all of the fixed places of business together", Pleijsier, A, "The Artificial Avoidance of Permanent Establishment Status: A Reaction to the BEPS Action 7 Final Report", *International Transfer Pricing Journal*, no. 6 2016, p. 445. Bal describes the purpose of the anti-fragmentation rule as "to prevent the use of exemptions in paragraph 4 to artificially avoid PE status by fragmenting a cohesive operating business into several small operations in order to argue that each part is merely engaged in preparatory or auxiliary activities." Bal, A, "The Spanish *Dell* Case – Do We Need Anti-BEPS Measures If the Existing Rules Are Broad Enough?", *European Taxation*, no. 12 2016, p. 576. There would be no need to "argue that each part" is under the exception if each part were not a fixed place of business in its own right.

are part of a cohesive business operation". Thus, this situation would be covered by the anti-fragmentation rule and the office would be a PE as the exceptions are not applicable. Clearly, this example has nothing to do with artificial fragmentation to abuse the exceptions in Article 5(4). Indeed, this organization is likely based on genuine business reasons, e.g. there is no need for permanently stationed journalists in the state of establishment. As this is not artificial fragmentation in order to avoid having a PE, this should not be covered by the anti-fragmentation rule.

In general, it is much more likely that the fragmentation into several fixed places of business is done in order to avoid having a PE. Consequently, requiring that a place of business is "fixed" would be more in line with the stated objective of the anti-fragmentation rule. Furthermore, this fits better with the general structure of the PE concept, which is to only tax business operations of a certain duration and magnitude. One could of course imagine a less strict qualification than being "fixed" to avoid this. However, such a less strict qualification would add a new and possibly difficult assessment to the already complicated PE concept. By contrast, the "fixed" assessment is already known and no new difficulties are added.

Some might ask, what about the risk that enterprises circumvent the anti-fragmentation rule by avoiding having a fixed place of business? Well, this is already possible today as it is in theory perfectly doable to move around and never stay in one place long enough to be considered fixed. In practice, however, it is in general not possible to conduct any serious business that way, and the risk of this is rather small.

Based on the discussion above, the conclusion is that it is both intended and preferred to require the places of business to be fixed and not include temporary activities in the assessment under the proposed anti-fragmentation rule. With that said, the more likely interpretation when reading the actual rule, and not the background material, is that no requirement of being "fixed" exists. Thus, it is recommended that the wording of the rule is changed to clearly reflect that it is only activities performed at fixed places of business that are included in the assessment. This could be achieved by changing the first part of the rule to "at the same fixed place of business or at another fixed place of business in the same Contracting State".

Let us move on to the second condition, which in effect includes two alternative conditions. The *first alternative condition* is that at least one of the involved places of business should constitute a PE. This makes this condition quite easy in the sense that it is only referring back to the regular PE assessment. As this is basically discussed throughout this study, there is no reason, nor is it possible, to discuss this any more here.

However, there is one matter that can be discussed in this context and that is that at least one of the places of business should constitute a PE according to "this Article", i.e. Article 5 in that specific treaty. This means that the scope of this condition to a degree depends on the specific tax treaty. The reference to a specific physical location, however, makes the room for different meanings depending on the treaty quite narrow. This is because there are very few differences when it comes to the fixed place of business rule. Furthermore, a PE according to the agency clause and the service PE are not based on a specific physical location. This means that these types of PEs are not included in this condition, i.e. an agency PE is not considered a place constituting a PE according to the anti-fragmentation rule. What could have an impact on the scope is the construction PE. Specifically the twelve-month threshold in the OECD MTC can have an impact as that threshold is often lower in actual treaties. Finally, differences in the exception in Article 5(4) can affect the scope of this condition. This can potentially make this condition somewhat confusing in practice.

For instance, enterprise A has an establishment in Z, which seen on its own performs auxiliary activities and consequently does not constitute a PE. The related person B, resident in a different state than A, has recently established in Z, and performs exempted activities connected with A's. The relevant tax treaty for B is based on the current OECD MTC while the treaty relevant to A is based on the new version proposed in the BEPS project. What makes this confusing is that B does not have a PE according to the applicable tax treaty. However, B has a PE according to the treaty applicable to A, which means that A cannot use the exceptions in Article 5(4) and consequently has a PE in Z. In situations with many related persons resident in different countries and active in the state of establishment, it can become quite complicated to oversee the situation if the relevant tax treaties contain differences in the PE provisions.

Furthermore, if the changes to the list of exceptions proposed in the BEPS project are not adopted, a fully fragmented business operation might not fulfill this condition as none of the places of business are PEs because of the exceptions. However, as we will see, the second alternative condition solves this problem.

The *second alternative condition* is that if the combination of activities carried on at the various places of business is not of a preparatory or auxiliary character, this condition is fulfilled. This basically means that this is the same assessment as the current Article 5(4)f, albeit with the difference that activities are pooled together from different places of business. In principle, however, it is still the same assessment. At a first glance, one might think that this means that the second alternative condition does not pose any new difficulties of interpretation as it is just an addition of a general assessment of whether a combination of activities is of preparatory or auxiliary character.[849]

Nevertheless, there is one question created by this change that is not discussed in the OECD reports, and that is what the object of reference should be. What is a core business activity and what are preparatory or auxiliary activities will differ depending on the business of the enterprise. In other words, to decide what a core business activity is and what it is not, one must have a specific business to lean on, an object or point of reference. It should be pointed out that selling goods or providing services to customers can never be preparatory or auxiliary activities, so the question of what the object of reference should be does not need to be answered in all situations. If all of the places of business belong to the same company it is easy as the object of reference is the business of that company. Now, the stated objective of the anti-fragmentation rule is to extend the already existing reasoning about fragmentation in the commentary to situations where fragmentation is achieved by using different legal entities. Thus, the question of what the object of reference should be arises as it is not as clear what the reference should be when we have a large multinational enterprise established through several companies in the state of establishment. There is no guidance to be found in the report on Action 7 as this question is not discussed, and both examples provided are designed with PEs in the state of establishment, i.e. the first alternative condition in Article 5(4.1)a is fulfilled.

[849] See the previous discussion about this in section 6.4.

In general, one can imagine three different ways to deal with this. These ways, or options, are (1) to view the activities performed in the state of establishment, and assessed under the anti-fragmentation rule, as a business of its own, (2) to use the entire, and global, business of the multinational enterprise and (3) to decide the object of reference on a case-by-case basis taking into account all relevant facts and circumstances. These three options are discussed below.

Starting with the *first option*, namely, using the activities performed in the state of establishment, a problem presents itself as the reasoning becomes somewhat circular. This is because if the object of reference is the business conducted in the state of establishment, then the activities assessed under the anti-fragmentation rule will always coincide with the determined "business". The consequence of this is that the assessed activities would always be considered core business activities as they coincide with the "general purpose" of the enterprise. Such reasoning basically removes the purpose of the two alternative conditions. This is because the second alternative condition will always be fulfilled and in that case it has no function as a legal condition. As such a result cannot be accepted, this alternative is clearly not viable and, consequently, it is not further explored.

The *second option* is to assess whether the combination of activities is preparatory or auxiliary based on the multinational enterprise's global business. There are several problems with this option. First of all, determining the global business could potentially be a complex operation. This is because some multinationals are large and often operate in several lines of business, which can lead to the object of reference becoming difficult to use as it is difficult to determine a "single business". Furthermore, it requires a large amount of materials, perhaps written in different languages, to assess correctly, which of course adds complexity.

Finally, one can question whether it is always suitable to use the global business of a multinational enterprise as the object of reference. As just mentioned, it does not seem suitable in situations where the enterprise is active in several different lines of business as that makes the object of reference difficult to apply. Furthermore, the scale of the global business may create a situation where the assessed activities seem minor and unimportant when compared to the whole, which, in turn, implies a bias towards considering activities auxiliary when it comes to large multinationals. Then again, the scale of a large multina-

tional's business may often create the opposite assumption as the auxiliary activities can be objectively extensive. Be that as it may, enough concerns have been raised regarding this approach to warrant not recommending it.

This leaves us with the *third option*, to decide the object of reference on a case-by-case basis. However, in reality this says little about how this assessment should be made. This is because how one will approach this depends on the facts and circumstances of the specific case. It is not possible to articulate a clear rule or method to apply in every situation. Nevertheless, a few guidelines on how to do this can be mentioned. First of all, if the group of closely related enterprises is exclusively involved in a specific line of business, e.g. to manufacture and sell a specific type of goods, it seems suitable to use the entire group's business as an object of reference. However, if the group is involved in several clearly separate lines of business, that approach seems less suitable. Instead, I would argue that in this situation it would be best to use a specific line of business as the object of reference.[850]

But what if we have a situation where the activities in the state of establishment belong to different lines of business but still are complementary? How should the object of reference be determined in such a situation? To make it a bit clearer, a simple example can be used:

> A group is, among other things, in the business of building boats and ships, which are subsequently sold, either in the group's own stores or through independent distributors. To help its customers finance their purchases, a group of companies is set up with the sole purpose of providing finance solutions for the group's customers. It turns out that the "new group" is very good at the business of providing finance and as the years go by this line of business expands to provide finance solutions for various unrelated companies as well. In time, the finance business surpasses the building of boats and ships and becomes the most important line of business for the entire group.

[850] Here I assume that all the activities assessed under the anti-fragmentation rule belong to the same line of business. If the activities belong to different lines of business they are likely not "complementary functions that are part of a cohesive business operation" anyway.

The large and luxurious ships are always custom built and, because of this, the group only has an information office in the state of establishment. From there it provides information about its products, but nothing is sold there. Furthermore, the group has a workshop at a harbor where the ships are delivered and inspected by the customers. In that workshop, any minor faults found in the inspection are fixed before the ships are delivered to the buyer.

In addition to this, the finance part of the group also has an information office in the state of establishment. The office is mainly trying to promote its new service of providing payment and finance solutions for e-tailers. Furthermore, it provides information about its finance services to some of the customers buying ships. The ship business's information office has recommended that these customers use this company for financing. However, both the actual sale and financing agreement are concluded abroad.

Now, the question is whether these are two separate lines of business or whether they are sufficiently connected to be considered as one when determining the object of reference. On the one hand, they are both distinct lines of business on their own. On the other hand, they are connected both through history and part of the same transaction from the customers' point of view. My conclusion is that in this example, both lines of business are sufficiently connected to be viewed together. However, this does not mean that a complete merge is implied. There are still two lines of business, a pure payment and finance business and a ship plus finance business. What does this mean? I would argue that the object of reference in this situation will depend on which place of business is being assessed.

This might seem to precede the final condition of "complementary functions" in a "cohesive business operation", perhaps even making the last condition of the anti-fragmentation rule redundant. That may indeed be true in certain instances but not in all situations. Regardless of this overlap, one cannot always determine whether a pool of activities is of a preparatory or auxiliary character without first establishing an object of reference. Thus a certain overlap must be accepted.

Having already mentioned the final condition, it is now discussed in more detail in the following. The third, and final, condition of the anti-fragmentation rule is that the activities pooled together must be "complementary functions" in a "cohesive business operation". There is not much guidance provided on how to understand this condition

in the BEPS Action 7 report. The only help is the two examples.[851] From the first example we know that to verify information in loan applications and then grant said loan are complementary functions that are part of a cohesive business operation. The same is true for storage in a warehouse and the subsequent sale of the items stored. Regarding this example the OECD states that "storing goods in one place for the purpose of delivering these goods as part of the obligations resulting from the sale of these goods through another place in the same state" is an example of complementary functions that are part of a cohesive business operation.

From the examples with explanations, two things can be concluded. First, there must be a connection between the activities. The most obvious connection is that the activities all form a necessary part of a transaction, e.g. storage, delivery and sale of goods. Second, the activities must both be part of the same business operation. This implies a deliberate business strategy by the enterprises in question. This can be described as a requirement that the activities should be in the same line of business. In my opinion, this must be understood against the background of the anti-fragmentation rule, namely the objective of preventing artificial fragmentation in order to abuse the exceptions in Article 5(4). Thus, it is not enough that the activities are in the same line of business. The activities must also constitute a cohesive operation that makes sense if pooled together in one place of business.

For example, a multinational enterprise has a factory that manufactures a specific part of an airplane, the engine for instance, and a display and information office to sell airplanes in the state of establishment. To some extent one can consider these activities complementary as both are part of the same chain of activities resulting in the sale of airplanes. However, it is not possible to consider these activities as "part of a cohesive business operation" as these activities do not seem natural to perform in the same place of business and viewed together can hardly be seen as a cohesive operation. There are too many steps in between the activities to consider them a cohesive operation. Thus, no fragmentation has taken place, which means that there is no reason that the anti-fragmentation rule should apply.

[851] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 40-41 and para. 81 of the commentary to Article 5 of the 2017 draft of the OECD MTC.

In summary, the references to "place" should be understood as "place of business". It was also argued that a requirement of "fixed" is implied. It was noted that the alternative condition in Article 5(4.1)a may be complicated in practice when there are several related persons from different states with materially different PE provisions. Regarding the second alternative condition, it was concluded that the object of reference should be determined on a case-by-case basis. Finally, it was concluded that complementary functions of a cohesive business operation means that all activities are necessary parts of the same transaction or chain of events in the same line of business. One additional test should be applied to determine whether functions are part of a cohesive business operation. This test is whether the assessed activities make sense to conduct at the same place of business. If not, then no artificial fragmentation has taken place and the rationale behind applying the anti-fragmentation rule is missing and it should not be applied.

6.5.4 Conclusion

Having already discussed the different BEPS proposals regarding the exceptions in Article 5(4) in detail, there is no reason to repeat that in this section. Instead, this section is focused on a discussion relating to the argument provided by the OECD for implementing the anti-fragmentation rule, namely that it is a "logical consequence" following the changes to the list of specifically exempted activities.[852] It is not intended to discuss this argument of logic in a narrow sense. Instead, the logic of the new Article 5(4), specifically the anti-fragmentation rule, is discussed in general but with related persons in mind.

First of all, one can agree with the OECD that the changes to the list of exceptions, i.e. the change from exceptions to examples, would be possible to circumvent without the anti-fragmentation rule. One can question, however, how common this would be in practice. As it is only internal operations that can be exempted, the different related persons cannot perform any services on behalf of other enterprises, related or unrelated. Nevertheless, it would be possible to avoid the

[852] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 39.

changes in Article 5(4) in certain instances, and the anti-fragmentation rule is motivated to prevent this.

The anti-fragmentation rule represents, to some extent at least, what I have previously labeled an economic view of the group. This means that the group is seen as one unit, or as with the case of the anti-fragmentation rule, part of the group is seen as one enterprise. This is a clear change from the separate entity baseline, which is still the main approach in the PE concept.[853] As the previous discussion has shown, this change is made to prevent abuse.

This is important to remember as the "logic" does not make sense without the objective of preventing abuse in mind. This is because the current Article 5(4) is based on the separate entity baseline, which means that a company providing services to another group company is not engaged in an auxiliary activity as it is not acting "for the enterprise" itself.[854] The proposed new list of examples in Article 5(4) still has the phrasing "for the enterprise" and "belonging to the enterprise" in subparagraphs a)-e), just as the current list has.[855] Based on this it seems that companies should still be seen as separate in the "normal" situations. The consequence of this is that an activity performed on behalf of another group company is by default a core business activity. This is true even if the said activity would have been considered auxiliary if the group was seen as one unit.

Thus, the "logic" mentioned by the OECD is only logical if the anti-fragmentation rule is restricted to abusive situations. Otherwise it is not logical at all; it is illogical. In a non-abusive situation it would not make sense to all of a sudden apply an economic approach to the group, leading to the existence of a PE, if at the same time it would not be allowed to use the same reasoning to not have a PE because the activities performed are preparatory or auxiliary for the group as a whole.

Having established this, it is somewhat troubling that it is not clearly expressed in the anti-fragmentation rule, or the proposed commentary, that the rule only applies in abusive situations. It seems

[853] See for instance para. 40 of the commentary to Article 5 of the OECD MTC.
[854] Para. 26 of the commentary to Article 5 of the OECD MTC.
[855] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 28-29.

perfectly possible that the wording of the anti-fragmentation rule can be applied to non-abusive situations. In the proposed commentary it is explained that the rule intends to prevent fragmentation of cohesive business operations, but "abuse" is not mentioned and it is not clear whether the rule only applies to situations of abuse or not. Whether or not non-abusive situations are covered by the rule will depend on the interpretation of "complementary functions that are part of a cohesive business operation". As I see it, the risk of opening up for the view of the group as one economic unit is that this may lead to considering the business of related persons as one as a general rule. This risk is lessened with the interpretation advocated in the previous section, but it is not completely eliminated.

This leads to the conclusion that the proposed anti-fragmentation rule may be used by tax agencies in order to extend their countries' rights to tax a foreign enterprise in non-abusive situations at the expense of the residence state. In such situations the "logic" becomes flawed. One can accept the logic that abusive situations are assessed by different principles and standards as what makes the abuse possible in the first place is often the inadequacies of the "normal" principles and standards. Consequently, it is logical to introduce a mechanism to prevent abuse that becomes possible with the change to the list of exceptions. However, it is not logical to extend that mechanism to all situations, at least not if the objective is to prevent abuse. Thus, the final conclusion, and recommendation, is that it should be made clear in the anti-fragmentation rule that only abusive situations are covered.

6.6 Conclusion

The main theme of this chapter can be described as the tension between the separate entity baseline and the economic approach to viewing related persons as one economic unit. To some extent, this tension is present throughout this study, but it is particularly evident in the context of the exceptions for preparatory and auxiliary activities and the proposed changes presented in the BEPS project.

A general remark is that the aggregation of several related persons' activities can be motivated in the interest of preventing tax avoidance. However, given the structure of the exceptions, i.e. the focus on in-

ternal operations, one cannot motivate such an approach in general without abandoning the separate entity baseline first.

It can be noted that the question of whose business is being conducted can to some degree prevent artificial fragmentation between related persons in situations where the proposed new anti-fragmentation rule is not included in the relevant tax treaty.[856] If a person can be said to conduct the business of another related person, one can apply the reasoning regarding fragmentation already present in the commentary. If the new rule is included, however, and the only issue is artificial fragmentation, it seems preferable to apply the new rule.

[856] Regarding the question of whose business is being conducted see section 4.2.2.

7 Concluding Remark

7.1 Introduction

This is the final, and concluding, chapter of this study. This chapter is based on the results of the previous chapters and is focused on presenting the most important results of the previous chapters. Additionally, the third research question, regarding the PE concept as an anti-avoidance tool, is discussed.

The main objective of this final chapter is to sort and evaluate the various lines of reasoning regarding the related person PE situation identified in the previous chapters with the addition of the anti-avoidance argument. The conclusions in this chapter will be of a general and of a principle nature. Based on the findings in previous chapters, a *de lege ferenda* discussion about the future of the PE is presented. The objective of this chapter is to provide an overview of the most important findings in the study and to present general suggestions on how to proceed with the PE concept and related persons. To some extent, the reasoning from the previous parts of the study is repeated here. However, this is mainly done to set the results of the study in the proper context. Thus, to fully understand the reasoning behind the results, it is necessary to observe the different chapters and, for the general conclusions, the entire study.

This chapter is structured as follows. First, the impact of the interest to prevent tax avoidance on the PE concept is discussed (section 7.2). Second, the results of this study's three research questions are discussed (section 7.3). Third, the result of the study's general objective is discussed (section 7.4). Finally, this chapter and the study are concluded with some general remarks.

7.2 The PE Concept and Tax Avoidance

It was stated in the description of this study, in chapter 1, that the objective of preventing tax avoidance is a driving force behind the in-

creased interest in the related person PE. This statement has been reinforced throughout the study and it seems clear that it still holds true. In this section, the objective of preventing tax avoidance is discussed in general but still in relation to the PE concept. What this means is that I will only deal with preventing tax avoidance by using the PE concept and not, for example, GAARs, CFC rules, transfer pricing or any other type of legislation, anti-avoidance or otherwise, not specifically related to the PE concept. The objective of this section is to establish a framework to evaluate the results of the first and second research questions in order to answer the third research question.

To begin with, there are two fundamental questions that need to be answered. The *first* question asks what "tax avoidance" is in the context of the PE concept. The *second* question is about how the objective of preventing tax avoidance relates to the PE concept with its underlying principles and theories.

Let us start with the first question on how "tax avoidance" should be understood in the context of the PE concept. Initially, it is necessary to explain what I mean by tax avoidance. This is necessary as tax avoidance can mean many things. As I see it, tax avoidance represents the conscious act of structuring a business in a way to reduce taxation. Not all tax avoidance is problematic. What is problematic is structuring a business in order to achieve unintended results from a tax law perspective resulting in the loss of tax revenue for one or more jurisdictions. This is the type of tax avoidance discussed in this study, and all further references to tax avoidance below concern this type. Depending on the circumstances, problematic tax avoidance can be described as a sort of abuse of rules without formally breaking them. This means that tax avoidance in the context of the PE concept means using the concept in such a way that unintended tax consequences arise. Most commonly, this means using a business structure that avoids having a PE in the state of establishment.

However, structuring the business operations to avoid a PE cannot in principle be considered abusive or even problematic; it must also be required that an unintended taxation is achieved. Consequently, for a business structure to be considered abusive in regard to the PE con-

cept it must be in breach of the concept's objective.[857] It was previously concluded that the PE concept's objective is to divide taxing rights of business profits in a correct, equitable and neutral way.[858] Thus, the conscious act of structuring one's business in a way that will achieve an unintended allocation of taxing rights can be said to be abusive. The OECD expresses a similar opinion and states that a "guiding principle" should be that the main purpose of a business structure should be to achieve a favorable taxation in breach of the objective of the relevant rule.[859] It can be noted that this approach is similar to a GAAR.

To some extent this means that abuse needs to be determined on a case-by-case basis as the question of whether a business structure is in breach of the PE concept's objective cannot be fully answered in the abstract. Additionally, it is difficult to determine whether a business structure is in breach of the objective. The difficulty lies in the notion of "unintended" consequences, discussed above, and the nature of the PE concept.

An example can illustrate what is meant by unintended consequences. If we take the business of selling music, prior to the internet era, it used to be conducted by selling physical records either through a record store or mail order. A record store would normally constitute a PE while mail order would not. Mail order from abroad was not easily available to everyone and could be seen as complicated, and sending and receiving orders by mail would take additional time. By contrast, nowadays music is mainly sold over the internet, either by streaming or digital download. This is basically a modern version of mail order and does not typically constitute a PE for the service provider. The difference, however, is that the present digital distribution is cost effective and easy to use, and it gives the consumer instant access.

This shift in business practice has made it possible to establish oneself in a favorable tax jurisdiction and still be able to effectively conduct business in other countries. This, however, is not an unin-

[857] Similarly, see De Broe, L, *International Tax Planning and Prevention of Abuse – A Study under Domestic Tax Law, Tax Treaties and EC Law in Relation to Conduit and Base Companies*, p. 345.
[858] See section 2.2.
[859] Para. 9.5 of the commentary to Article 1 of the OECD MTC.

tended consequence, mere sales in a jurisdiction were never intended to constitute a PE, nor is the business model mainly chosen to reduce taxes. Thus, it cannot be seen as abuse of the PE concept to set up a company in a low-tax jurisdiction and from that company distribute digital products or services. This leads to the conclusion that one cannot expand the PE concept in these situations in order to prevent tax avoidance as no abusive avoidance exists. Instead, this must be solved, if that is deemed desirable from a policy perspective, by adapting the existing rules or introducing new ones.

What can be considered unintended consequences must be determined based on a specific PE rule and with the PE concept's underlying principles in mind. This leads us to the second question.

The second question is how the objective of preventing tax avoidance relates to the PE concept and its underlying principles. This is discussed with the conclusions in chapter 2 in mind. First, the notion of source in relation to the PE context was concluded to be the carrying on of activities for a sufficient duration in the state of establishment. Based on this conclusion, it is required that activities are performed in the state of establishment for an argument of tax avoidance to be accepted. Without any activities one cannot say that a business structure is abusing the PE concept. One can relate this to the example of digital distribution above, where no activities take place in the state of establishment.

Second, it was concluded in chapter 2 that the PE concept includes the basic neutrality notion and that equity arguments support taxation in the state of establishment. The example of a commissionaire can be used to discuss this. In practice, i.e. based on the actual activities performed, in many situations it can be argued that there is little difference between a commissionaire and a local sales office. The commissionaire, however, will not constitute a PE while the sales office in general will. This can be argued to be in breach of the basic neutrality notion and the equitable allocation of taxing rights. Given the similarity in activities it could also be argued that this is in breach of the notion of source. Nevertheless, commissionaire arrangements cannot be regarded as abusing the PE concept. This is because one must require a certain level of legal certainty, and commissionaires are not included under the agency clause. Consequently it can also be questioned whether this is an unintended tax consequence. This does not mean, however, that commissionaire arrangements are in line with the PE

concept's underlying principles; they are not, and should constitute PEs from a policy perspective.

How does this discussion connect to the related person PE? Initially, it can be concluded that the mere use of a subsidiary instead of a branch can never be considered abuse of the PE concept. The use of separate legal entities instead of branches can have many valid business reasons besides taxation and tax considerations are in general also a valid business reason.[860] It is also clear from the discussion throughout this study that the PE concept, in general, respects the use of separate legal entities.[861] There is, however, based on this study's result, one situation that stands out as abusive in the context of related persons. This situation is the act of trying to avoid a PE by not performing the PE-constituting activities by yourself but instead having a related person perform them. In order for this to be abusive, it should be a conscious act aimed at changing the outcome of the taxation in an unintended way. In other words, having a person perform activities that economically belong to another related person in order to conceal the fact that you are performing activities in the state of establishment can often be considered abusive. This practice is in essence a way to try to abuse the notion of separate legal entities.

One can compare this with other abusive practices mentioned in the commentary. Specifically, the act of splitting up negotiations and signing of contracts under the agency clause and the splitting up of contracts under the construction clause can be mentioned.[862] Another example is the fragmentation of activities between related persons, discussed under Action 7 of the BEPS project.[863] To some degree, all of these strategies have in common that they try to take advantage of a formal view of the circumstances in order to hide the economic substance of the situation. As has been previously shown, it is in line with the PE concept to apply a substance-over-form approach in these situations to prevent tax avoidance.

However, as the use of subsidiaries and other related persons is not abusive on its own, one must still carefully examine the circum-

[860] See section 1.3.2.
[861] See specifically chapter 3.
[862] Para. 18 and 33 of the commentary to Article 5 of the OECD MTC.
[863] OECD, *BEPS Action 7 Final Report: Preventing the Artificial Avoidance of Permanent Establishment Status*, p. 39-41.

stances in the specific situation to determine whether the structure is abusive or not.

Based on all of the above, abuse of the PE concept in the context of related persons is likely to be in the form of trying to take advantage of the formal aspects of the notion of separate legal entities. In order to prevent such abuse it is sometimes necessary to apply substance-over-form. This should only be done, however, after a careful consideration of the circumstances in the specific situation. Specifically, it should be examined whether the structure is deliberately chosen to achieve an unintended taxation. What is "unintended" should be determined by analyzing the specific PE provision and the PE concept's underlying principles and theories.

7.3 The Result of This Study's Research Questions

7.3.1 Introduction

In the following sections, the results of this study's research questions are presented. The reasoning leading up to the results is briefly summarized, but the focus is on the actual results.

7.3.2 The First Research Question

The first research question of the study concerns the scope of the related company clause found in Article 5(7) of the OECD MTC and Article 5(8) of the UN MTC.[864] This question was further divided into two subordinate questions. The first subordinate question was to examine the historical context and the underlying principles of the related company clause. The second subordinate question was to interpret and define the scope of the related company clause.

Starting with the first subordinate question, it was concluded that a treaty-based protection for related persons was included in the League of Nations' draft convention from 1933. This inclusion coincided with the adoption of a transfer pricing rule, and it was concluded that these changes where connected.

[864] See section 1.4.2.1.

In principle, related persons can be dealt with in three different ways. The first option is the single entity approach, which treats related persons as one, i.e. as PEs. The second option is the separate entity approach, where related persons can never constitute PEs of each other. The final option is a circumstantial approach, which means that whether a related person constitutes a PE depends on the circumstances. In short, the historical development of the related company clause started with a short period of the single entity approach in the 1920s and early 1930s. This was followed by a longer period of the separate entity approach. Finally, when the OEEC, and later the OECD, assumed responsibility for developing a MTC, it introduced a circumstantial approach in its first report on the PE concept in 1956. The circumstantial approach thus introduced is still in force.

Regarding the different ways to deal with related persons under the PE concept, it was concluded that the circumstantial approach is the preferred option. To begin with, it was argued that presently it is the only practically achievable option. Furthermore, this approach is flexible and allows for the PE concept to adapt as needed to uphold the notions of source, neutrality and equity in the context of related person PEs. However, it was also concluded that the circumstantial approach is adding complexity to the PE concept, which can decrease legal certainty. Additionally, the circumstantial approach is no guarantee that the underlying principles of the PE concept are fulfilled. This means that the ongoing development of the PE concept in the related person PE situation should be continuously examined and assessed in the light of those principles.

The second subordinate question was to interpret and define the scope of the related company clause. Initially, it was concluded that the related company clause's personal scope is limited to companies, as is implied by the wording of the provision. After this it was concluded that "control" should be understood as derived from ownership or similar circumstances. Furthermore, "control" refers to what I have labeled *normal control*. Normal control can be described as control typically exercised by an owner. In general, normal control can be said to include the formal power granted as a shareholder and it can also be said to exert influence through general policy decisions. Finally, it was concluded that the related company clause does not impose any limitations on the rest of the PE concept.

Thus, the answer to the first research question is that the related company clause does not have any substantial scope. However, one cannot completely disregard the related company clause as it does not seem unlikely that its mere existence has served as a reminder that related persons are, as a starting point, not PEs of each other.

As such, the overall answer to the first research question had little impact on the rest of this study. Nevertheless, the reasoning leading up to this answer is of greater relevance, especially the history, policy and notion of normal control.

7.3.3 The Second Research Question

7.3.3.1 Introduction

The second research question deals with the application of the PE concept to related persons.[865] In this study, the fixed place of business rule and the agency clause were studied. Additionally, the exception for preparatory and auxiliary activities from these two rules was also studied. In the following sections the result of this question is presented. For clarity, the results regarding the fixed place of business rule, the agency clause and the exception for preparatory and auxiliary activities are presented separately.

7.3.3.2 The Fixed Place of Business Rule

This section is structured around the different conditions discussed under the fixed place of business PE. This section follows the order in which the conditions are discussed in chapter 4. Initially, however, the fundamental question of whose business is being conducted is discussed.

It was concluded that a fundamental question when it comes to the related person PE is the question of *whose business is being conducted*. It was argued that, in principle, this question should be answered by using a substance-over-form approach. Additionally, it was concluded that support and guidance for such a substance-over-form assessment could be found within the PE concept, most notably in the dependency assessment under the agency clause. These conclusions were then strengthened by studying case law dealing with related person PE situ-

[865] See section 1.4.2.2.

ations. It was found that courts used reasoning similar to legal and economic dependence when determining whose business is being conducted. It was also found that this reasoning was often connected to situations including aspects of tax avoidance. Nevertheless, it was concluded that the substance-over-form assessment was not limited to situations involving tax avoidance but inherent to the fixed place of business rule. However, it was argued that a certain degree of caution should be observed when applying the above as the assessment is complex, which can result in decreased legal certainty, risk of double taxation and more litigation. Finally, it was concluded that the discussion and conclusions regarding whose business is being conducted has general relevance for the entire PE concept and not just the fixed place of business rule.

For a fixed place of business PE to exist, there must be a *place of business*. It was concluded that the term "place of business" is wide and in principle encompasses any types of physical locations and objects. Whether a location or object constitutes a fixed place of business depends on whether it is used to carry on the business. Regarding the related person PE situation, it was concluded that it is possible to have a place of business on the premises of a related person. However, in many cases the most relevant question is, to whom does the place of business belong, i.e. whose business activities are being conducted from the place of business?

In addition to the existence of a place of business, the place of business must be *fixed*. The term "fixed" includes both a geographical and a temporal aspect.

Starting with the geographical connection, it was concluded that this is fulfilled if the place of business is connected to a specific geographical point. It was also concluded that no particular questions regarding the related person PE arise under this question.

The geographical connection has been broadened and a commercially and geographically coherent whole is a sufficient geographical connection. It was concluded that the commercial coherence is the most important and that this must be assessed from an economic point of view. The geographical coherence requires a defined area, which should be assessed in light of the business's nature. Additionally, the OECD's use of examples was criticized as the typical service provider situation is better suited to be dealt with under the service PE.

Regarding the related person PE, it was concluded that the commercial whole is relevant. It is not possible to split up activities between related persons in order to avoid having a commercially coherent operation. If this split-up is artificial or the activities of one or more persons belong to another related person, the activities should be aggregated in the PE assessment.

The temporal connection was concluded to normally mean a minimum duration of six months. In the case of recurring activities it was concluded that the permanence test is met if the six-month threshold is clearly passed in three years. When it comes to related persons, it was concluded that the same reasoning applies as under the geographical aspect of "fixed".

A certain level of control is required over the fixed place of business. It is required that the enterprise have the fixed place of business at its *disposal*. Initially, it was concluded that the requirement of "disposal" is somewhat unclear. This can be described as whether "disposal" requires de facto use or something more. It was concluded that it was not possible to exactly determine what "disposal" means. However, it was argued that it should be understood as requiring something more than just de facto use.

The question of "disposal" was identified as of great importance to the related person PE situation. It is not uncommon for related persons to be present at each other's locations. If "disposal" is interpreted as just de facto use of a place of business, it will mean that as long as business activities are performed at a particular place with a sufficient duration, a PE exists. In practice this would mean that if a person performs activities belonging to a related person, it is likely that the first mentioned person would constitute a PE of the latter. The examples from Sweden show that the homes of individual shareholders run the risk of being seen as PEs of their foreign companies.

Finally, it was concluded that the business of the enterprise should be exercised "through" the place of business, which in principle means that the place of business should serve the business activities and not be the object of the business. However, given the influence of the OECD MTC, it seems likely that this is being changed to just require a presence, effectively removing any meaning of this condition.

7.3.3.3 The Agency Clause

This section is structured around the different conditions discussed under the agency clause. It follows the order in which the conditions are discussed in chapter 5.

Initially, it was concluded that a person, including both individual shareholders and companies, can act as an agent on behalf of related persons. Indeed, the agency clause has been the traditional focus when it comes to the related person PE.

In order for an agency PE to exist it is necessary that the agent has *an authority to conclude contracts*. It was concluded that such authority is to some extent based on substance-over-form. This means that the act of signing the contracts is not decisive. In addition to this, the authority to conclude contracts should be *habitually* exercised. This includes both a time and frequency component and should be assessed on a case-by-case basis with regard to the specific line of business. None of these conditions are of special interest for the related person PE situation.

The contracts concluded should also be *in the name of* the principal. It was concluded that this condition, in principle, is not of any special interest between related persons. In practice, however, related persons have been in focus. Presumably, this is because related persons can utilize the commissionaire structure to shift profits in a way unrelated persons cannot. Thus, the meaning of "in the name of" is of indirect relevance for the related person PE. It was concluded that "in the name of" means legally binding and that the economic substance argument was based on policy considerations and not grounded in any legal material.

It is not enough that all of the above conditions are fulfilled for an agency PE to exist. The agent must also be considered *dependent* on the principal. There are three categories to assess when determining whether an agent is dependent. The first category is comprehensive control and detailed instructions. It was concluded that normal control typically is not enough and that control over the day-to-day business is required. Additionally, it was concluded that control between related persons can be assessed in a wider sense, including control from related persons other than the principal.

The second category is whether the agent assumes the *entrepreneurial risk* or not. Initially, it was noted that related persons are in a differ-

ent situation than unrelated, as the related persons have a much stronger shared economic interest, sometimes even belonging to the same economic unit. Based on this, it was argued that the risk must be assessed in a wider way between related persons, taking into account the entire financial situation between them and, to some degree, other related persons. In general, it was concluded that it is a strong indication of dependence if the financial aspects of an agency agreement between related persons deviate from what can be considered normal between unrelated persons.

The final category is the *number of principals*. It was concluded that this was not decisive on its own but that having few clients makes independence less likely. Regarding related persons, it was concluded that, depending on the circumstances, several related persons could be regarded as one principal.

If an agent is considered independent, one must also determine whether the agent is acting in its *ordinary course of business*. Initially, it was concluded that this should be viewed as an extension of the dependency assessment and not a completely different and separate test. It was found that the starting point is what can be considered ordinary in the specific line of business. The approach of aggregating the activities of several related persons when determining what is "ordinary" was rejected as it does not comply with the notion of separate entities.

7.3.3.4 Preparatory and Auxiliary Activities

This section is structured around the different exceptions discussed in the context of preparatory and auxiliary activities. It follows the order in which the exceptions are discussed in chapter 6.

Initially, it was concluded that the list of exceptions is clearly based on the notion that related persons are dealt with as separate persons. This means that a person acting on behalf of a related person cannot be said to be performing an excepted activity but also that one cannot determine whether an activity is a core business activity based on the business of a group. This notion has led to the possibility to fragment an operation between different related persons in order to avoid having a PE.

This issue is dealt with under Action 7 of the BEPS project with a proposed new provision. The proposed anti-fragmentation rule was criticized for not clearly being limited to preventing abuse. It was con-

cluded that it was not logical to sometimes treat related persons as separate entities and sometimes as a unit unless there is an abusive situation. Applying substance-over-form to prevent abuse is acceptable. Mixing substance and form in comparable non-abusive situations is not.

7.3.4 The Third Research Question

The third research question concerns what function the PE concept has, and should have, when it comes to preventing tax avoidance.[866] The PE concept could be used to prevent tax avoidance either with a wide interpretation or by applying a separate concept, such as substance-over-form, to the PE conditions or the facts. In contrast to the previous research questions, the answer to this question cannot be directly found in the different chapters. Instead, the answer is provided here and it is based on all the preceding chapters.

Initially, it can be concluded that the go-to method to prevent tax avoidance within the context of the PE concept is to apply substance-over-form. This is especially true when it comes to the related person PE as tax avoidance is usually achieved by relying on formal aspects, e.g. activities that economically belong to a person are performed by a different related person. The following discussion is based on this typical aspect of tax avoidance in a related person situation.

Regardless, substance-over-form has its limits when it comes to preventing tax avoidance. This is connected with what can be considered abuse of the PE concept. It was concluded that problematic, or abusive, tax avoidance represents the conscious act of structuring a business in a way to reduce taxation, resulting in unintended consequences, from a tax law perspective, which are contrary to the underlying principles of the PE concept. If this is not the case, specifically the unintended tax consequences, it is not possible to use substance-over-form as there is no abuse. For instance, it was concluded that the profit shifting achieved through a commissionaire structure cannot be seen as an unintended result as the agency clause is applied as it is constructed. However, in certain instances one could argue that the related person acting as a commissionaire is used to conceal the fact

[866] See section 1.4.2.3.

that the foreign principal is conducting business in the state of establishment through a fixed place of business.

Thus, the general conclusion, and answer, to the third research question is that substance-over-form not inherent to a specific PE condition should be limited to situations that can be considered abusive. Taxation in general, and the PE concept, is based on the recognition of separate persons even if they are related. One cannot ignore this in situations where the PE concept is not abused. To determine whether something is abusive one should consider the specific PE provision and its intended outcome in allocating taxation rights. Additionally, one should compare the outcome with the notions of source, neutrality and equity. If the outcome can be considered unintended and in breach of the PE concept's underlying principles it is justified to apply substance-over-form.

7.4 The Result of the Study's General Objective

The general objective of the study is to analyze and define the substantive scope of the PE concept, as applied to related persons.[867] In the previous section, the results of the three research questions were presented in a more detailed manner. In this section, the result of the study in general is discussed. This discussion will be on a principle level without going into the specifics of a particular PE provision or condition.

Initially, it can be concluded that there are basically two general questions that are relevant when it comes to the related person PE.[868] These questions are: (1) whose business is being conducted? and (2) whether it is possible to aggregate the activities of several related per-

[867] See section 1.4.

[868] Perhaps one could argue for a third aspect as well. This aspect would be how to assess the facts and circumstances in a related person PE situation. To some extent, the Swedish case law seems to include an assumption that if a sufficient level of activities cannot be proven to be performed abroad, the activities are considered to be performed at the place of business of the Swedish related person. This, however, is not an aspect of the PE concept but rather of domestic legal traditions and, consequently, is not discussed further.

sons? Thus, it can be concluded that the difficulty of the related person PE lies in the tension between the notions of legally separate entities and related persons as an economic unit. Variants of these questions have been found under the different PE conditions discussed throughout the study, and the issues specifically connected to related persons can be subsumed under these two general questions. Consequently, if one is facing a related person PE situation, these are the questions one should pay specific attention to.

Both of these questions are inherent in certain parts of the PE concept and addressing them is often a way to prevent abuse of the concept. For instance, the question of who is conducting the business is inherent to the dependency assessment under the agency clause, as well as under the fixed place of business rule, and to some degree both situations deal with preventing tax avoidance. Hence, the related person PE is strongly connected with the prevention of tax avoidance and abuse of the PE concept. This means that, in general, one should only ask these questions in situations where different persons are used in order to achieve an unintended tax consequence, typically to hide the existence of a PE. In non-abusive situations, an expanded view of the related person PE based on the two questions above should be limited to obvious situations.[869]

Some may perhaps question whether there are two separate questions and instead consider them as the same question in practice. For instance, what is the difference between, on the one hand, considering a person performing activities belonging to another related person and on the other hand, aggregating the activities of related persons? From a practical perspective, the outcome is probably the same, i.e. a related person PE exists. In principle, however, it is different to consider that a person conducts someone else's business and to disregard that entities are separate. The first approach still recognizes the different entities. The second is, to some extent, in breach of the separate entity baseline upon which the PE concept rests. Thus, the use of the second approach, or question, is in general limited to situations where several related persons' activities are seen together to create an object

[869] "Expanded" should be understood as other situations than the standard dependency assessment under the agency clause. This is because the question of "whose business is being conducted" is already included for related and unrelated agents alike.

of reference and where the same aggregation is made for related and unrelated persons alike.

7.5 Concluding Remark

In this section some concluding remarks are presented. These remarks concern three different themes: (1) the influence of domestic legislation, (2) the current trend regarding related person PE and (2) the increased fragmentation of the PE concept.

Starting with the influence of domestic legislation, it can be said that how limited and unlimited tax liability is decided domestically may influence the related person PE. For instance, a country, such as Sweden, using the PE concept domestically to decide limited tax liability will to some degree mix the domestic objective of an inclusive provision with the tax treaty perspective of a restrictive one. It cannot be ruled out that this may affect the PE concept as a whole.

More interesting is how a country decides unlimited tax liability, specifically for companies. A country using "registration" must use the PE concept in order to tax a place of effective management.[870] By contrast, a country using "place of effective management" as a condition for unlimited tax liability is in some situations able to tax the company's worldwide profits without applying the PE concept, as it will be considered resident according to Article 4(3) of the OECD MTC. Thus, the case law from Sweden dealing with the owner's home or office as a place of management PE is less relevant to countries that use "place of effective management" domestically. This question is relevant in Sweden because "registration" is used domestically. This shows that a specific related person PE situation may only be relevant in certain countries depending on the domestic legislation.

This can be problematic as countries using different conditions for unlimited tax liability may have different opinions on the role of the PE concept in such situations, e.g. whether or not a place of effective management is within the PE concept's scope. However, this also shows that it is difficult to argue that the ultimate outcome is in

[870] It would also be possible to use CFC rules in this situation, at least outside the EU.

breach of the tax treaty in general in situations where a place of effective management is considered a PE on questionable, or even erroneous, grounds.[871] One could imagine the OECD recommending that its members use the "place of effective management" condition domestically to avoid this issue and to some extent remove some situations from the related person PE. However, this would not solve all related person PE situations under the fixed place of business rule. Additionally, it would probably be difficult to harmonize this worldwide. In summary, domestic legislation may influence the interpretation of the PE concept as well as which situations regarding related persons are relevant.

Moving on to the current trend regarding the related person PE, it can be concluded that the general direction is to widen the application of the concept in situations with related persons. This is mainly achieved with the application of substance-over-form to the PE concept. The opposite is also true as the OECD has proposed a rule to always consider agents acting almost exclusively on behalf of closely related persons to be dependent.

This trend is problematic as it increases the difficulty and decreases legal certainty. Furthermore, the studied case law typically show a lack of reasoning in these situations. Hence, it is good, in principle, that the OECD has proposed changes to Article 5 in order to decrease the number of countries and courts constructing their own solutions. However, it is disappointing that hardly any clarification is proposed regarding the question of whose business is being conducted under the fixed place of business rule. Therefore, it seems likely that the current trend will continue in the present direction. Based on this, it can be recommended that the OECD add a discussion on the question of whose business is being conducted in the commentary under the fixed place of business rule.

Finally, I will make a brief remark regarding the future of the PE concept in general and the related person PE in particular. On the surface, the PE concept is uniform and largely harmonized. However, different domestic interests, different domestic legislation and that the commentary sometimes obfuscates more than it clarifies means that

[871] For instance, in the *Galantus* case it was highly questionable that a PE existed. However, I would say that it was fairly clear that the place of effective management was situated in Sweden. See section 4.2.2.3.

the PE concept, in reality, is much more fragmented and unclear than the polished surface shows.

This can be assumed to become worse with the implementation of BEPS as a complete lack of case law and experience with the new rules will create a lot of uncertainty for a time. In addition to this, it seems that the BEPS project has created two quite different versions of Article 5 as it is clear that there are countries not interested in implementing the proposed changes for now. In this aspect, the BEPS project has failed. This will create increased fragmentation specifically regarding the agency clause and the exception for preparatory and auxiliary activities. Furthermore, one cannot dismiss the risk that the fixed place of business rule will continue to be under pressure as there will still be countries using the current version in their treaties with countries accepting the BEPS proposals. To be somewhat pessimistic and hyperbolic, one may predict that the PE as a coherent concept will end and be replaced by a fragmented PE umbrella under which various specific rules, akin to source taxation, are collected. Similarly, one can question the position of the OECD MTC as the leading instrument when it comes to influencing and interpreting tax treaties in the future.

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Sammanfattning

Den här avhandlingen undersöker begreppet ”fast driftställe”, i en skatteavtalskontext där de inblandade personerna är närstående, med avsikten att förtydliga tillämpningen. Bakgrunden till studien är att den ökande globaliseringen och teknikutveckling har inneburit ett ökat tryck på det fasta driftstället som huvudsakligt instrument att fördela beskattningsrätten mellan stater på inkomster från näringsverksamhet. Detta ökade tryck beror på att multinationella företag i viss utsträckning har möjligheten att organisera sig för att undvika att få fasta driftställen. Detta kan leda till en snedfördelning, eller i alla fall en förändring, av den överenskomna fördelningen av beskattningsrätten mellan stater. För att komma till rätta med detta har det varit en rättsutveckling där begreppet vidgats, ibland på tveksamma grunder. Även OECD har genom BEPS-projektet behandlat den här problematiken. Sammantaget har detta inneburit en ökad osäkerhet om hur begreppet ”fast driftställe” ska tillämpas i närståendesituationer.

För att undersöka ovanstående har tre forskningsfrågor identifierats. Den första frågan är att undersöka och förtydliga innebörden av den särskilda regeln som behandlar närstående bolag i Artikel 5(7) i OECD:s modellavtal. Den andra frågan behandlar tillämpningen av de regler som rör stadigvarande platser för affärsverksamhet och agenter i situationer där de inblandade personerna är närstående. Den tredje frågan undersöker om, och hur, ”fast driftställe” kan användas för att förhindra skatteplanering.

Det andra kapitlet syftar till att etablera ett teoretiskt ramverk inför resten av studien. I kapitlet konstateras att det fast driftställets funktion är att fördela beskattningsrätten mellan stater. Denna funktion ska förstås mot bakgrund av skatteavtalens syfte att minimera och undanröja dubbelbeskattning. Därefter studeras hur beskattningsrätten bör fördelas mellan stater och relevanta principer diskuteras i kontexten av fasta driftställen. Slutsatsen av detta är att neutralitet, inkomsternas källa och rättvisa är de viktigaste principerna för fördelning av beskattningsrätten genom begreppet ”fast driftställe”. Vidare konstateras

att ”substans före form” är tydligt kopplat till modellavtalet och begreppet ”fasta driftstället”.

Det tredje kapitlet behandlar den första forskningsfrågan och inleds med en historisk genomgång av den särskilda regeln rörande närstående bolag i Artikel 5(7). Det konstateras att det historiskt har funnits tre olika metoder att hantera närstående personer när det kommer till fasta driftställen. Dessa metoder är: (1) att behandla närstående som separata subjekt (aldrig fast driftställe), (2) att behandla närstående som ett subjekt (alltid fast driftställe) och (3) att variera behandlingen av närstående beroende på omständigheterna (ibland fast driftställe). Det slås fast att nuvarande reglering är att avgöra frågan om närstående personer utgör fasta driftställen utifrån omständigheterna. Denna metod är även att föredra på grund av dess flexibilitet och att den bäst överensstämmer med neutralitet, inkomstens källa samt rättvisa. Gällande den särskilda regeln för närstående bolag konstateras att den inte har något materiellt innehåll. Det går dock inte att utesluta att bestämmelsen ändå kan påverka genom de signaler den sänder ut.

Kapitel fyra utreder den andra forskningsfrågan i relation till regeln rörande en stadigvarande plats för affärsverksamhet. Inledningsvis konstateras att en centra fråga att svara på är vems verksamhet som bedrivs från den stadigvarande platsen. Det argumenteras att ledning för denna bedömning bör hämtas från agentregelns beroendebedömning, det vill säga juridisk kontroll och det ekonomiska förhållandet mellan de närstående personerna. Det olika rekvisiten gås igenom och slutsatsen är att den principiellt viktiga frågan är vem som bedriver verksamheten. Det noterades dock att frågan om ”förfogande” är praktisk viktig för situationer med närstående personer.

Även kapitel fem behandlar den andra forskningsfrågan men utifrån agentregeln. Det konstateras att en praktiskt viktig fråga är rekvisitet ”i vems namn” agenten sluter avtal. Slutsatsen är att rekvisitet innebär att principalen ska vara juridiskt bunden av avtalet och att det inte är tillräckligt att vara ekonomiskt bunden. När det kommer till beroendebedömningen är slutsatsen att situationen mellan närstående personer kräver särskilda hänsyn. Detta innebär att kontroll och det ekonomiska förhållandet mellan personerna ibland måste bedömas utifrån flera närstående personer. Vad gäller kontroll betyder det att andra än de direkt inblandade närstående personernas kontroll ska beaktas. När det kommer till det ekonomiska förhållandet måste den

samlade ekonomiska situationen mellan de närstående personerna beaktas, när det är relevant även mellan andra närstående personer.

Kapitel sex behandlar undantagen för förberedande och biträdande verksamheter i Artikel 5(4) i OECD:s modellavtal. Det argumenteras för att de särskilt listade verksamheterna i underparagraferna a)-d) är rena undantag och inte innefattar ett krav på att vara förberedande eller biträdande. Det konstateras att nuvarande regel är baserad på närstående personer som separata subjekt och att det därför aldrig kan vara en biträdande verksamhet att utföra tjänster åt en närstående person. Det är inte heller möjligt att bedöma vad som är förberedande eller biträdande utifrån exempelvis en koncerns samlade verksamhet. Därefter granskas OECD:s förslag, inom ramen för BEPS-projektet, till förändringar av detta undantag. Förslaget kritiseras för bristande koherens och otydlighet, särskilt vad gäller närstående personer. Det argumenteras för att den föreslagna regeln endast ska tillämpas för att förhindra missbruk.

Kapitel sju avslutar avhandlingen genom att gå igenom de viktigaste resultaten från tidigare kapitel och behandlar den tredje forskningsfrågan som rör intresset att förhindra skatteflykt och fast driftställe. Det argumenteras för att principen om substans före form är en lämplig metod att förhindra skatteplanering. I situationer där en substansbedömning inte redan ingår i ett specifikt rekvisit bör principen dock endast tillämpas om resultatet är oförutsett och strider mot begreppets underliggande principer, det vill säga missbruk av begreppet ”fast driftställe”. Angående studiens övergripande syfte är slutsatsen att det i huvudsak är två principfrågor som skiljer närståendesituationen från andra situationer. Dessa frågor är: (1) vems verksamhet som bedrivs och (2) när det är möjligt att behandla närstående personers verksamheter som en verksamhet.