

The evolution of the Agency Permanent Establishment Concept

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Abstract

The BEPS project produced several significant changes to the OECD MC. One notable development is the broadening of the Agency PE. This paper provides an historical study of the Agency PE concept from the period of nationalistic Empires competing for prestige (mid-19th century Germany) to a period of interconnected globalisation (early 20th century). This paper illustrates the general trend to restrict the Agency PE from its original broadened application to a legal test of “bindingness”. Therefore, the recent changes represent a reversal of the general trend and an important victory for source countries. This paper aims to offer the reader a widened perspective than a more standard analysis of the text.

1. Introduction

History itself is inescapable. Despite the overall fall in the study of history as an academic study¹, history remains a fundamental tool for knowledge. We can learn from the challenges of history to apply to modern problems. To understand the present, one requires an understanding of the past. Linking the past with the present is essential for a deeper understanding of international tax law. The recent changes to the Agency Permanent Establishment (‘PE’) under Action Plan 7 of the Base Erosion and Profit Shifting (‘BEPS’) have created a lot of debate among scholars. This paper aims to provide an historical study of the Agency PE concept and reveal the underlying tensions that exist. The first drafters would have considered travelling salesmen or local representatives of a foreign manufacturing firm when formulating Agency PE. Drafters today consider a wide range of factual scenarios in a far more complex world.

2. German origins

The original PE concept can be traced back to Germany. In fact, the concept is first seen in the 1845 Prussian Industrial Code, however, this was not used for taxation purposes.² Prussia and Saxony concluded the first ever tax treaty in 1869, which specified the conditions for taxation as a *stehendes Gewerbe* (standing operation).³ According to article 2(1), a non-citizen was taxable in a state where an

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¹ <http://www.nationalreview.com/corner/446401/niall-ferguson-history-decline-academic-discipline>.

² Kolck, *Der Betriebstättenbegriff und nationalen und internationalen Steuerrecht (“PE Concept in National and International Tax Law”)* 9 (1974).

³ *Preußische Gesetzessammlung (“Prussian Laws collection”)* 142 (1870).

enterprise used a *gewerblichen oder Handels-Anlage* (business establishment). There is no mention of agency.

The Prussian concept of a standing operation was a general limitation of source-state taxation. Two conditions were required:

- i) A fixed location in the other state;⁴ and
- ii) The enterprise has an intention to continue performing business activities at that location⁵

These conditions, based fundamentally on a fixation to the state, later became the core elements of the PE concept. The term *Bestriebsstätte* (PE) itself was not used in legislation until 1885.⁶ The term “agency” was not included in the legislation, however, it was used in a list deeming a PE; including place of management and a branch, which could trigger source-state taxation.⁷ Thus, the only requirement was an agency relationship without any contractual requirements or independence exceptions that exist today. However, the general requirement was a fixed location. Hence, agency was simply an example of the early FOB PE.

The first general definition of a PE occurred in the German Double Taxation Act of 1909, for the purposes of preventing double taxation between German states.⁸ The general definition moved away from a long deeming list and provided a more general concept under a business activity test, which included partner, manager or other permanent representative (*Geschaefstteilhaber, Prokuristen oder andere ständiger Vertreter*)⁹.

The terms “partner, manager or other permanent representative” can all be interpreted as synonyms for “agent”. Overall, the notion of some form of agency PE was established in the late 19th century by German states.

3. Pre-League of Nations

During the 19th century, empires had sought to codify rules for the operation of trade with their own empires. This was necessary due to the economic strategies of nations. For example, the British Empire had sought to increase its power through its own trade routes, rather than through trade with other

⁴ *Preußische Oberwaltungsgericht* (“Prussian Higher Administrative Court”) Bd. 14 (1886) 120.

⁵ *Preußische Oberwaltungsgericht* (“Prussian Higher Administrative Court”) Bd. 17 (1889) 249.

⁶ §2 Abs. I of Kommunalabgaben-Notgesetz (“Section 2, paragraph 1 of the Municipal Emergency Tax Act”), July 27, 1885.

⁷ *Ibid.*

⁸ *Doppelsteuergesetz* (“Double Taxation Act”), March 22, 1909, RGBI 332 (1909).

⁹ *Ibid.*, Section 3, paragraph 2.

empires. However, the inevitable increase in inter-Empire trade led to the need for more rules to regulate this trade.

The DTA signed by Austria-Hungary and Prussia¹⁰ contained a general definition of business establishment, which conformed to the Prussian concept, was provided with a list of examples that included:

*“branch establishments, factories, depots, offices, places where purchases and sales are effected and other facilities by which the owner, **partner, manager, or other permanent representative** carries on his normal business activities”*¹¹

Consistent with the later German legislation mentioned above, the treaty uses the terms “partner, manager, or other permanent representative”. Thus, “agent” was not explicitly used, however, concepts analogous to “agent” were used. Additionally, the use of fixed establishments was necessary, thus, forming part of the FOB PE. The 1899 treaty was extremely influential in the earlier part of the 20th century:

*“This 1899 treaty became the model for the relative handful of tax treaties entered into before World War I. Virtually the same language continued to appear in most tax treaties entered into prior to 1927.”*¹²

It is important, however, to note the divergence in the title employed. The term “business establishment” was also later used by the League of Nations secretariat to translate the Germany-Czechoslovakia tax treaty.¹³ The secretariat used the term “industrial establishment” for the Austrian-Czechoslovak tax treaty.¹⁴ The identical term for the Italy-Germany treaty became “establishment”.¹⁵

The wording itself also showed some major variations in the early Post-WWI treaties. In Continental Europe, a general definition was provided (consistent with the German definition).¹⁶ On the other hand, a list of examples with a provision “including other fixed places of business (‘FOB’)” was used by the Anglo-Saxon treaties.¹⁷ The UK used the “trade or business” concept, which was in line with common law as a threshold for source-state taxation. Importantly for this study, the term “permanent representative” was later included. However, in relation to the Agency PE, there was less variation as

¹⁰ 21 June 1899.

¹¹ Ibid.

¹² Robert L. Williams, *Fundamentals of Permanent Establishments* (The Hague: Wolters Kluwer, 2014), 3.

¹³ 31 December 1921, 17 LNTS No. 447.

¹⁴ 18 February 1922, 14 LNTS No. 371.

¹⁵ 31 October 1925, 53 LNTS No. 1261.

¹⁶ For example, see DTA *Germany-Italy* (1925).

¹⁷ Kunze, *Der Begriff der Betriebsstätte und des ständigen Vertreters* (“The PE concept and the permanent representative”) 47 (1963); Including France and Spain.

evidence by the various treaties concluded, which provided for the inclusion of some form of a permanent representative.¹⁸ This period certainly represented the early stage of development for the Agency PE concept and the variation of terms used is clear. It is also important to note that there was no distinction between dependent and independent agents. Furthermore, both PE definitions, listed examples or general definition, required some level of fixedness with the source state. The early concept of Agency PE was still inherently tied to the FOB PE.

4. League of Nations period

The League of Nations was established in 1919 to guarantee peace and stability to avoid the catastrophe of World War One.¹⁹ In the field of taxation, the League of Nations paved the way for future development. The importance of the League of Nations as the first global body for establishing a common framework for DTTs cannot be understated. The issue of double taxation was particularly relevant given the large nominal tax rates. This was the first real attempt to achieve uniformity and develop a common platform for countries to express their views.

The strategy chosen by the League of Nations when the issue of double taxation came up in 1921 was to establish a theoretical basis for the principles of international tax jurisdiction. For this purpose, a group of experts, in this work referred to as the “Group of Economists”, was appointed in 1922 to submit a report on double taxation.²⁰ The subsequent reports have formed the academic foundations for discussing the principles of international double taxation. The authors did not draft a treaty, however, the economic principles of avoidance of international double taxation were discussed. The first attempt to define a PE was in a 1925 report²¹, which recognised the “State in which the source of income is situated is entitled to impose impersonal or scheduler taxes”²². The text of the resolution provided that the source-state may tax income from Immovable property, agricultural undertakings, and commercial & industrial activities. Additionally, a contracting State may tax a portion of the net income produced by “a branch, **agency**, an establishment, a stable commercial or industrial

¹⁸ See following DTAs: *Austria-Liechtenstein* (1901), *Austria-Saxony* (1903), *Austria-Baden* (1908), *City of Basle-Prussia* (1910), *Austria-Hessen* (1912), *Austria-Bavaria* (1913), *Czechoslovakia-Germany* (1921), *Austria-Germany* (1922), *France-Saar* (1922), *Germany-Hungary* (1923; in the 1936 Protocol the PE definition is adapted and independent agents are excluded), *Germany-Poland* (1923), *Austria-Hungary* (1924), *Czechoslovakia-Poland* (1925), *Germany-Soviet Union* (1925), *Hungary-Italy* (1925), *France-Spain* (1926) and *Northern Ireland-United Kingdom* (1926).

¹⁹ See: Clavin, *Securing the World Economy: The Reinvention of the League of Nations*, (Oxford University Press, 2013).

²⁰ Arvid A. Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* (Kluwer, 1991), 79.

²¹ League of Nations: Technical Experts to the Economic and Financial Committee Double Taxation and Tax Evasion Report and Resolutions submitted by the Technical Experts to the Financial Committee Document F.212 Geneva, February 1925.

²² *Ibid*, p. 25.

organisation, or a **permanent representative**” in their territory.²³ Thus, this is the first moment where “agency” is used. The term “permanent representative” is also taken from previous treaties. It is not entirely clear how to distinguish between the two terms “agency” and “permanent representative”. Unlike the more developed general German PE definition, there was no attempt by the League of Nations to define a general PE. There is simply a list of PEs. Furthermore, there is no definition of “agencies”.²⁴

4.1. Exceptions to PE

Two other key components of Agency PE also began to take shape in this period. Firstly, the auxiliary or preparatory exception of PE emerges. The Poland/Czechoslovakia DTA of 1925 provides:

“For the purposes of this Convention the term “working establishment” shall not include the following: journeys made by the head of the undertaking to obtain orders, delivery of orders, delivery of goods on commission to an established dealer, delivery to customers of goods transported from one country to the other or of goods lying in warehouses belonging to a transport undertaking or to a forwarding agent, providing that such transactions are not carried out by offices or employees of the undertaking”

Thus, there is a certain threshold level of activity which needs to exist before a PE can be justified. This indicates a narrowing of the PE concept. This is the origin for the modern auxiliary or preparatory paragraph under article 5(4).

Second, the emergence of an independent agent is also seen in the League of Nations period. The origins derive from the United Kingdom. The 1915 Finance Act states:²⁵

“Nothing in section forty-one of the Income Tax Act, 1842 (as amended by any subsequent enactment or by this section), shall render a non-resident person chargeable in the name of a broker or general commission agent, or in the name of an agent, not being an authorised person carrying on the non-resident’s regular agency or a person chargeable as if he were an agent in pursuance of this section, in respect of profits or gains arising from sales or transactions carried out through such a broker or agent”

This was an exception to the general rule that where an agent carries on principal trading in the UK, the principal is liable to taxation. In 1920, a Royal Commission criticised this provision and

²³ Ibid.

²⁴ The influence of the UK is quite clear. The author speculates that Germany had less influence in immediate aftermath of World War One given the enormous blame placed on Germany for World War One.

²⁵ (No. 2) section 31(6).

recommended it be kept under review.²⁶ The 1925 Finance Act provided a more refined exception for brokers:

*“(1) Where sales or transactions are carried out **on behalf of a non-resident person through a broker in the ordinary course of his business as such**, and the broker satisfies the conditions required to be satisfied for the purposes of this section, then, notwithstanding that the broker is a person who acts regularly for the non-resident person as such broker, the non-resident person shall not be chargeable to income tax in the name of that broker in respect of profits or gains arising from those sales or transactions.*

(2) The conditions required to be satisfied for the purposes of this section are that the broker must be a person carrying on bona fide the business of a broker in Great Britain or Northern Ireland, and that he must receive in respect of the business of the non-resident person which is transacted through him remuneration at a rate not less than that customary in the class of business in question.

(3) In this section the expression ‘broker’ includes a general commission agent.”

The provision establishes the framework for the current paragraph 6. The agent must be carrying on “bona fide the business of a broker” and he receives a customary remuneration. The first component represents the legal and economic test for independence and the second component is a transfer pricing measure. It is also interesting to note that a general commission agent is an example of a broker. This suggests that broker is a broader term and that general commission agent is a certain class of agent. In fact, the Inland Revenue in 1920 held that:²⁷

“Then there is the general commission agent, who sells any goods consigned to him or takes orders for transmission to any trader with whom he can get into touch, although not regularly acting for him nor authorised to describe himself as the non-resident’s agent. And there is the broker, who merely acts as salesman for goods, and has no other duties than to sell the goods at the market price and remit the proceeds, less his charges.”

It seems, therefore, that a general commission agent has greater independence to the principal than the normal broker. In any case, the terms are derived from English common law and, as such, have no origin in civil law. This creates issues when interpreting article 5(6) of the OECD MC.

²⁶As cited by John F. Avery Jones and D.A. Ward, ‘Agents as Permanent Establishments under Article 5 of the OECD Model Convention’, *Eur. Taxn.* 33, no. 5 (n.d.): 224.; UK National Archives file IR63/75 at 97; 1920 Royal Commission on the Income Tax, 1920, Cmd.615, Minutes of Evidence q 10,307(a).

²⁷ Avery Jones and Ward, 225.; Inland Revenue evidence to 1920 Royal Commission on Taxation, Cmd.615.

The International Chamber of Commerce supported the independent agent clause generally and argued that agencies established based on commission were not an integral part of the enterprise, and should therefore not constitute a PE.²⁸ In 1927, the League of Nations introduced a general distinction between dependent and independent agents in their first draft tax convention:²⁹

*“The real centres of management, affiliated companies, branches, factories, **agencies**, warehouses, offices, depots, shall be regarded as permanent establishments. **The fact that an undertaking has business dealings with a foreign country through a bona fide agent of independent status (broker, commission agent, etc.), shall not be held to mean that the undertaking in question has a permanent establishment in that country.**”*

“Affiliated companies” are expressly included as a PE, which is contrary to article 5(7) of the OECD MC and UN MC. However, this was later dropped in 1933.³⁰ The reader will note the broker and commission agent are given as examples of a bona fide agent of independent status, rather than as separate categories. Pijl argues that “bona fide” was used to “distinguish real independent agents from those that only pretend to be independent...bonafide is the forerunner of “acting in the ordinary course of their business” in the OECD Models.”³¹ Thus, any bona fide agent that is legally and economically dependent would constitute a PE. The Commentaries state that:³²

“bona fide agent of independent status are intended to imply absolute independence, both from the legal and economic point of view. The agent’s remuneration must not be below what would be regarded as a normal remuneration.”

The concept of legal and economic independence is introduced, and this is consistent with the current interpretation of “agent of independent status” under article 5(6). The League of Nations 1929 Report had a more civil law flavour as evidenced by the discussion of a “commissionaire”.³³ The subsequent

²⁸ International Chamber of Commerce, *Resolutions passed at Third Congress*, Brochure No. 40, at II (1925).

²⁹ League of Nations, *Double Taxation and Tax Evasion*, Committee of Technical Experts art. 5(2) (1927).

³⁰ League of Nations, *Report to the Council on the Work of the Fourth Session of the Committee* (1933).

³¹ Hans Pijl, ‘Agency Permanent Establishments: In the Name of and the Relationship between Article 5(5) and (6)’, *Bulletin for International Taxation* 67, no. No. 1 (2012): 14.

³² League of Nations: Committee of Technical Experts on Double Taxation and Tax Evasion and Double Taxation and Tax Evasion, ‘Double Taxation and Tax Evasion: Report; C. 216. M. 85’, accessed 20 February 2017, <http://www.taxtreatieshistory.org/>; League of Nations: General Meeting of Government Experts on Double Taxation and Tax Evasion and Double Taxation and Tax Evasion: Report Presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion Document, ‘League of Nations Double Taxation and Tax Evasion, C.562.M.178.1928.II.’

³³ League of Nations Fiscal Committee, ‘Report to the Council on the Work of the First Session of the Committee; C516.M.175.1929.II.’

reports showed a misunderstanding by civil lawyers of the independent agent and there was no real understanding achieved according to Jones & Luedicke.³⁴

Interestingly, some civil law countries also adopted the dependent/independent distinction as can be reflected in the Austria/Swiss treaty of 1927:

“Where an independent agent merely negotiates business for the firm he represents, without maintaining on its behalf any warehouse, and without being authorized to conclude on its behalf any transactions, this shall not be regarded as constituting the maintenance of a business establishment (Betriebsstätte).”

This is a mix of the dependent and independent agent concepts in one sentence. The first part uses “independent agent”, and the phrase “authorized to conclude on its behalf any transactions” is a precursor to the dependent agent phrase to “conclude agents in the name of the enterprise”. However, the use of the dependent/independent distinction was rather limited, which is not surprising as it essentially relates to common law systems.

4.2. Subsequent reports

The League of Nations produced a total of nine reports before the breakout of World War Two (1929-1939). Some of these reports deal with PE questions and reproduce largely a list of PEs with some minor exceptions. These reports significantly developed the Agency PE concept. The Report to the first session (1929) provides specific and detailed criteria for a Dependent Agent PE:

“The fundamental principle is: When a foreign enterprise regularly has business relations in another country through an agent established there, who is authorised to act on its behalf, it shall be deemed to have a permanent establishment in that country. A permanent establishment may be presumed to exist:

(1) When the agent carries out the whole or part of his activities in an office or other premises placed at his disposal by the enterprise;

(2) When the office or premises where the agent carries out the whole or part of his activities are designated by outward signs as being an establishment of the enterprise itself;

(3) When the agent is habitually in possession, for the purposes of sale, of a stock of goods belonging to the enterprise, exclusive of samples;

³⁴ J. Luedicke and John F. Avery Jones, ‘The Origins of Article 5(5) and 5(6) of the OECD Model’, *WORLD TAX JOURNAL*, 2014, 203–41.

(4) When the agent, having a business headquarters in the country, is a duly accredited agent (fondé de pouvoirs) who habitually enters into contracts on behalf of the enterprise for which he works;

(5) When the agent is an employee who habitually transacts commercial business on behalf of the enterprise in return for remuneration.”³⁵

The definition is more complex than previous definitions. However, there is no independent status exception, but a list of specific exceptions after the PE-constituting categories. The first sentence of the definition begins to resemble the current article 5(5).

A foreign enterprise must have “regular business relations” through an agent “established there” who is “authorized to act on its behalf”. “Regular business relations” provides a certain threshold for economic penetration, which is not required in the later Agency PE definition. However, the auxiliary or preparatory exception is applicable. An agent “established there” is also another factor linking the foreign enterprise to the source state and suggests a FOB PE of the agent is required. This requirement was later removed and now there is now no FOBPE requirement. Interestingly, “Authorized to act on its behalf” is a wider term than “in the name of”, thus, the Agency PE concept was based on the activities on the agent, rather than the concrete activity of concluding contracts.

The first PE-constituting agent “the activity-agent” resembles the FOB PE as an office or other premises are required. This category was later removed. The second PE-constituting agent is the “designated agent”, where an agent appears to act for the enterprise at their premises. The designated agent is a more nuanced category than the activity agent as the agent must outwardly show that he is working for the enterprise itself. This is somewhat similar to the common law concept of “apparent authority”. The second category was also discarded. The last three categories are the most significant, and represent the building blocks for the current Agency PE; stock holding agent, binding agent and the employee agent.

The stock-holding agent requires only habitual possession of goods belonging to the enterprise. Thus, the level of activity required is low even compared to the first two categories. The stock-holding agent still exists in the United Nations Model Convention (‘UN MC’) Agency PE article.³⁶ The binding-agent requires habitually entering into contracts on behalf of the enterprise. This is the first time the binding agent was introduced and represents the genesis of the current dependent agent under the OECD MC. However, “business headquarters” is also required, which again is analogous to a FOB PE. The fifth PE-constituting category, employee agent, requires an employee to habitually transact commercial business on behalf of the enterprise. The difference between “entering into contracts” and “transacts

³⁵ Commentary League of Nations Fiscal Committee, ‘Report to the Council on the Work of the First Session of the Committee; C516.M.175.1929.II.’

³⁶ Article 5(b).

commercial business” is unclear, however, it appears that one could transact commercial business without concluding contracts. For example, an employee could conduct all negotiations without concluding contracts. There is no explicit requirement for any fixedness to the source state. However, it is probably assumed at that time that an office was necessary, and the Commentary explicitly mentions an “establishment”. Furthermore, the general definition provides for an agent “established” in the source state, therefore, the author argues that something akin to a FOB would be necessary. In any case, the employee agent remained important for a prolonged period and was eventually transposed into the binding agent.

The Commentary additionally provides three tests which must be met:

- 1) Authorisation given for the agent to **act for the** foreign enterprise; and
- 2) The fact of his carrying out these transactions regularly; and
- 3) The fact of his carrying them out in **an establishment**.³⁷

The agent need only act for the foreign enterprise which covers a lot of potential activities. Furthermore, it is “immaterial where the contract is concluded, or where title to property passes”.³⁸ This is an interesting development which uses substance over legal form. However, a commission agent (commissionaire) who acts in his own name is explicitly excluded, referring to a legal form.

The subsequent reports are somewhat analogous to the 1929 report with some exceptions. Only the later three PE-constituting agents remain. The 1933 contains an actual draft model. The independent status exception is reintroduced as early as 1933 and a list of PEs is provided.³⁹

4.3. Summary

The League of Nations Reports were the most sophisticated attempt to develop the Agency PE concept. Importantly, the scope of Agency PE was narrowed from requiring an “agency” into three categories. However, these are only illustrative examples and the scope is potentially limitless. The categories are a mix of economic tests i.e. activity agent and the stock-holding agent, and a legal test, entering into contracts on behalf of the enterprise. The general overall principle is still the same as today, an agency PE exists where “a foreign enterprise has business in another country through an agent established there”.

³⁷ ‘Report to the Council on the Work of the First Session of the Committee; C516.M.175.1929.II., page 4-5.

³⁸ Ibid, page 5.

³⁹ League of Nations Fiscal Committee: Report to the Council on the Fourth Session of the Committee. C.399.M.204.1933.II.A.

Another significant point is that the independent status exemption was removed by the 1929 Report, which indicates that workers and commission agents did not bind other person and, therefore, excluded from the core criterion that gives rise to a PE by their nature as non-binding agents. However, the later reports reintroduced the independent agent exemption. Interestingly, the independent status test comes before the agency tests. Thus, the reader would need to test whether a commission agent or broker was independent before the agency tests. Another key point is the requirement of an “establishment” analogous to a FOB PE. Thus, any agent would be required to conduct business through something fixed. An agency was seen in connection with a FOB PE, but simply covered scenarios where the business itself was not performing the activities.

4.4. Mexico and London Model Conventions

The work of the League of Nations had been generally in favour of greater residence taxing rights. There was a huge political dispute occurring in the League of Nations between net exporters and net importers of capital. Net capital exporters (developed countries) had argued for greater residence taxing rights. On the other hand, net importers (developing countries) had argued for greater source taxing rights. In the end, the net capital exporters had won the discussion and the reports reflected greater residence taxing rights. However, the Mexico Draft 1943 represents a shift more towards source taxing rights. This was because developed countries were under-represented during the drafting process. Source countries, therefore, generally had greater source taxation rights. The London Draft 1946, on the other hand, shifted back to greater residence taxing rights.

4.5. Protocol to Article V

Both Drafts⁴⁰ provide a protocol to Article V which forms the PE article for both drafts. The entire article resembles to a certain extent the current article 5 and it is helpful to analyse its content. The Model Conventions provide the main framework for future Model Conventions. The PE definition includes a list of specific enterprises that have a fixed place of business and a productive character which includes “agencies”, also including other enterprises who met the criteria. The general definition is again discarded in favour of a list. A PE is also created where an established agent has “regular business dealings” and is authorised to act on the behalf of the enterprise. This is broad and general category which covers a wide range of potential activities. Specific examples are also included: contracting

⁴⁰ League of Nations Fiscal Committee London and Mexico Model Tax Conventions Commentary and Text. C.88.M.88.1946.II.A.

agent, employee agent and stock-holding agent. However, several agents are excluded: buy-sell activities, commission agents and commercial traveller

Paragraph 1 provides a list of PEs:

“The term “permanent establishment” includes head offices, branches, mines and oilwells, plantations, factories, workshops, warehouses, offices, agencies, installations, professional premises and other fixed places of business having a productive character.”⁴¹

“Agencies” is explicitly mentioned. A PE must have a “fixed place of business that has a productive character”.⁴² Hence, establishments which do not contribute to the earnings of a business are excluded. Furthermore, a “fixed” place is requiring connecting the agency to such a place. It is arguable whether other enterprises not explicitly listed could also constitute a PE as the Commentary explicitly refers to “enterprises” generally.⁴³ Paragraph 3 then provides an independent test disqualifying a deemed PE:

“The fact that an enterprise established in one of the contracting States has business dealings in another contracting State through an agent of genuinely independent status (broker, commission agent, etc.) shall not be held to mean that the enterprise has a permanent establishment in the latter State.”

This definition is identical to the 1933 League of Nations Report. Furthermore, analogous to that report, the independent test is before the Dependent Agent test. Paragraph 4 provides that:

“When an enterprise of one of the contracting States regularly has business relations in the other State through an agent established there who is authorised to act on its behalf, it shall be deemed to have a permanent establishment in that State.”

This is identical to the 1933 Report and provides the same central criterion of authorisation to act of an enterprise’s behalf and regularly have business relations in the other State. The enterprise must have a fixed place of business and this place of business must have a productive character.⁴⁴ A list of deemed Dependent Agent PEs is provided:

- a. Accredited agent who habitually enters into contracts for the enterprise; or
- b. Is bound by an employment contract and habitually transacts business on behalf of the enterprise in return for remuneration from the enterprise;⁴⁵ or

⁴¹ Ibid, article V(1).

⁴² Ibid, page 7.

⁴³ Ibid, page 7.

⁴⁴ Ibid, article V(1).

⁴⁵ Where the rent of the agent is paid by the enterprise, this is evidence for an employment contract (paragraph 5).

c. Is habitually in possession, for the purpose of sale, of a depot or stock of goods belonging to the enterprise.

This is identical to the 1933 Report.⁴⁶ Each condition, however, must “correspond to a permanent state of things or a habitual practice”.⁴⁷ Thus, the requirement of a FOB remains.

Paragraph 6 provides a whole host of exceptions. A broker bringing buyer and seller together does not “in itself imply” the existence of a PE. It is not entirely clear what are criteria is relevant in that case. A commission agent who receives a normal rate of return does not constitute a PE even where goods are in a warehouse. Paragraph 7 also excludes a commercial traveller if they do not fall under the preceding paragraphs. Paragraph 8, a precursor to the current Article 5(7), provides that a subsidiary does not mean that a PE exists.

4.6. Success of the Model Conventions

The success of the Mexico and London Model Conventions was limited as countries adopted tax treaties that deviated from its contents. The PE definition created significant deviation.⁴⁸ Skaar attributes the reasons for the lack of influence to the fact that the League of Nations was a pioneer, the lack of homogenous group and lack of involvement of tax authorities.⁴⁹ However, for the PE article, the work of the League of Nations was important:

“In general, the principal of residence-state taxation was established throughout this period. The PE principle was also generally accepted among industrialized countries, both among countries influenced by civil law and by common law. Moreover, the conceptual structure of the basic rule, particularly the requirement of a fixed place of business, was established.”⁵⁰

The subsequent work on the OEEC/OECD will tear down the notion of fixed place of business for an Agency PE, which fundamentally widens the scope and changes the fundamental nature of the PE concept. But, at the same time, restrict the scope to binding-agents in a legalistic manner.

5. OEEC/OECD Period

The Organisation for European Economic Development (‘OEEC’, later known as the ‘OECD’) took up the torch of developing provisions to prevent international double taxation. This work was undertaken by the OEEC Fiscal Committee. This was initiated on 2 July 1954, where the Executive Committee of

⁴⁶ An extra condition is added at page 8: (d) Payment of the rent of the premises used by the agent and of his office expenses.

⁴⁷ Ibid.

⁴⁸ See OEEC Working Party no. I of the Fiscal Committee, *Final Report on the Concept of Permanent Establishment* (1957).

⁴⁹ Skaar, *Permanent Establishment*, 95.

⁵⁰ Ibid.

the International Chamber of Commerce adopted a resolution urging the Council of the OEEC to adopt tax treaties. On 16 March 1956, the Council established the Fiscal Committee to study questions concerning double taxation.⁵¹ The first subject was the PE concept.⁵² Working Party 1 was established to study permanent establishments.⁵³ The make-up of Working Party I proved critical to the current issues that arise around Agency PE.

5.1. Working Party Reports

5.1.1. 1st Report⁵⁴

The draft article contains many key changes from the London Model (1946). A general PE definition was used:

“The term “permanent establishment” means a fixed place of business in one of the territories in which the business of the enterprise is wholly or partly carried on.”⁵⁵

The complete separation of the Agency PE from the FOB PE is complete. The Dependent Agent paragraph is now before the independent agent paragraph.⁵⁶ The new language adopted for the Agency PE paragraphs such as “has and habitually exercise” were taken by some treaties concluded after the Second World War.⁵⁷ Paragraph 4 states:

“4. An agent acting in one of the territories on behalf of an enterprise of the other territory – other than an agent of an independent status to whom paragraph 5 applies – shall be deemed to be a permanent establishment in the first-mentioned territory if the agent:

(a) has and habitually exercises a general authority to negotiate and enter into contracts on behalf of the enterprise unless the agent’s activities are limited to the purchase of goods or merchandise; or

(b) habitually maintains in the first-mentioned territory a stock of goods or merchandise belonging to the enterprise from which he regularly delivers goods or merchandise on its behalf.

⁵¹ Resolution of the Council Creating a Fiscal Committee, C (56) 49 (Final), Paris, 19th March, 1956.

⁵² *Minutes of the first Session*, FC/M(56)1(Prov), 6 June 1956, at p. 2.

⁵³ *List of delegates to the Fiscal Committee*, TFD/DI/29 (23 May 1956), at p. 4.

⁵⁴ Fiscal Committee, Report of the Working Party No. 1 on the concept of permanent establishment, FC/WP1(56)1 Paris.

⁵⁵ *Ibid*, Appendix 1, paragraph 1.

⁵⁶ However, the independent agent is analysed first: See: Hans Pijl, ‘Agency Permanent Establishments: In the Name of and the Relationship between Article 5(5) and (6)- Part 2’, *Bulletin for International Taxation* 67, no. 2 (2013): 65.

⁵⁷ See Germany-Austria DTA (1954), Germany-UK DTA (1954), UK-Australia (1946), Australia-Canada (1946), UK-South Africa (1946).

An employee of the enterprise shall be deemed to be a permanent establishment of the enterprise if he also satisfies the further conditions of (a) and (b).

The dependent agent paragraph has been substantially modified compared to the Mexico & London Model Conventions. First, there are only two possible dependent agents in the new article, whereas, the Mexico & London Conventions provide for a general definition that captured a wide range of potential agents and includes three examples. The new article requires the agent acts on behalf of an enterprise and either is a binding-agent or a stock-holding agent (includes also an employee if both conditions are satisfied⁵⁸). Second, there is no requirement that the agent is “established” in the source state. The Commentary explicitly rules out the requirement for a fixed place of business:

“it seems necessary in conformity with the international practice hitherto followed to treat certain groups of agents as permanent establishments on account of the nature of their business activities, even though they may not have a “fixed place of business”⁵⁹

This is a serious deviation from previous treaty practice and reflects the evolving view of the PE concept.⁶⁰ The increase in cross-border activity and the reduced cost of transportation made conducting business without a “fixed place of business” easier. Some treaties concluded around this period also put in doubt the requirement for a “fixed place of business”.⁶¹ The binding agent is based on the “scope of the agent’s authority” and the stock-holding agent is based on “nature of agent’s business dealings”. Thus, the former category is based on a legal concept of authority and would require no real fixedness to the source state. The authority must be “general” and the agent must be able to adjust the terms and prices of contracts.⁶² The latter category is based on the economic activities of the agent and does not explicitly require any fixedness to the source state, however, stock-holding does require some physical goods, thus, there is a high degree of physical presence.

The independent Agent paragraph was also modified:

5. An enterprise in one of the territories shall not be deemed to have a permanent establishment in the other territory merely because it carries on business dealings in that other territory through a broker, general commission agent or any other agent of a generally independent status where such persons are acting in the ordinary course of their business as such.”

⁵⁸ However, the Commentary refers to either (a) or (b) being satisfied. Hence, there is some debate about whether both conditions are required or only either condition. See FC/WP1(56)1 Paris, Appendix 2, [9]-[12]

⁵⁹ FC/WP1(56)1 Paris, Appendix 2, [9].

⁶⁰ There is, however, some ambiguity. See: Richard Vann, ‘Tax Treaties: The Secret Agent’s Secrets’, *British Tax Review*, no. No. 3 (2006): 548.

⁶¹ For example, *United Kingdom/United States of America (1945)*.

⁶² *Ibid* [12].

An extra condition of “ordinary course of their business” is added.⁶³ Furthermore, independence is defined from both a legal and economic point of view”.⁶⁴ Thus, the working Party moved away from the London and Mexico Model Conventions and back further to the work on the League of Nations regarding the independent agent. Ultimately, the scope of the independent agent has been narrowed as the extra condition of “ordinary course of their business” removes the possibility of an otherwise independent agent who acts outside of their normal business.

5.1.2. 2nd Report⁶⁵

The 2nd Report made some minor changes. It added an “employee” to the first sentence, which resolves the confusion caused by the first Report requiring both binding-agent and stock-holding agent conditions to be satisfied, a debate was had about the need for the stock-holding agent. Despite calls by the French and Swiss delegates to eliminate the category, Working Party 1 retained the stock-holding agent category.⁶⁶

5.1.3. 3rd Report⁶⁷

The 3rd Report finally removes the stock-holding agent altogether. This removed an important category of potential PE-constituting agents and represents again a further narrowing in the scope of agency PE. Had the Working Party known about the future rise in online business structures, perhaps they would have not removed the stock-holding agent. Furthermore, the UN MC still maintains the stock-holding agent.⁶⁸ Additionally, “general authority” was replaced with “authority”.⁶⁹ The Report also confirms that the agent’s authority must be such that the enterprise is bound and not the agent.⁷⁰ The Commentary also provides a discussion about the agent’s authority to conclude contracts and enter into negotiations, and the removal of the stock-holding agent:

*“From the point of view of business activity it makes no difference whether the agent has the power to conclude a contract or **whether he has the authority to negotiate all the terms and details of a contract the formal signature of which subsequently takes place in the other country[...]** It should here be strongly emphasised that the agent who has no power to conclude contracts should only be deemed*

⁶³ UK Finance Act 1925.

⁶⁴ Ibid [10].

⁶⁵ Fiscal Committee, Report of the Working Party No. 1 on the concept of permanent establishment, FC/WP1(57)1 Paris, 7th January 1957.

⁶⁶ Ibid, para. 12(b).

⁶⁷ Fiscal Committee, Report of the Working Party No. 1 on the concept of permanent establishment, FC/WP1(57)2 Paris, 29th August 1957.

⁶⁸ UN MC, article 5(5)(b).

⁶⁹ See *Report on the concept of permanent establishment*, FC/WP1(57)2. p. 11, para. 9, last para. (29 Aug. 1957).

⁷⁰ Ibid, Appendix 2, [12].

*to be a permanent establishment when he has the **authority to carry on substantial negotiations on behalf of the enterprise**. The activities of a mere intermediary or the selecting of orders should not constitute a permanent establishment. In view of these considerations the Group now withdraws the proposal in paragraph 4(b) of the earlier draft which related to the agent with a stock of goods or merchandise. The new proposals which the Group now puts forward are based on the view that the real criterion is the nature of the authority entrusted to the agent.”⁷¹*

This paragraph presents a fascinating perspective on the nature of a dependent agent and the recent BEPS changes. The Committee views the entire contracting process and believes that an agent only need “authority to carry on substantial negotiations on behalf of the enterprise”. This is despite the wording on paragraph 4 which requires “negotiate and enter into contracts”, thus, mere negotiation would not be sufficient. Furthermore, the “mere intermediary or the selecting of orders” does not constitute a PE. Identifying the role that any agent plays in negotiating contracts is an arduous task for tax authorities. It is interesting to note how similar this perspective is in the new BEPS Agency PE.

5.1.4. Final Report (4th Report)⁷²

The fourth report replaces “an agent or employee” with “a person” “in order to make it clear that, irrespective of the function, the authority held was the criterion”.⁷³ There was an obvious difficulty in distinguishing between an agent and an employee. In any case, the change to “a person” represents only a minor widening of the scope as the authority condition was still necessary. There are no other notable changes.

5.1.5. Fiscal Committee’s Reports⁷⁴

The Fiscal Committee released several Reports on its activities combining the work of various working groups. The first draft report replaces the requirement of the agent to have an “authority to negotiate and enter into contracts on behalf of the enterprise” with “an authority to conclude contracts on behalf of the enterprise”.⁷⁵ The second draft report subsequently replaces “an authority to conclude contracts on behalf of the enterprise” with “an authority to conclude contracts in the name of the enterprise”.

⁷¹ Ibid.

⁷² Fiscal Committee, Report of the Working Party No. 1 on the concept of permanent establishment, FC/WP1(57)3 Paris, 12th November 1957.

⁷³ As cited by Pilj, p. 71, *Minutes of the 5th Session held at the Chateau de la Muette, Paris, on Tuesday 1st, Wednesday 2nd and Thursday 3rd October 1957*, FC/M/(57)3, p.4 (November. 1957).

⁷⁴ *Draft Report by the Fiscal Committee on its activities*, FC(58)2, Paris, 13th February 1958; *Draft Report by the Fiscal Committee on its activities*, FC(58)2rev1, Part I, Paris, 19th April 1958; *Report by the Fiscal Committee on its activities*, C(58)118, 28 May 1958.

⁷⁵ FC58(2), Annex 2, paragraph 4.

Two notable changes require comment. First, there is no requirement for “enter into contracts” has been removed. It is arguable that this removes a dependent agent PE where the agent carries on substantial negotiations. The previous Commentary is removed and contains a new statement:

“When the agent has sufficient authority to bind the enterprise by entering into contracts, the extent of the enterprise’s participation in the business activity of the other country is such that the agent should be deemed to be a permanent establishment.”⁷⁶

It is clear, therefore, that authority must exist to enter into contracts and not only the substantial negotiation of contracts. Second, “on behalf of” has been changed to “in the name of”. The change of language has caused widespread debate and is quite possibly the single most important event to occur with Agency PE. This is compounded by the fact that there is no commentary discussing the change.

Figure 1

	FC/WP1(56)1	FC/WP1(57)1	FC(58)2	FC(58)2rev1	C(58)118
Original language	English	English	French	French	French
English	on behalf of	on behalf of	on behalf of	in the name of	in the name of
French	pour le Compte de	au nom de	au nom de	au nom de	au nom de

There are a number of observations one can make. First, French version changed from “pour le Compte de” to “au nom de” without any change to the English version. The second last report switched from “on behalf of” to “in the name of”. The switch was made where the original language was French and then translated into English.

Luedicke and Jones have carefully examined this specific issue.⁷⁷ Luedicke and Jones had access to the UK National Archives and the Bundesarchiv, which recorded negotiations between the United Kingdom and Germany that ultimately resulted in the United-Kingdom-Germany Income and Capital Tax Treaty

⁷⁶ Report by the Fiscal Committee on its activities, FC(58)2 (1st Revision) Part II, Paris, 19th April 1958, [15].

⁷⁷ Luedicke and Avery Jones, ‘The Origins of Article 5(5) and 5(6) of the OECD Model’, 201–241.

(1954).⁷⁸ Representatives from both countries formed part of the Working Party 1. It appears there was confusion between the participating countries Mr Willis (United Kingdom) and Mr Mersmann (Germany). Jones and Avery skilfully illustrate how both Mr Willis and Mr Mersmann did not fully understand each other's law defining "agent" and the notion of "general authority". "This is not to be critical of him; anyone in his position would have done the same. But it shows the dangers of if your own legal system applies universally."⁷⁹ To compound the problem further, when "on behalf of" was changed to "in the name of", the British representative did not immediately notice this change.⁸⁰ The consequence, therefore, is that the British representative equated "on behalf of" as binding and either did not read the change to "in the name of" or did not notice the difference.

Pijl⁸¹ argues that both terms were interpreted as "bindingness":

"the terms appeared in an environment where they were traditionally understood as meaning the same, i.e. "binding""⁸²

Furthermore, the intended concept is "bindingness" and the terms "on behalf of", "in the name of" and "binding" were all mutually interchangeable by the drafters of the OECD MC.⁸³ Pijl also believes that the UK representative did not object as it was irrelevant and "in name of" meant "bindingness".⁸⁴ Further evidence for Pijl is gathered from the work of the UN in taxation issues. The Reports from the UN Group of Experts work on the UN Model between 1986 and 1990 illustrate a clear understanding of "on behalf of" and "in the name of" as referring equally to the concept of "bindingness" among the Group of Experts.⁸⁵ Further evidence to suggest "bindingness" is the UK's change to "in the name of" with their subsequent tax treaties.⁸⁶

⁷⁸ UK National Archives, file IR40/9629A and Bundesarchiv file B 126/6034 and 6035.

⁷⁹ Luedicke and Avery Jones, 'The Origins of Article 5(5) and 5(6) of the OECD Model', 218.

⁸⁰ Luedicke and Avery Jones, 222.

⁸¹ Pijl, 'Agency Permanent Establishments: In the Name of and the Relationship between Article 5(5) and (6)'.
⁸² Pijl, 10.

⁸³ Pijl, 18.

⁸⁴ Pijl, 18.

⁸⁵ Pijl, 'Agency Permanent Establishments: In the Name of and the Relationship Between Article 5(5) and (6)- Part 2', 73.

⁸⁶ Pijl, 77.

⁸⁶ See: UK tax treaties with *Germany (1964), Jamaica (1965), Canada (1966), Singapore (1966), Belgium (1967), the Netherlands (1967), France (1968)* (the Zimmer tax treaty), *South Africa (1968), Norway (1969), Trinidad and Tobago (1982), New Zealand (1983), Sweden (1983), China (People's Rep.) (1984), the Soviet Union (1985), Pakistan (1986), Turkey (1986), Belgium (1987), Bulgaria (1987), Italy (1988), Czechoslovakia (1990), Guyana (1992), Uganda (1992), Indonesia (1993), Malaysia (1996)* (in the earlier tax treaty "in the name of" was also used) and *Switzerland (1996)*.

5.1.6. Council Recommendation

On 11 July 1958, the Council adopted a final Recommendation.⁸⁷ There were several subsequent Reports and discussions relating to PE more generally.⁸⁸ A final report was adopted by the Council on 30 July 1963.⁸⁹ At no stage was the issue of “in the name of” discussed and there was little discussion worthy of comment in relation to Agency PE. Paragraphs 4 & 5 provide:

“4. A person acting in a Contracting State on behalf of an enterprise of the other Contracting State – other than an agent of an independent status to whom paragraph 5 applies – shall be deemed to be a permanent establishment in the first-mentioned State if he has, and habitually exercises in that State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business”

The binding agent is the only PE-constituting category which has survived from the previous PE-constituting categories. The Agency PE continues its gradual narrowing from its original inception of requiring simply agency or a permanent representative. There is also an exception for purchasing activities. Neither the text nor the commentaries refers to a “fixed place of business” or even a “place of business”. Some scholars have argued, therefore, that the “the OECD 1963 fulfils the elaboration of the “personal connection” of an agent as an alternative to the “location test” for the place of business.⁹⁰ The legal test of “concluding contracts” is the ultimate test, which represents a major victory of form over substance.

The 1963 OECD version is substantially similar to the pre-BEPS Agency PE, which is somewhat concerning. Despite the obvious technological advances in the later part of the 20th century, the Agency

⁸⁷ *Recommendation of the Council concerning the elimination of double taxation*, C(58) 118 (Final)(11 July 1958 (French))(15 July 1958(English)).

⁸⁸ Minutes of the 5th Session held at the Château de la Muette, Paris, on Tuesday 26th, Wednesday 27th, Thursday 28th and Friday 29th June, 1962, FC/M(62)4 Part I, p. 5.; at the Château de la Muette, Paris, on Tuesday 14th, Wednesday 15th, Thursday 16th and Friday 17th May, 1963, Minutes of 24 June 1963, FC/M(63)4, pp. 3 and 4.; Draft Report to the Council on the draft Convention for the avoidance of double taxation with respect to taxes on income and capital between the member countries of the O.E.C.D, FC(63)4-Part I (1st Revision) (13 June 1963).; Report to the Council on the draft Convention for the avoidance of double taxation with respect to taxes on income and capital between the member countries of the O.E.C.D, C(63)87 Part I (6 July 1963).

⁸⁹ C(63)113 .

⁹⁰ Skaar, *Permanent Establishment*, 97.

PE changed very little. One could speculate that the lack of action has culminated in the major changes made by the BEPS project.

5.1.7. 1966-1977

There are several Reports discussing Agency PE which culminated in the updated 1977 OECD MC version.

5.1.7.1. Preliminary Report⁹¹

There are some notable comments. The German delegation puts forward an interesting question regarding the interaction between dependent and independent agent, namely:

“Is an independent agent who has an authority regularly to conclude contracts in the name of another enterprise to be regarded as a PE?”⁹²

The Working Party provides a negative and a positive answer. The positive answer can be given because an authorized agent normally must follow the instructions of the enterprise he represents and therefore cannot be fully independent from an economic perspective.⁹³ This answer would suggest that a dependent agent can never satisfy the independent agent criteria, hence, there would be a wide scope for an Agency PE. The question remains whether an agent who does not meet both dependent and independent tests, could be regarded as creating an Agency PE? This theory is explored later in section 4.3.4.⁹⁴ The negative answer can also be given because as paragraph 4 expressly provides that it does not apply to the fully independent agents and, therefore, fully independent agents would not constitute a PE.⁹⁵ The Working Party is “inclined to believe” the negative answer in order to facilitate international economic relations if the agent is independent from an economic and legal perspective.⁹⁶ Thus, the Working Party is suggesting that an Agency PE can only be created if a dependent agent is created who does not fulfil the independent agent criteria. Furthermore, an agent is dependent if the agent “is required to obtain the approval of the enterprise for each transaction, if his operations as a whole are supervised or if he is subject to other additional controls.”⁹⁷ Hence, the test for independence focuses heavily on the control of the enterprise over the agent.

⁹¹ Preliminary Report on the question in connection with the definition in article 5 of the term “permanent establishment”, FC/WP1(70)1 (17 Aug. 1970).

⁹² Preliminary Report, p. 22.

⁹³ Ibid.

⁹⁴ S.I. Roberts, ‘The Agency Element of Permanent Establishment: The OECD Commentaries from the Civil Law View (Part One)’, *Intertax* 21, no. 9 (1993).

⁹⁵ *Preliminary Report*, p. 22.

⁹⁶ Ibid., p. 23.

⁹⁷ Ibid.

The negative answer is confirmed in the second report.⁹⁸ A PE can only be constituted where the agent is not independent and satisfies the criteria for a dependent agent.⁹⁹ The subsequent revised report provides some notable changes.¹⁰⁰ The exclusion for “activities limited to the purchase of goods or merchandise” is extended to also include “the collection of information”.¹⁰¹ Furthermore, the scope of taxable activities is widened to include exempted activities.¹⁰² Thus, once the dependent agent criteria are met, all activities performed by that agent belong to the PE.

Several subsequent discussions occurred relating to the revised report.¹⁰³ First, the agent is not the PE, but rather that the enterprise is deemed to have a PE.¹⁰⁴ Second, the exclusion for certain activities is again widened to include all activities performed under paragraph 3.¹⁰⁵ Thus, the dependent agent scope is again narrowed.

5.1.7.2. 1977 OECD MC

The reports all culminated in the 1977 OECD MC, which contained a Commentary. This represents the first published Model Tax Convention as the 1963 version was a draft report. If one takes a comparison to the 1963 version, the agency clause included modifications, however, the substantive meaning was not materially altered:

*“5. **Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.***

⁹⁸ Second Report by Working Group No. 1 on potential amendments to article 5 and to the Commentaries thereon, DAF/CFA/2697 (18 May 1973).

⁹⁹ Ibid., p. 26.

¹⁰⁰ Revised Report on article 5, CFA/WP1(74)6 (30 Aug. 1974).

¹⁰¹ Ibid., p. 4.

¹⁰² Ibid., p. 23.

¹⁰³ Summary of discussions on 8-10 October 1974, Summary of 21 November 1974, DAF/CFA/WP1/74.18; The commentary on article 5-1 and 5-2. Summary of discussions on 17-20 December 1974, Summary of 29 January 1975, DAF/CFA/WP1/75.2; Summary of discussions on 4-7 March 1975, Summary of 26 March 1975. DAF/CFA/WP1/75.8. See also the note on the 15th meeting on 4 to 7 March 1975, Note of 13 March 1975, DAF/CFA/WP1/75.7.

¹⁰⁴ DAF/CFA/WP1/75.7, p.9.

¹⁰⁵ DAF/CFA/WP1/75.8, p. 9.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.”

Paragraph 5 now includes “notwithstanding the provisions of paragraphs 1 & 2”. It is explicit that an Agency PE can still arise where a FOB PE does not arise. Therefore, the analysis of article 5 is clear. One must first analyse whether a FOB PE exists before an agency PE analysis can be conducted. Furthermore, paragraph 5 now refers to activities limited to activities explicitly mentioned in paragraph 4, which had previously only excluded the “purchase of goods or merchandise for the enterprise”. Thus, the exception was widened. As a result, the agency concept was again narrowed. On the other hand, all activities performed by the agent are attributed to the PE. Thus, a potentially wider amount of business income can be taxed by the source state.

6. UN MC Agency PE

While the OECD is the primary authority for the drafting of tax treaty provisions, the UN is perhaps the second most important authority. The OECD membership consists mainly of wealthy developed nations who favour stronger residence taxing rights. However, the UN membership consists of nearly every recognised nation in the world. Thus, there is a more diverse membership, which generally advocate for a stronger source taxing rights. Against the backdrop of the work by the OECD favouring the residence taxing rights:

“the Secretary-General of the UN set up an Ad Hoc Group of Experts on tax treaties in 1968. The Group was composed of tax officials from a number of developed and developing countries, and later increased with observers from several other countries and international organizations.”¹⁰⁶

This was the catalyst for work on tax treaties. The Group of Experts produced guidelines in 1974 for the negotiation of bilateral tax treaties between developed and developing countries.¹⁰⁷ In 1980 the Group produced a MC¹⁰⁸ with commentaries as an alternative to the OECD MC. The Agency PE under the UN MC is broader than the OECD MC in several aspects. First, an Agency PE can arise where the agent maintains a “stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise”¹⁰⁹ i.e. the stock-holding agent. Second, an Agency PE can arise where an enterprise “collects premiums in the territory of that other State or insures risks

¹⁰⁶ Skaar, Permanent Establishment, 99.

¹⁰⁷ UN Manual 1974.

¹⁰⁸ UN Model Tax Convention on Income and on Capital (UN 1980).

¹⁰⁹ Article 5(5)(b).

situated therein through a person other than an agent of an independent status”.¹¹⁰ As insurance agents generally do not have the authority to conclude contracts, under the OECD MC, there would be no Dependent Agent. Both provide greater source taxing rights and act as proxies for economic penetration. The UN Agency PE is contrary to the gradual narrowing of Agency PE and enables developing countries to gain greater source taxing rights.

7. 1994 OECD Commentary change

In 1992, a UK tax tribunal interpreted “in the name of” under article 5(5) literally, thus, an agent who concludes contracts literally in the name of the enterprise, could be regarded as constituting an Agency PE. This was contrary with the common law understanding of the term “in the name of”, which had been understood as “bindingness”. In response, the subsequent changes to the OECD Commentary were:¹¹¹

“Also, the phrase “authority to conclude contracts in the name of the enterprise” does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise.”

This confirmed the general understanding of “in the name of” as “bindingness”. “In the name of” is an agency civil law concept, which undoubtedly is confusing for any common law court, and the court case is not entirely surprising. However, the subsequent change to the Commentary and the response from other common law countries illustrate that “bindingness” is the test.¹¹²

8. Modern Period

Since 1992, the OECD Fiscal Committee has undertaken a policy of periodic updating of the 1977 MC. The text of article 5 has not changed, however, the commentary to article 5 has changed significantly. There have also been several reports from the Fiscal Committee discussing various issues such as software, e-commerce, container leasing and transfer pricing.

¹¹⁰ Article 5(6).

¹¹¹ Recommendation of the Council, adopted by the Council on 31 March 1994, C(94)11/FINAL (13 July 1994), Now contained in: Commentary on article 5, para. 32.1.

¹¹² See: Comments from Australia, DAFFE/CFA/WP1(93)3/REV1/ADD2, p. 2. (1 Sept. 1993) ; Summary Record of the 56th meeting of Working Party No. 1 (held on 7 and 8 September 1993), DAFFE/CFA/WP1/M(93)2, p. 6 (9 Nov. 1993); Report of the Committee on Fiscal Affairs, DAFFE/CFA(94)11 (25 Jan. 1994).

8.1. Reports

A 2002 OECD Report¹¹³ discussed several important PE topics which lead to changes to the OECD MC in 2003.¹¹⁴ In relation to Agency PE, there are several notable additions to the Commentary based on certain issues discussed.

The requirement of a “fixed base of business” is explicitly stated as not necessary.¹¹⁵ This is most likely simply a statement of already had views given the previous reports.¹¹⁶ It was suggested that “conclude” be extended to “substantially negotiate or conclude”.¹¹⁷ There were fears that contracts negotiated in State A and only concluded in State B would not create a PE in State A. This point is particularly difficult as the results may differ depending on the commercial laws of the source state. For example, an agent may negotiate contracts and the foreign enterprise only “rubber-stamps” the contracts. State A may treat that as binding the principal (implied authority), while State B may treat that as not binding the principal. A new part is added to the Commentary:

“Lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions.”¹¹⁸

It is questionable whether the paragraph introduces a new test for “authority” replacing the commercial legal test under domestic law or it simply an expression of a position in certain countries. The new part follows directly the Commentary which outlines that an “authority” also covers contracts “binding” on the enterprise, not only literal contracts. Thus, it appears to be merely an example of the underlying concept of “binding”.

The Report also suggests dealing with certain abusive situations with “the application of normal domestic anti-avoidance mechanisms.”¹¹⁹ This is certainly an interesting idea as such mechanisms are

¹¹³ OECD, Issues in Taxation: 2002 Reports Related to the OECD Model Tax Convention, (No. 8).

¹¹⁴ 28 January 2003.

¹¹⁵ OECD MC, Commentary to Article 5, para. 32: “Such persons may be either individuals or companies and need not be residents of, nor have a place of business in, the State in which they act for the enterprise.”

¹¹⁶ See section 2.5.1.

¹¹⁷ Issues in Taxation, para. [107].

¹¹⁸ OECD MC, Commentary to Article 5, para. 32.1.

¹¹⁹ Issues in Taxation, para. [113].

seldom used in PE cases. The Committee held that exclusive agency is not decisive in determining independence.¹²⁰ The following sentence is added to the Commentary:

*“Independent status is less likely if the activities of the agent are performed wholly or almost wholly on behalf of only one enterprise over the lifetime of the business or a long period of time. However, this fact is not by itself determinative.”*¹²¹

This is an important statement especially for subsidiaries that are likely to only work for the parent company. The overall question is instead “whether the agent’s activities constitute an autonomous business conducted by an agent who bears risk and receives reward using his entrepreneurial skills and knowledge.”¹²² The problem of performing activities for one enterprise will dominate the BEPS discussion around independence.

The Committee also added that the test of “ordinary course of business” must be examined based on “the business activities customarily carried out within the agent’s trade as a broker, commission agent or other independent agent rather than the other business activities carried out by that agent”.¹²³ There had been some debate about the appropriateness of using the agent’s own business or the trade of the industry as the correct comparison tool.

A 2004 Public Discussion Draft¹²⁴ made one change to the Commentary which was added in the 2005 MC update. It specifically adds (changes in bold):

*“A person who is authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority “in that State”, even if the contract is signed by another person in the State in which the enterprise is situated **or if the agent has not formally been given a power of representation. The mere fact, however, that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has exercised in that State an authority to conclude contracts in the name of the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise.**”*¹²⁵

A Discussion Draft in 12 October 2011 proposed many significant changes to the Commentary of article 5 including: commissionaires, toll manufacturing, secondments, and attributed PE issues relating to

¹²⁰ Issues in Taxation, para. [128].

¹²¹ OECD MC, Commentary to article 5, para. 38.6.

¹²² Issues in Taxation, para. [129].

¹²³ OECD MC, Commentary to article 5, para. 38.8.

¹²⁴ PROPOSED CLARIFICATION OF THE PERMANENT ESTABLISHMENT DEFINITION, Public discussion Draft, 12 April 2004.

¹²⁵ OECD MC, Commentary to article 5, para. [33].

non-resident Enterprises' (NRE) use of independent contracts.¹²⁶ Item 19 considered the meaning of the phrase “to conclude contracts in the name of the enterprise” and para 32.1 of the Commentary in relation to undisclosed principals. Item 20 discussed whether paragraph 5 is limited to situations where sales of goods are concluded and paragraph 33 of the Commentary. It suggested it could also cover contracts of leasing or contracts for services. Item 21 asked whether paragraph 6 applied only to agents who do not conclude contracts in the name of their principal. It made no recommendations as it was concluded that such a question cannot be solved via Commentary changes.

After comments from various groups, the OECD Working Party released a revised Discussion Draft on 19 October 2012,¹²⁷ which backed down on the significant proposals. One prominent scholar aptly commented that “these three discussions in the Revised Proposals might, perhaps, be characterized as a discussion about moving the deckchairs around on the Titanic.”¹²⁸

Finally, the OECD published in July 2013 a report entitled “An Action Plan on Base Erosion and Profit Shifting”¹²⁹, which outlines 15 Action Plans dealing with various perceived problems of the modern international tax system. The subsequent reports culminate in the final report widening the scope of the agency PE to include persons playing “a principal role”, including economic bindingness and narrowing the independent agent scope.¹³⁰

9. Summary

The Agency PE provision has evolved considerably since its origins in the mid-19th century and much like the natural process of evolution, it is evolved into a more technical and specialised provision. Since the inception of an Agency PE, there has been a general trend to narrow its scope considerably. The Agency PE has been developed in tandem with the general PE definition. However, this evolution has slowed considerably since the OECD MC 1963 Draft. Despite the change to cross-border trade caused by globalisation, the Agency PE has not changed.

The early concept of Agency PE was developed by Germany and was simply a “permanent representative, manager or partner” in a list of possible PEs, thus, covering a wide range of possible PE-constituting agents. The Agency PE was inherently linked to a FOB PE. Germany later created the general PE definition which also included the early concept of an agency PE. The various tax treaties concluded between countries were divergent in their PE articles and no real consensus can be seen.

¹²⁶ See <http://www.oecd.org/ctp/treaties/48836726.pdf>.

¹²⁷ <http://www.oecd.org/ctp/treaties/PermanentEstablishment.pdf>.

¹²⁸ Baker, *Dependent Agent Permanent Establishments: Recent OECD Trends*, in Michael Lang et al., eds., *Dependent Agents as Permanent Establishments*, 1. Aufl. (Wien: Linde, 2014), 27.

¹²⁹ <https://www.oecd.org/ctp/BEPSActionPlan.pdf>.

¹³⁰ This is discussed in greater detail in part D.

The League of Nations developed the concept further and provided some form of convergence with various PE-constituting activities. The scope was potentially limitless under their Draft Reports. The League of Nations used only a list of PE examples, rather than a general PE definition. The PE-constituting agents were: activity agent, rental agent, binding agent, employee agent and stock-holding agent. During this time, the important independent agent exception was introduced in response to UK domestic law. The Mexico and London Model Conventions represent the first significant attempt to provide a Model Treaty for countries. Despite the work of the LON, there were still treaties concluded after WW2 that differed from the LON Model Drafts.

The OEEC, and later the OECD, provided the most extensive work on the Agency PE and ultimately developed the Agency PE that exists today. The OECD was able to provide a greater measure of convergence never seen until then. It narrowed Agency PE considerably by including only the “binding agent”. Furthermore, it changed from the broader concept of “on behalf of” to the restrictive concept of “in the name of”, however, the underlying understanding of the term was legal “bindingness”. Additionally, the requirement of a “fixed business” is arguably removed, which was a huge deviation from the traditional understanding of a PE. The OECD MC 1977 update subsequently broadened the exception to Agency PE by expanding from mere purchasing activities to all activities covered under paragraph 4 of article 5. The UN MC was developed in 1980 as an alternative to the OECD MC and contains a broader DAPE concept. It includes also the “stock-holding agent” and the “insurance agent”. The modern work of the OECD has seen an attempt to broaden the DAPE, however, all attempts have ultimately failed until the recent BEPS project.

It is clear the pendulum of change currently swings towards a broadened Agency PE. The attempts to broaden the Agency PE in the last decades have occurred mostly in the commentaries and various reports, which have done little to substantially alter paragraphs 5 & 6 of the OECD MC. The BEPS Project has given the OECD the window of opportunity to broaden the scope. This paper reveals how the concept has been slowly narrowed and the recent attempts to broaden its scope is a reversal of the general historical trend.