International Association of Tax Judges

Agency permanent establishment – general information

Hans Pijl

Agenda of the commissionaire session (9-12.30)

- 9.00-10.30 Presentations Hans Pijl, Philippe Martin, Clement Endresen, Manuel Garzon
- 10.30 -10.45 Health break
- 10.45-12.15 Discussion

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Recent case law

- Zimmer case:
  - France
  - *Conseil d'État* (Supreme Court) 2010
- Dell case:
  - Norway
  - *Høgsterett* (Supreme Court) 2 December 2011
- DSM Case (also called: Roche case)
  - Spain
  - *Tribunal Supremo* (Supreme Court) 12 January 2012
- Boston Scientific
  - Italy
  - *Corte Suprema* (Supreme Court) 9 March 2012

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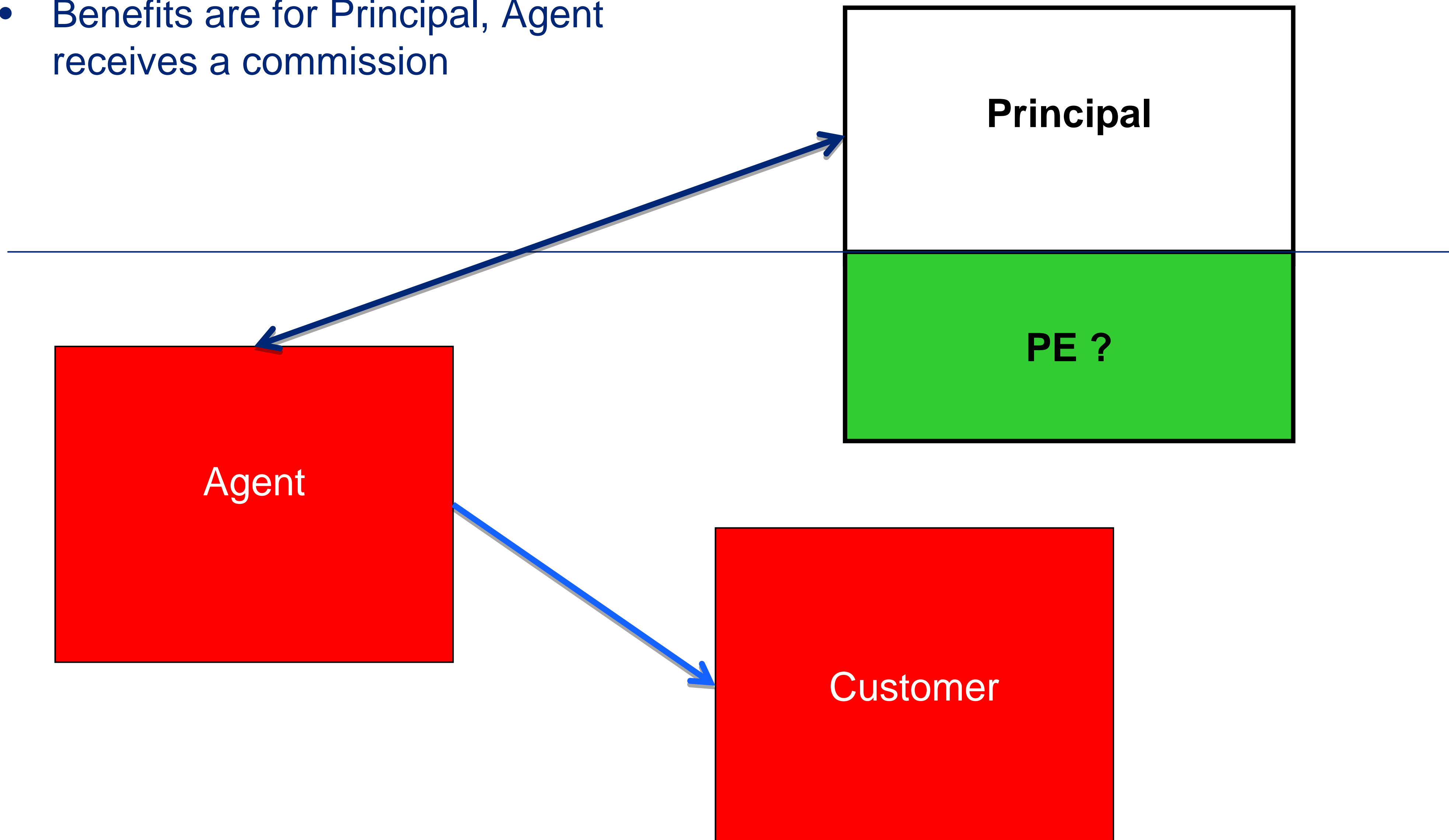
Agent may constitute a PE for Principal

- Agent sells Principal's products
- Benefits are for Principal, Agent receives a commission



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Art. 5-5 and 5-6 OECD MC 1977-2010

5. ... where a person -other than an agent of an independent status to whom paragraph 6 applies- is acting on behalf of an enterprise and ... habitually exercises ... an authority to conclude contracts **in the name** of the enterprise, that enterprise shall be deemed to have a permanent establishment...
6. An enterprise shall not be deemed to have a permanent establishment ... merely because it carries on business in that State through ...an agent of **an independent status**, provided that such persons are **acting in the ordinary course of their business**.”

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The issues

- The “in the name/binding” issue
- The relationship issue (between article 5-5 and 5-6)

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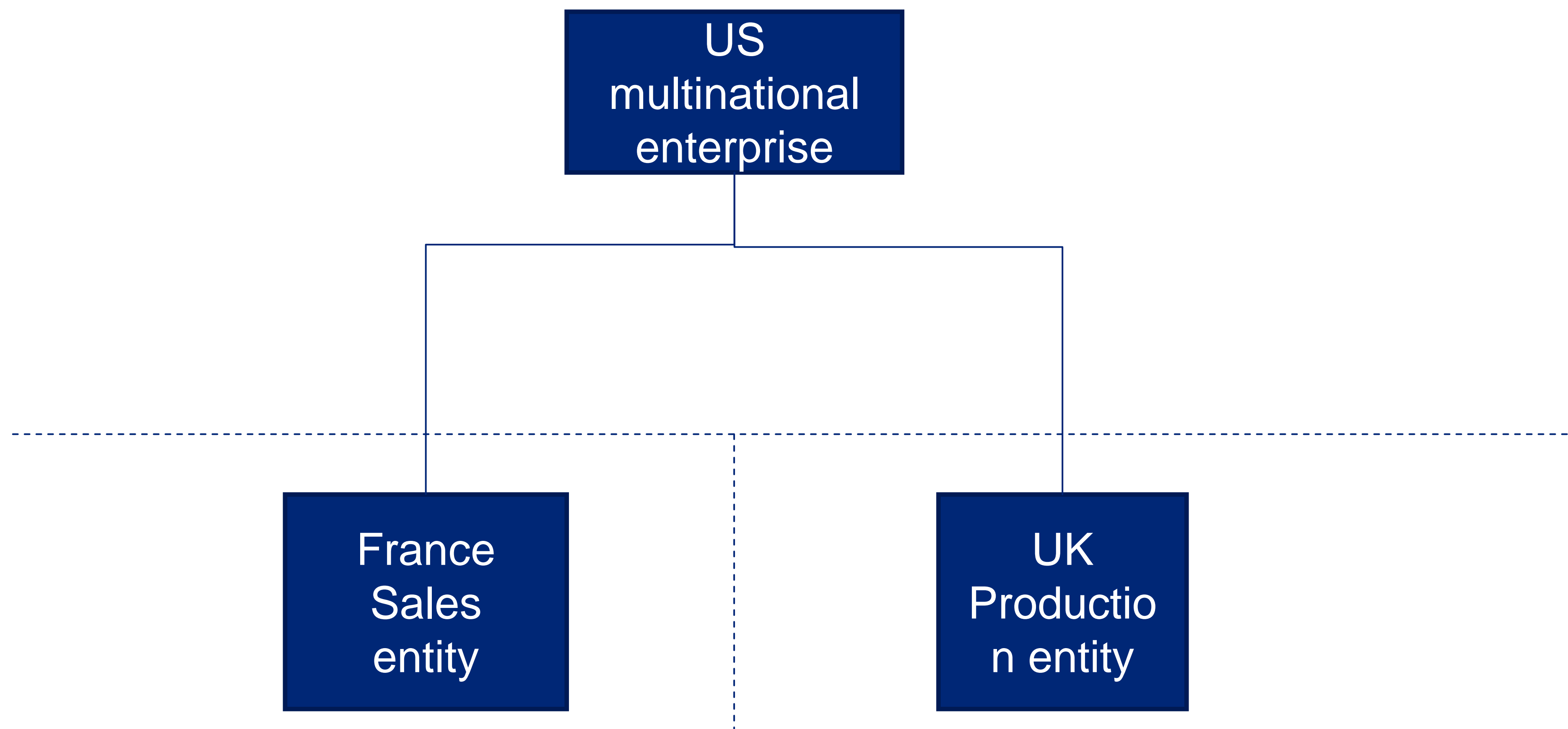
Typical pre-1990 function allocation in multinational groups



- Entities are so-called “fully fledged” sales and production entities:
  - They take the risks relating to sales and production
  - Transfer pricing rules: operating profits relatively high

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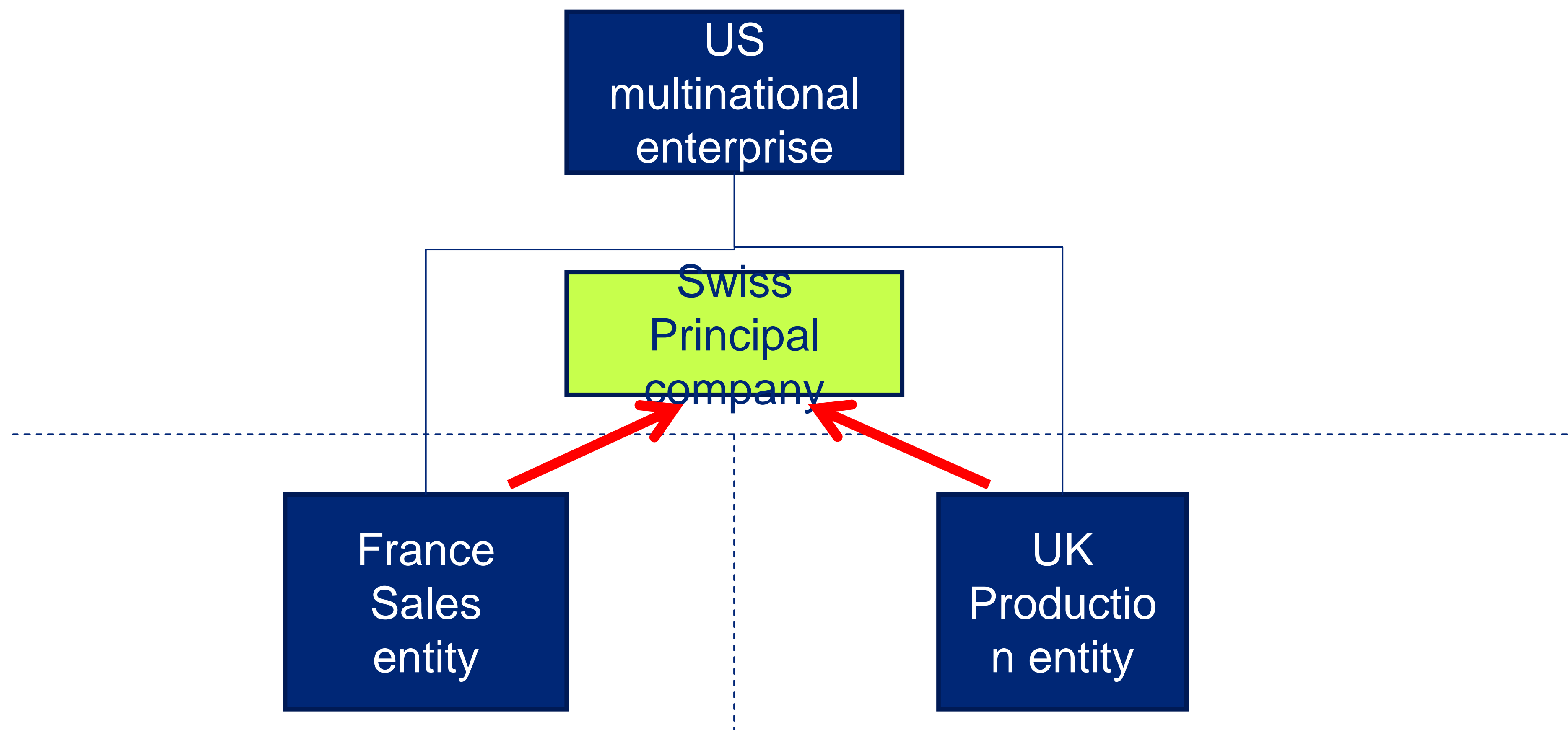
Typical post-1990 functions (after a “business re-organisation”)



- The entities turn themselves into “stripped” sales and production entities
  - They transfer their risks to a low taxed Principal by shifting the functions that manage those risks
  - Transfer pricing rules: profits substantially lower

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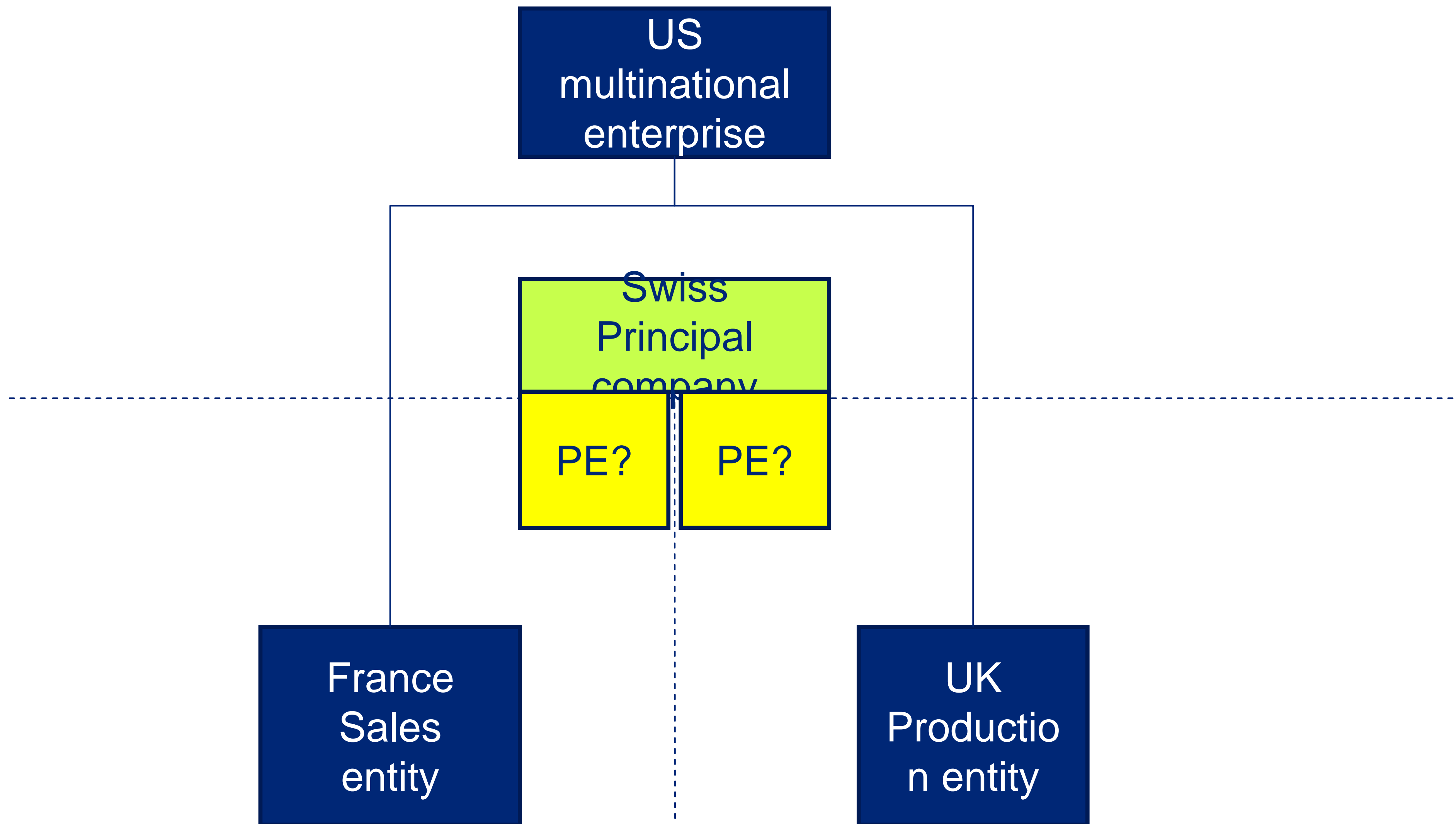
A PE of the Swiss Principal in France or the UK?



"... an authority to conclude contracts **in the name** of the enterprise ..."

Is a place of business at the Swiss Principal's disposal?

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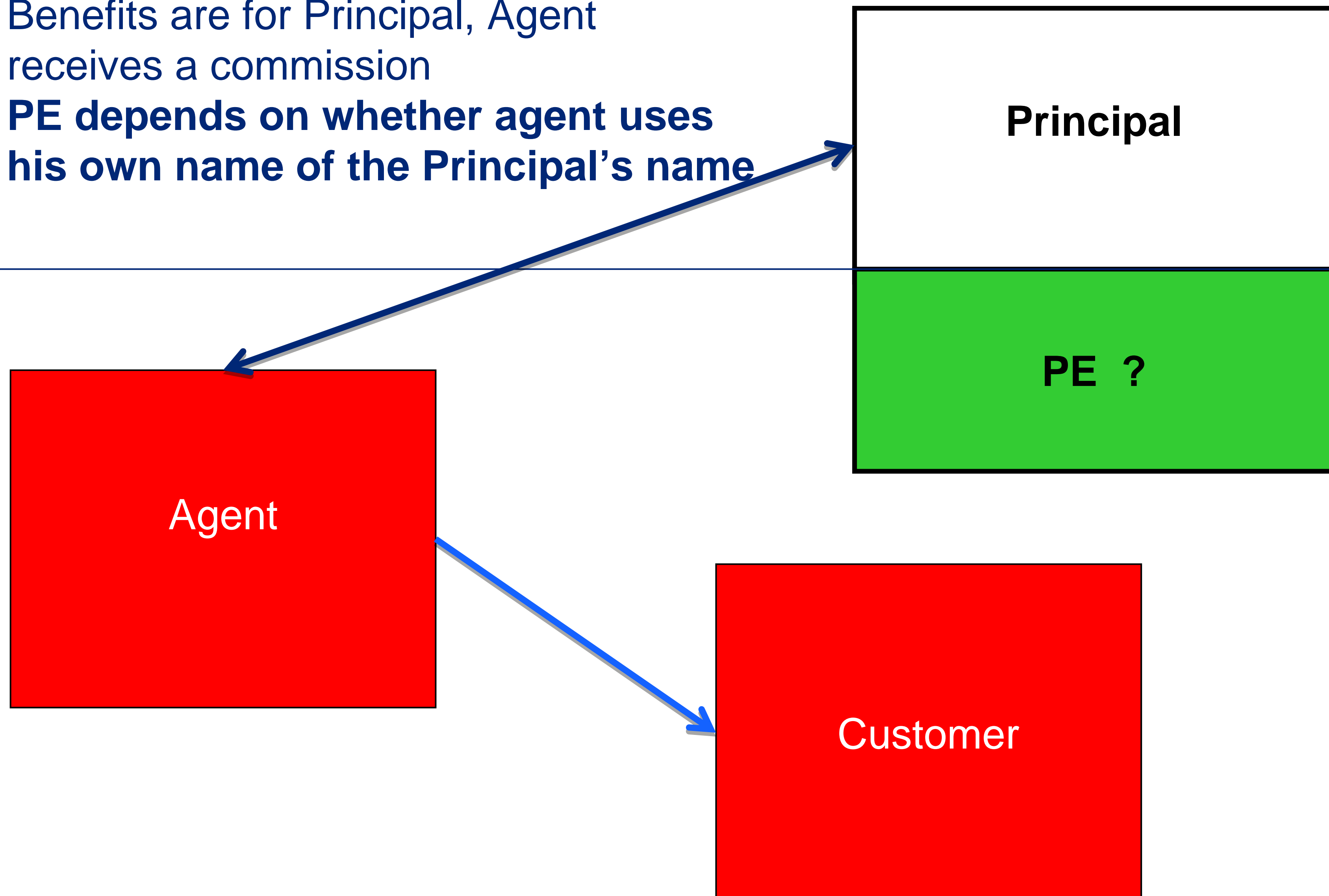
Agent may constitute a PE for Principal

- Agent sells Principal's products
- Benefits are for Principal, Agent receives a commission
- **PE depends on whether agent uses his own name of the Principal's name**



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The
“in the name/binding”
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The Commentary of 1994

"... 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** ..."

(Now paragraph 32.1 Commentary (2010) Article 5)

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The terms “on behalf of”, “in the name of”, “binding” in the Report of the League of Nations (1929)

- “duly accredited agent (*fondé de pouvoir*), who habitually enters into contracts on behalf of the enterprise for which he works”
- “a criterion of a legal nature, it being considered that the only agents dependent on an enterprise are those having sufficient powers to conclude contracts binding upon that enterprise”
- “It is important to distinguish the agent who constitutes a permanent establishment from the commission agent (*commissionnaire*) who acts in his own name and not in that of the party for whose account he acts. The commission agent is, under the law of many countries, an independent person in business for himself and is responsible to persons buying from him the products which the real vendor has shipped to him to sell.”
- The commission agent (*commissionnaire*) in this sense is not to be confused with the so-called commission agent (*agent à la commission*) who has a stock of goods belonging to a foreign enterprise on consignment and makes retail sales out of it continuously for the account of the foreign enterprise.
- Such a “commission agent” usually acts expressly, if not in fact, for the foreign enterprise, inasmuch as the contract of sale or invoice usually bears the name of the foreign enterprise and the agent usually signs on its behalf

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“For” and “binding” in the Mexico (1943) and London (1946) Model Conventions

- “... Is a duly accredited agent (fondé de pouvoir) and habitually enters into contracts for the enterprise for which he works” (Article V-4, sub A)
- Inofficial Commentary to the M/L Model Conventions: article V-4, sub A expresses the “[p]ower of the local agent to bind the enterprise”

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“Binding”, “on behalf of”, “in the name of”: of a different kind, but saying the same

- “Binding”: the true criterion, the principle behind the agency PE
- “On behalf of”: the term expressing that in the treaty
- “in the name of” : how that effect is reached

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Same in the United Nations (Reports Committee of Experts 1969-1979)

- “Although there was agreement that all those terms were intended to describe the conditions under which the principal would be legally bound by the acts of the agent, there was a difference of opinion as to which of those formulations was best suited to accomplish this purpose. Some members expressed concern whether the phrase " in the name of “ in the OECD Draft Convention required the agent to name his principal or whether the OECD Draft Convention extended to contracts signed by an agent, but which bound the principal. On the other hand, there was considerable uncertainty whether transactions carried out by the agent "on behalf of" the principal would establish legal liability of the principal. Some members from developing countries expressed themselves in favour of retaining the words "on behalf of because of their traditional use.”

(2nd Report 1970)

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The commissionaire's principled inability to constitute a PE (League of Nations Report (1929))

- "This concept [the fundamental principle, HP] excludes: (1) Casual or even frequent transactions through a broker, because such an intermediary merely brings the parties together; (2) Sales through a commission agent who acts in his own name for any number of parties; (3) …."

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OEEC: “on behalf of” (1956-1958)

- WP1 for the drafting of the PE article: Germany (Klaus Vogel) and UK
- English was WP1’s working language (“Or. Eng.” and “Or. Angl.”)
- WP1 and the Fiscal Committee Reports 1956- February 1958 used “on behalf of”, e.g. from the first Report (17 September 1956):

“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 activates 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.”

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OEEC: “pour le compte de” and “au nom de” (1956-1958)

- 1st Report 17 September 1956: “pour le compte de
- 2nd Report 5 January1957 and following: “au nom de”

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The swap of “Or. Angl.” to “Or. Fr.”

- Draft Fiscal Committee Report to the Council (“Or. Fr.”) 13 February 1958: “au nom de” (English still “on behalf of”)
- Note of 25 February 1958 Chairman Drafting Group: change “au nom de” into “pour le compte de”
- **Revised Fiscal Committee Report to the Council (Or. Fr.) 19 April 1958 : “au nom de” (English “in the name of”)**
- Report to the Council 28 May 1958: “au nom de”/”in the name of”
- Council Recommendation 11 July 1958: “au nom de”/“in the name of”

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Conclusion

- It was never intended to give “in the name of” a formal meaning
- “In the name of” was just another expression for “binding”
- The explantion given to “binding” in the Commentaries 1994 matches to what “in the name of” is intended to mean

- Article 31-4 VC: “A special meaning shall be given to a term if it is established that the parties so intended.”

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Interpreting “binding” as a legal concept

- “a criterion of a legal nature, it being considered that the only agents dependent on an enterprise are those having sufficient powers to conclude contracts binding upon that enterprise” (League of Nations Report 1929)
- “Although there was agreement that all those terms were intended to describe the conditions under which the principal would be legally bound by the acts of the agent, ...”(Group of Experts 2nd Report 1979)
- The context of the introduction of “binding” in 1992 (i.e. that the UK saw a principal legally bound)
- “Binding” elsewhere in the OECD context: art 25-5 MC, par. 21 Introduction

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“Binding” as a factual/commercial concept

- Perhaps best to understand as a something from which the principal cannot wihdraw from without a negative effect on its commercial interests

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OECD PE Discusion Draft avoids the answer with *for example*

"... 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 ... ***For example*, in some countries an enterprise would be bound, in certain cases, by a contract concluded with a third party by a person acting on behalf of the enterprise even if the person did not formally disclose that it was acting for the enterprise and the name of the enterprise was not referred to in the contract."**

(Proposed addition to par. 32.1 Commentary to Article 5)

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Status of the OECD PE Discussion Draft

- PE Discussion Draft October 2011: 25 proposed additions and changes in Commentary, 2 of them on agency PE
- Commentaries
  - http://www.oecd.org/tax/taxtreaties/49668097.pdf
- WP1 meeting 5 and 6 September 2012, preliminary changes made (but not in agency)
- Public Hearing on 7 September 2012
- WP1 meeting in February 2013
- Revised Discussion Draft expected early 2013
- ...
- Update Commentary 2014

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The "relationship" issue

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Three ways how to look at the relationship of article 5-5 and 5-6

- The exclusion-determination system
- The main rule-exception system
- The independent rules system

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Exclusion-determination system

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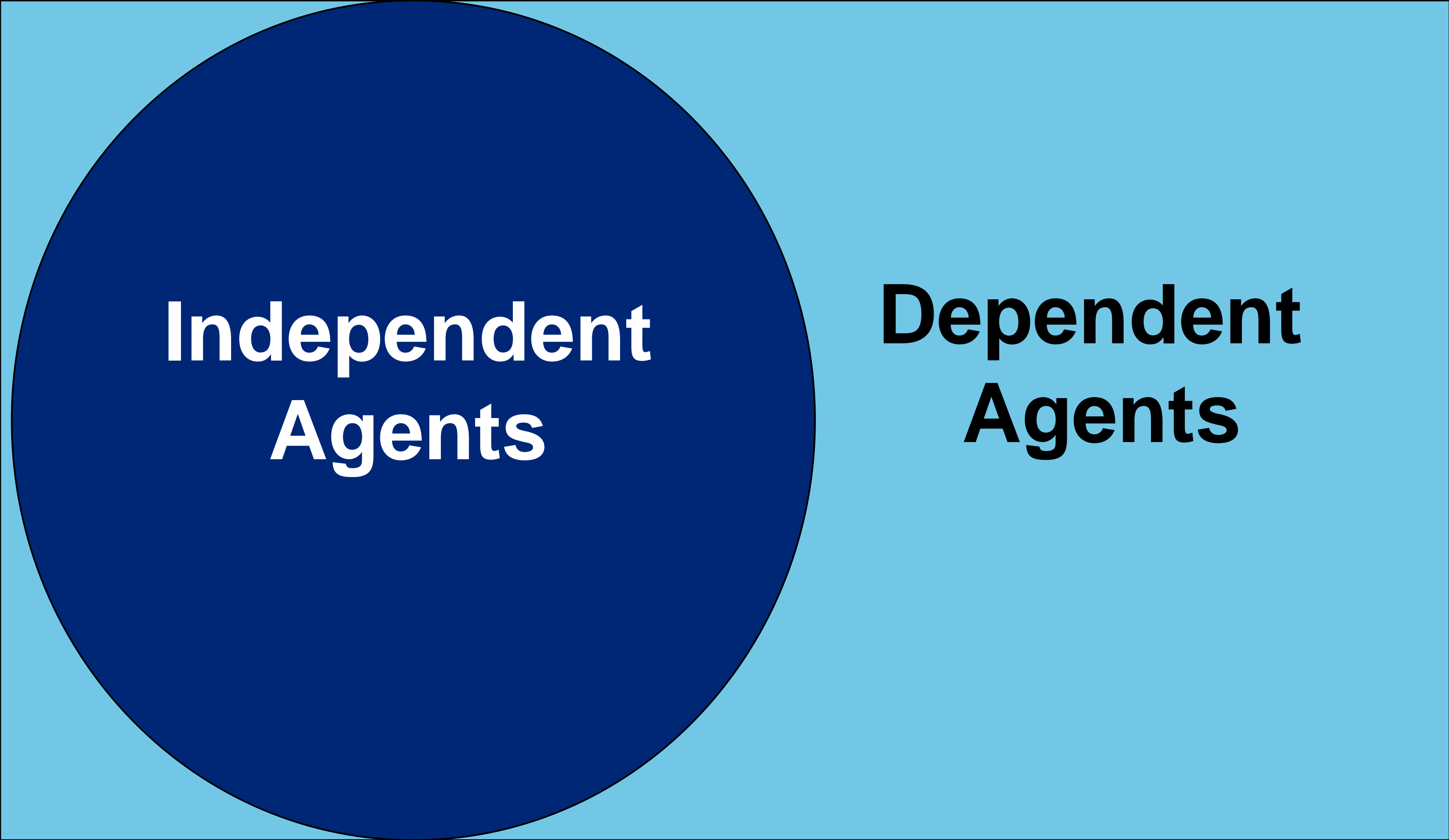
Exclusion-determination system



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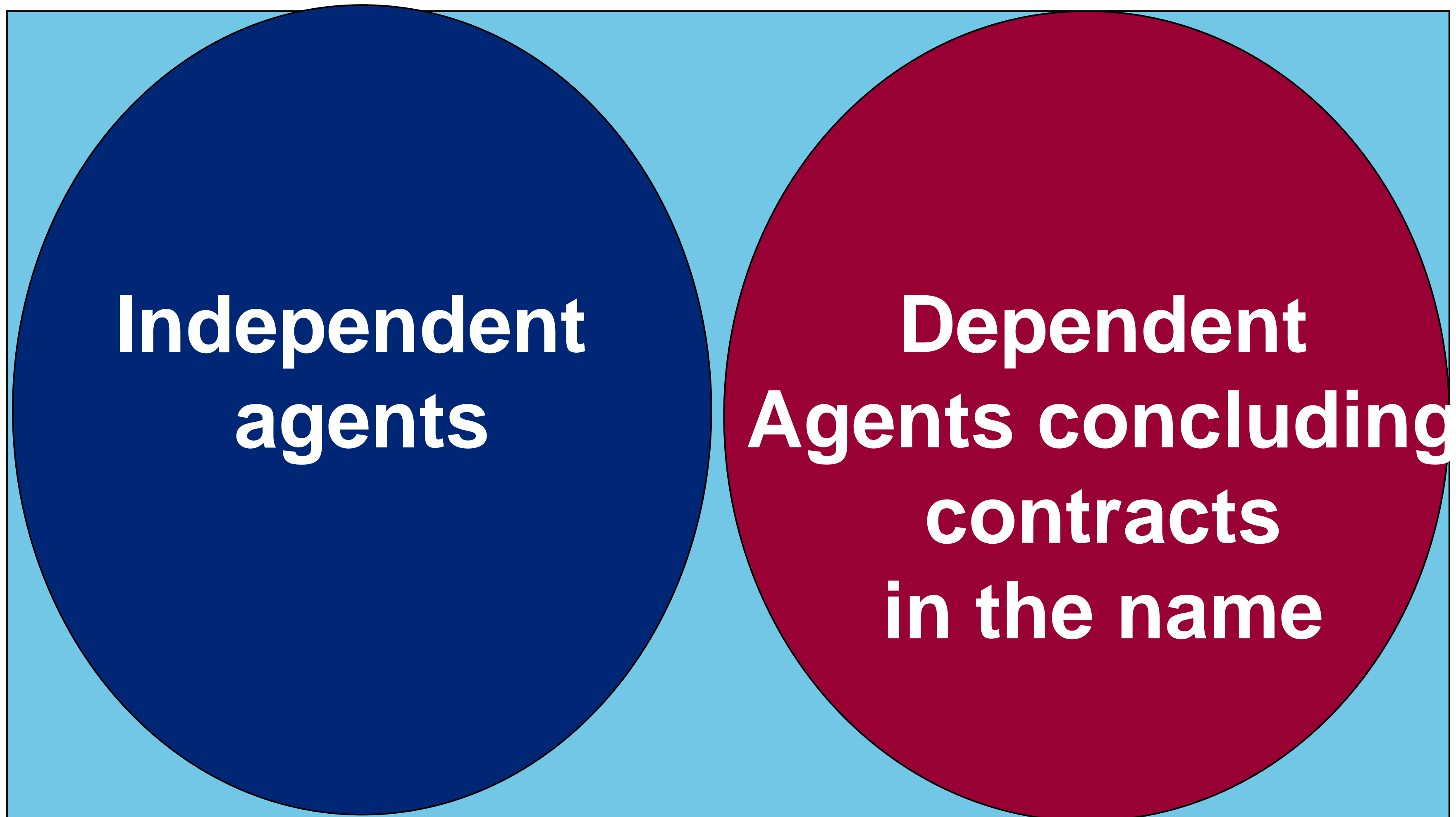
Exclusion-determination system



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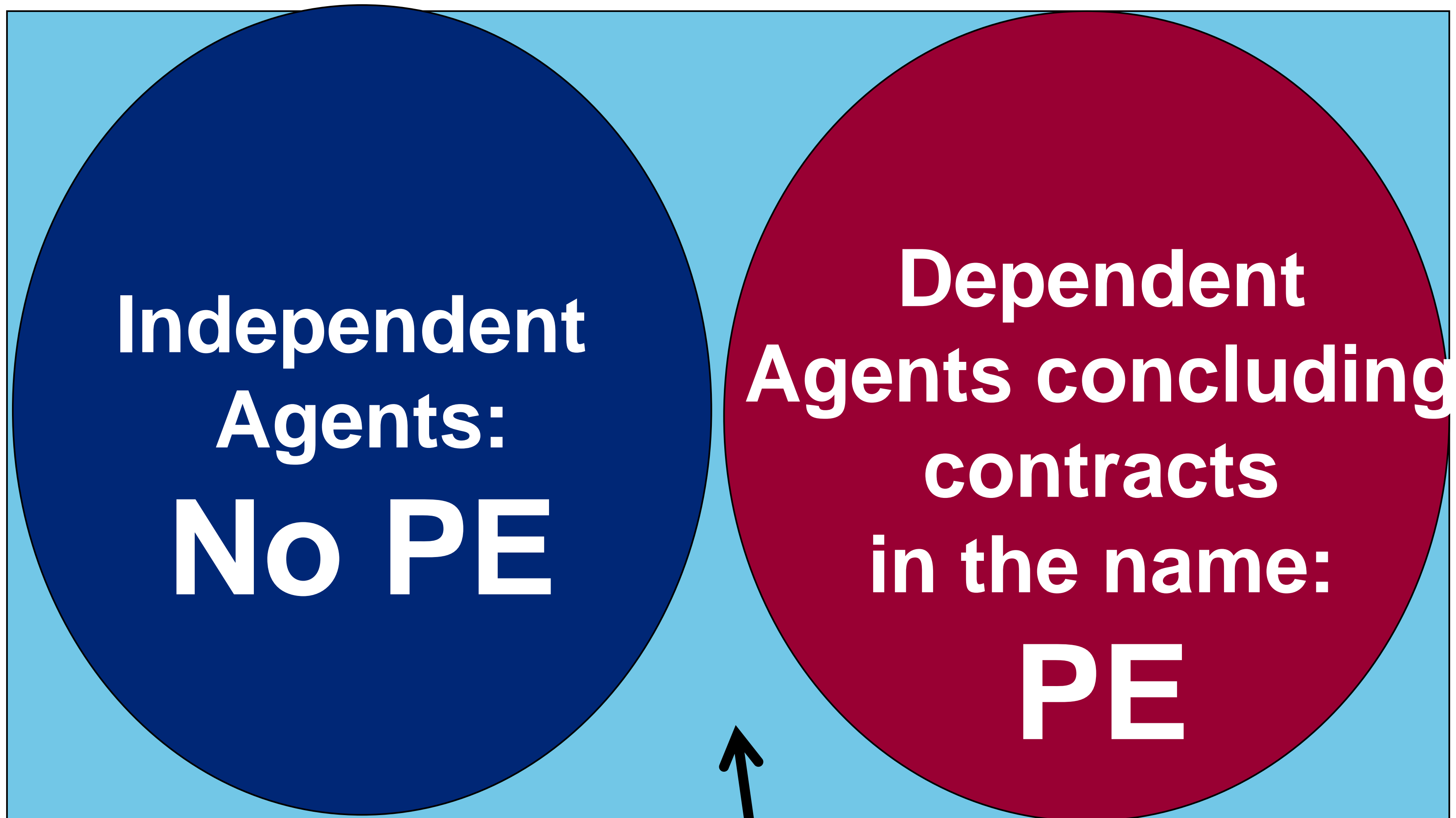
Exclusion-determination system



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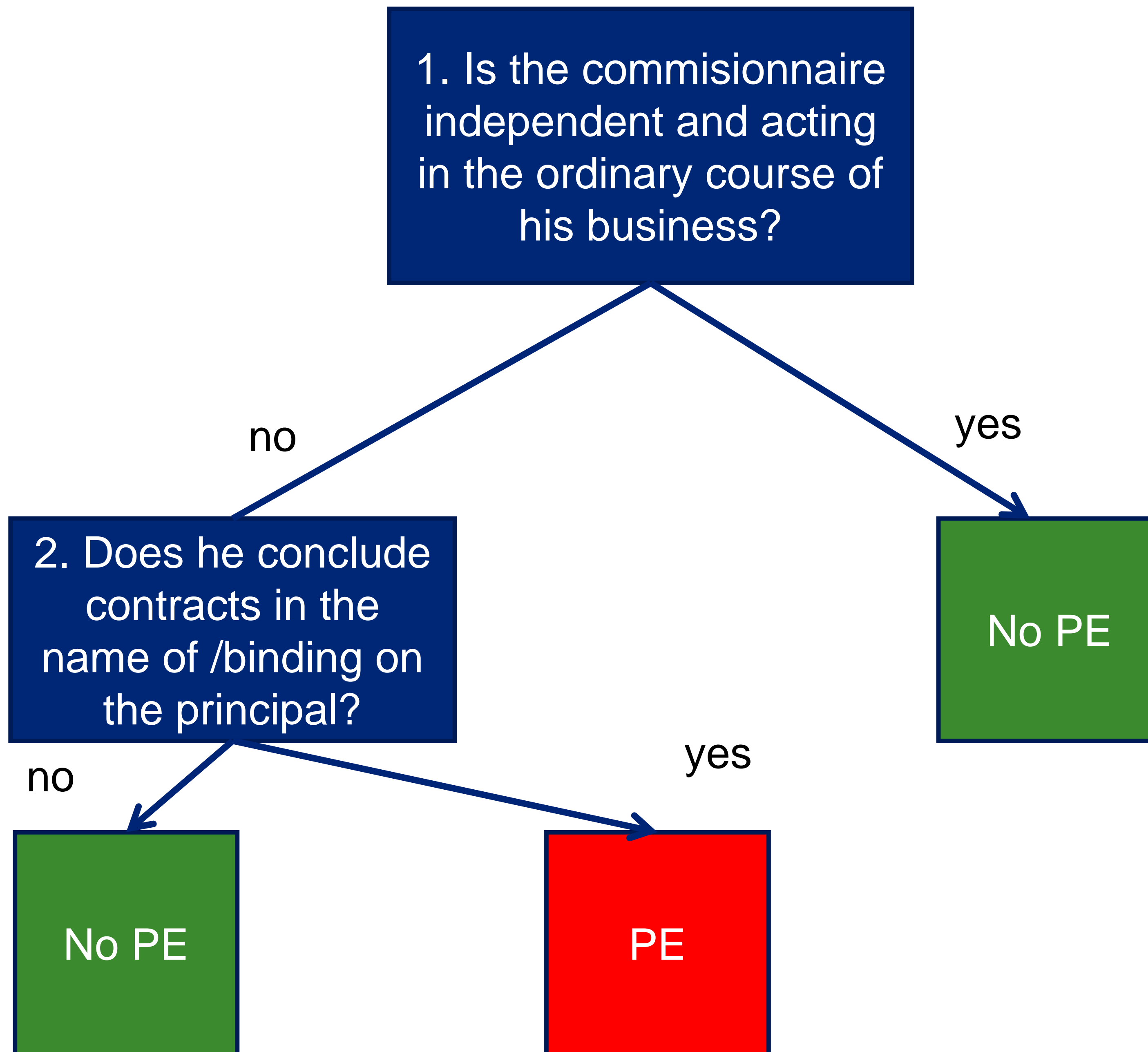
Decision tree for the commissionaire



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The relationship according to the Commentary (1963)

- “15 … Where an enterprise has business dealings with an independent agent, this cannot be held to mean that the enterprise itself carries on business in the other State. In such a case, there are two separate enterprises. 16. Having thus excluded the independent agents from the term ‘permanent establishments’ it would likewise not be in the interest of international economic relations to treat all dependent agents as being permanent establishments. Treatment as a permanent establishment should be limited to dependent agents , which, in vew of the scope of their agents’s authority ... take part to a particular extent in the business activities in the other State…”

(Paragraph 15 and 16 of the Commentary (1963))

- “Under paragraph 4 of the Article, only one category of dependent agents ... Is deemed to be permanent establishments. All indepoendent agents and the remaining dependent ones are [not] deemed to be permanent establishments

(Paragraph 19 of the Commentary 1963)

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The relationship according to the Commentary (1977)

"Persons whose activities may create a permanent establishment for the enterprise are so-called dependent agents, i.e. persons ... Who are not indepepdent agents falling under paragraph 6 ... It would not have been in the interest of international economic relations to provide that the maintenance of any dependent person would lead to a permanent establishment of the enterprise. Such treatment is to be limited to persons who in view of the scope of their authority ... Involve the enterprise to a particulat extent in business activities in the State concerned"."

(Paragraph 31 of the Commentary 1977, is par. 32 Commentary (2010).

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The exclusion-determination system is embedded in the hyphenized sentence

5. ... where a person **-other than an agent of an independent status to whom paragraph 6 applies-** is acting on behalf of an enterprise and ... habitually exercises ... an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment...
6. An enterprise shall not be deemed to have a permanent establishment ... merely because it carries on business in that State through ...an agent of an independent status, provided that such persons are acting in the ordinary course of their business."

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Main rule – exception system

In the name: PE

Unless independent: No PE

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Two independent rules system

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Robert’s main argument

“... A broker, general commission agent or any other agent of an independent status ...”

- Brokers and commission agents do not conclude contracts in their principals name (which is incorrect)
- Therefore also the “other agents of an independent status” do not conclude contracts in their principal’s name – *ejusdem generis principle*
- Therefore article 5-6 cannot be an exception to 5-5
- Therefore article 5-6 stand alone, “obviously” as a PE constituting rule

- Objections:
  - Brokers and commissionaires do under certain legal systems conclude contracts in the name of their principal
  - *Ejusdem generis* cannot be applied with any characteristic
  - Does not match with Commentary

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OECD does not clarify the matter

- Par. 119 Discussion Draft: the Commentary –allegedly- shows conflicting statements
- No position taken

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END

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Question 1

- Does “in the name of” (article 5-5) mean “binding” because the Commentary says so?
- The Swedish OECD delegate (when this was added in 1994, see first sentence of paragraph 32.1) expressed his fear of the judicial reaction and speculated that the judges would never accept that “in the name of” is interpreted as if “in the name of” were just not there...

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Question 2

- Why does the legal interpretation of binding prevail over the factual/economic binding?
- To what extent do you consider it relevant for the explanation of "binding" (par. 32.1 OECD Model Convention) as "legally binding", that the League of Nations has explicitly said that binding is legally binding, and not some factual/economic concept as the Norwegian tax authorities defended in Dell.

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Question 3

- Does article 5-5 (with its history and Commentary which appear to focus on legal bindingness) allow an approach of re-characterization of a commissionaire arrangement?
- What conditions should be met?

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Question 4

- Can we say that if the agent performs SPF relating to management of risks of the enterprise abroad that the risks of the enterprise should be allocated to the agent and rewarded there? (see e.g. TPGL (2010), para. 1.49)

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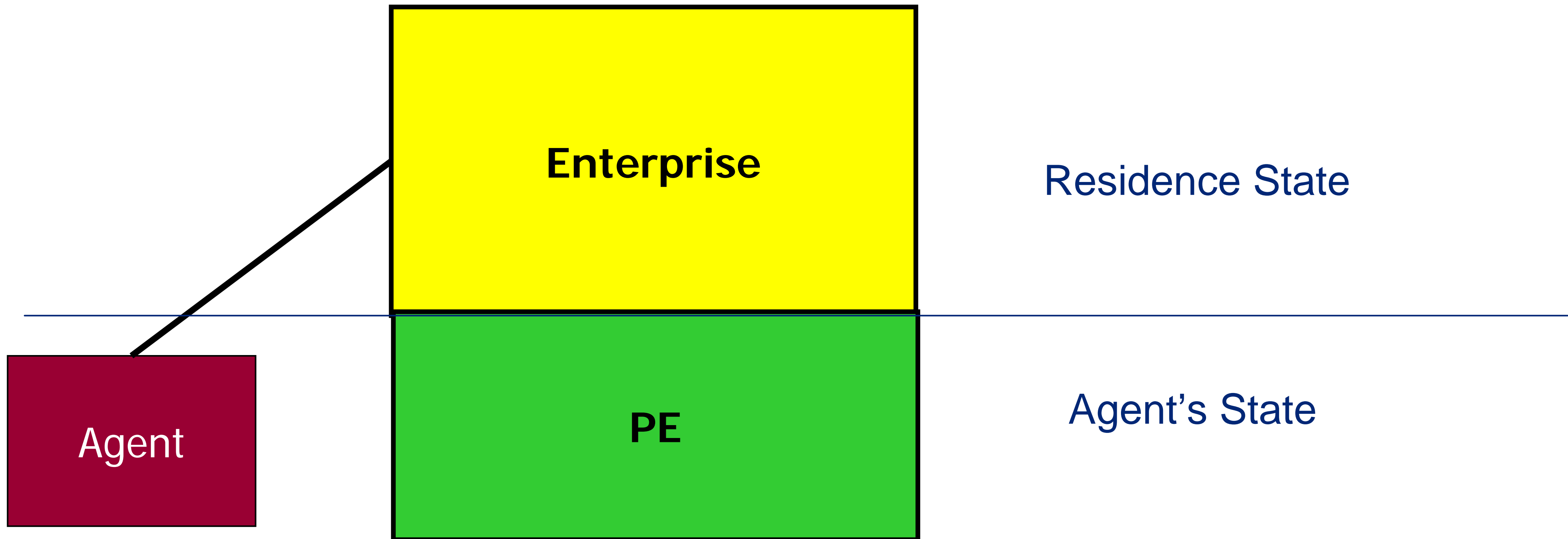
Illustration to question 4



- Assume 8 is adequate profit from Agent's SPF to manage the enterprise's risks (contractually, the risks remain with enterprise)
- Assume 7 is adequate profit for enterprise's risks drawn to PE (as in the Agent's State the risk managing function is performed: AOA
- Commentary: 8 taxed with Agent, 7 with PE (if there is a PE)
- TPGL : 15 at Agent (?)

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Question 5

- What's the relationship of article 5-5 and 5-6 OECD?
  - 5-5 main rule, 5-6 exception (Avery Jones)
  - Two separate independent paragraphs both of which offer the possibility of an agency PE (Sidney Roberts)
  - 5-6 and 5-5 integrated: do we exclude the independent agents under 5-6 first, and do we on the remaining dependent agents then apply 5-5? (Vogel)

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Question 6

- What role do the predecessors of the OECD Model Convention (1977-2010) play in interpreting concrete treaties?
- Does it matter that League of Nations Reports used “in the name of” and ”on behalf of” as synonyms of the same legal concept of bindingness?

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Question 7

- What role does the preparatory work of the OECD draft Convention (1963) and the OECD Model Convention (1977-2010) play in interpreting concrete treaties?
- “in the name of” was the result of a translation “error” and the original term was “on behalf of”

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