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Ensuring Favourable Taxing Rights for Business Profits: An Appraisal of the Permanent Establishment Concept in the UN and OECD Model Tax Conventions

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Kenneth Andrew Collett

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SUPERVISOR:
Prof Annet Wanyana Oguttu

CO-SUPERVISOR:
Prof Riël Franzsen

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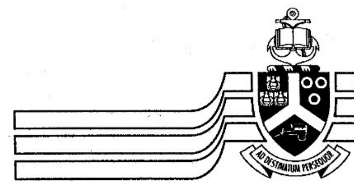

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STUDENT NUMBER:	15010602
STUDENT:	KENNETH ANDREW COLLETT
DEGREE:	MASTER OF TAXATION
DEPARTMENT:	TAXATION UNIVERSITY OF PRETORIA
SUPERVISOR:	PROFESSOR ANNET OGUTTU
CO- SUPERVISOR:	PROFESSOR RIEL FRANZSEN

ABSTRACT

As taxation across borders have become a significant event, this study therefore focusses on the taxation of business profits within the context of cross border transactions, especially with reference to permanent establishments. The study places emphasise on the various requirements and variations of the permanent establishment concept as used and defined in the OECD and UN Model Tax Convention respectively, by drawing comparisons between the various requirements and also identifying variances.

The study concluded by suggesting that the UN Model Double Tax Conventions offers better taxation of business profits from the perspective of developing countries, within the context of taxing business profits through the use of permanent establishments.

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List of acronyms

BEPS	Base Erosion and Profit Shifting
DTA	Double Tax Agreement
FDI	Foreign Direct Investment
MTC	Model Tax Convention
OECD	Organisation for Economic Development and Co-ordination
OEEC	Organisation for European Economic Co-operation
PE	Permanent Establishment(s)
UN	United Nations

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1 Introduction

This study provides insight into the differences in allocation of taxing rights for business profits depending on whether a double tax treaty has been signed, based on the Organisation for Economic Co-operation and Development's (OECD) Model Tax Convention on Income and Capital (OECD MTC) or the United Nations' (UN) Model Double Tax Convention between Developed and Developing Countries (UN MTC).

A discussion on the allocation of taxing rights for business profits requires a clear understanding of the concept of "permanent establishments" (PE's) in both the UN MTC (UN 2017:143 and 212) and the OECD MTC (OECD 2017:116 and 173). There are significant differences in the meaning of the PE concept in the two models that have an impact on the extent to which a country can have favourable taxing rights for business profits, as this depends solely on the specific MTC used in the conclusion of the double tax treaty.

Reviewing the theoretical aspects of MTC's alone will not provide sufficient insight and a definitive conclusion regarding favourable taxing rights for business profits. All aspects of the PE definition were considered and evaluated within the greater context of international taxation.

Understanding this topic requires a significant deal of background on double taxation in general and the rules pertaining to the allocation of taxing rights for business profits in a double tax treaty context.

1.1 Background

Since the PE concept plays a big role in allocating taxing between residence states and source states, it essentially helps in preventing the double taxation of business profits by more than one state.

Double taxation is a wide-ranging topic that has gained considerable attention over the last decade, given the growing importance thereof in the 21st century, with an ever-increasing transaction base across international borders (OECD 2017:10; Azam 2012:642). Double taxation can be as a result of either juridical or economic double taxation (Olivier & Honiball 2011:10-11). Juridical double taxation takes place when two countries tax the same income,

due to the jurisdictional taxing rules used by the country. This can be the case when countries levy tax either using the residence base or using the source base, which could result in the same income being taxed more than once (Olivier & Honiball 2011:10-11; Whittaker 1982:40). It can also arise when a company or individual is considered a resident of more than one contracting state (Miller & Oats 2014:83).

Economic double taxation is when income is taxed more than once, but not always in the hands of the same taxpayer. This also excludes factors that are covered by jurisdictional factors. Economic double taxation therefore focuses solely on the financial aspect of double taxation, thereby covering a wider range when compared with juridical double taxation (Miller & Oats 2014:83). An example is when an enterprise pays corporate taxes on profits made in conducting its business while the same profits are taxed in the hands of the individuals a second time when it is distributed as dividends (Miller & Oats 2014:83; Olivier & Honiball 2011: 6).

This study concentrates on preventing juridical double taxation with respect to business profits. Article 7(1) of the OECD or the UN MTC provides that the profits of an enterprise of a contracting state can only be taxed in that state (residence state) unless the enterprise carries on business in the other state (source state) through a PE. In that case, that other state (normally the source state) can only tax the profits attributable to the PE (OECD 2017: 33; UN 2017:15). From this DTA Article it is clear that the business profits can only be taxed in a source state if a PE is situated in the source state. In other words, the jurisdiction in which the business profits will be taxed is directly influenced by the application of the PE concept. This will ultimately, when applied correctly, prevent juridical double taxation of business profits (Miller & Oats 2014:83).

Preventing juridical double taxation of business profits first requires an understanding of what business profits are and then an understanding of the *PE* concept (OECD, 2008).

The term business profits are not defined in the OECD and UN MTC's. Where a term is not defined, Article 3(2) of the OECD and UN MTC provides that one should refer back to the domestic meaning of the word. Under the ordinary meaning, as provided by the Oxford Pocket dictionary, the term includes the performing of a trade (1984:93). The term trade specifically states that the income must be directly attributable to the trade performed and also includes passive income (58, 1962, Olivier & Honiball 2011:325). Given the context of trade and the term

business profits it therefore includes the performing of an active business, within this context, trade and includes active business received profits.

The PE concept (discussed in Part 2 ahead) is defined in Article 5 of the OECD and UN MTC's. The PE definition has a dual purpose (two rules). The first includes the introduction of a threshold rule and secondly it acts as a sourcing rule (Seerna Ceballos 2011:62).

The threshold rule sets a limit, where businesses will only be taxed in the source country when the specified limit is exceeded by the enterprise. The sourcing rule, however, determines that business profits obtained from a specific (source) state will be taxed in that state. This is due to the sourcing state being deemed to be the origin of the income derived by the foreign enterprise (Olivier & Honiball 2011:11).

It is important to note that this definition was introduced with the purpose to tax business profits in a source country when an enterprise has a direct economic nexus (level of economic presence) to the country within which it performs its activities (Seerna Ceballos 2011:61; Rohatgi, 2005).

1.2 History of the PE concept

Understanding the history of the PE concept provides perspective on the context in which PE's operate and the ultimate purpose of this concept in both the OECD and UN MTC's. The PE concept or *Betriebsstätte* was first used in the 1864 Code of Prussia (as cited by Timur Sokolov in PE in International and EU Law, 2011). The earliest examples of PE's used a German term called *stehendes Gewerbe* translated as a standing enterprise (Otegui Pita 2011:237; Oguttu 2009:773). The concept proposed that a business will be taxed based on the location it resides in, even if the business owner resides elsewhere (Otegui Pita 2011:237). This concept was further developed and included in the business legislation of the German Empire in 1909. From then on the PE concept evolved and by 1925 it was used by Italy, France and other countries as a concept for tax purposes (Pita 2011:237).

In 1927, the League of Nations tasked a Committee of Technical Experts on Double Taxation and Tax Evasion with drafting a Bilateral Convention for the Prevention of Double Taxation, which included 13 Articles (Freiherr von Roenne 2011:29). The Draft did not specifically define

the PE concept, but rather provided examples of possible PE's. The underlying purpose of this exercise was to allocate the taxing rights to the source country in which the PE is situated. The draft also provided possible recommendations to be used to allocate business profits to various PE's situated in different countries (Li 2002:858). This draft did not specify an overall methodology to be used to allocate business profits to PE's. The ultimate purpose of this draft model was to tax PE's on the portion of the business profits that are subject to the jurisdiction within which the PE is situated (Li 2002:858; Sprague & Hersey 2003:301).

The Draft Bilateral Convention created by the League of Nations was revised on two occasions. The first revision took place in Mexico. This adjusted Draft Bilateral Convention, published in 1943, reflected the interest of less developed countries and allocated tax revenues to the source country in which the investment was made (League of Nations 1946:14 & 74-76). The second revision took place in London. This Draft Bilateral Convention, published in 1946, favoured more developed countries and therefore allocated tax revenues to the resident country of the investor (League of Nations 1946:14 & 74-76). It is important to note that neither of these Draft Bilateral Convention revisions were fully and unanimously accepted, which indicated the division between developed and developing countries with regard to taxation (Sokolov 2011: 18). The second revision in London was the first version to suggest a direct relation between the term PE and business profits (Sokolov 2011:18; Whittaker 1982:43).

In 1948, the League of Nations was successes by the United Nations (UN) with the sole purpose of administering aid to Europe in the aftermath of World War II, under the Marshall Plan, as asserted by America and Canada (Freiherr von Roene 2011:32). However, the work on developing the Draft Bilateral Convention was taken over by the Organisation of European Economic Cooperation (OEEC), which was established around the same period (Oguttu 2018: 312). To achieve this goal, the OEEC formed a Fiscal Committee in 1956 that specifically focused on Double Tax Conventions (Freiherr von Roene 2011:32). The Fiscal Committee of the OEEC submitted four interim reports between 1958 and 1961, which led to the creation of the Draft Double Taxation Convention on Income and Capital (OECD 2017:10). The PE concept was one of the lead topics in these reports (Sokolov 2011:19).

In September 1961, the OEEC was replaced by the Organisation for Economic Co-operation and Development (OECD). The purpose of the OECD at that time was to create a uniform set of standards, to aid in the creation of Bilateral and Multi-lateral Double Tax Conventions (OECD 2017:9; Souza de Castelo Branco 2011:37). To date (2019), the OECD has 36 members including Australia, Austria, Belgium, Canada, Chile, The Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Mexico, The Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States (OECD Members and Partners list, 2019). Observer status was also provided to a number of countries, including South Africa (Olivier & Honiball 2011:270).

The OECD created its first MTC in 1963, emphasising the rights of residence countries' investors and thereby promoting the well-being of capital exporting countries, being mostly developed countries (Sokolov 2011:20). The 1963 MTC was the first draft to include the PE concept similar to that used in the current MTC's (Otegui Pita 2011:237). This MTC provided the first formal definition of a PE rather than a set of examples that were open to interpretation. Furthermore, it included possible indicators that could be used when determining whether a state is regarded as the residence or a source state (Otegui Pita 2011:237; Freiherr von Roenne 2011:34-35). These factors included the personal and economic relations of the enterprise and in which state the enterprise is effectively carried out and managed from, amongst other things. It was further stated that these factors are non-exhaustive and should be regarded as a guide and contributed to the determination of the source or residence of persons which influenced the determination of the existence of a PE (Sokolov 2011:20).

The PE principles developed by the League of Nations were used as the basis for determining the formal definition as provided in the 1963 MTC (Sokolov 2011: 21). This was done on the advice of a working group, and provided a fixed definition that has not changed significantly since then (Sokolov 2011:19-24). The simplified fixed definition provided by the OECD ultimately provided certainty as to the existence of a PE and essentially assisted with the interpretation and application thereof (Otegui Pita 2011:237-239; Sokolov 2011:19-24).

1.3 Overview of changes made to the meaning of the PE concept over the years

After the publication of the 1963 MTC, the OECD made an informed decision to maintain the MTC with current developments in international markets (OECD 2017:10). According to the OECD (2017:10-11), the rationale for the persistent updates was "to take account of the experience gained by the member countries in the negotiating and public application of the bilateral conventions, of changes in the tax systems of member countries, of the increase in international fiscal relations, and of the development of new sectors of business activities and the emergence of new complex business organizations at the international level".

The second edition of the MTC was published in 1977 and made some changes (OECD 2017:120). The most significant change was to the PE definition by replacing the words in which in Article 5(1) of the OECD MTC and UN MTC with through which, as it currently reads (OECD 2017:120; Sokolov 2011:24). This change expanded the criteria by indirectly including individuals that are dependent on the enterprise (such as employees of the enterprise) and by implication also included rapidly developing automated activities such as vending machines (Sokolov 2011:24).

Two other significant changes were made to the 1963 version of MTC, in addition to the change in the wording of the definition. The first included amending the description and requirements for a construction site to be considered as a PE through shifting the provision from paragraph 2 to paragraph 3 (the separation of the construction PE paragraph emphasized its importance). Under this change, it also included replacing the word assembly with installation. The second significant change included restructuring the dependant agent paragraph. Ultimately, these two changes expanded the scope of the PE concept in its totality (Melzerova 2011:276; Sokolov 2011:25).

The 1992 MTC was subsequently amended to make specific reference to scientific equipment. Other changes made to the 1992 version of the MTC included the broadening of the scope with regard to construction sites considered as PE's (Otegui Pita 2011:246-248).

From 2000, fiscally transparent partnerships with regard to construction PE's was also introduced for the first time (OECD 2017:131; Sokolov 2011:25). Additional amendments made to the OECD MTC from the year 2000 are discussed below. Firstly, an amendment was made

to clarify the treatment of scenarios where group companies are considered to be a PE of other companies in the group (Sokolov 2011:28). The second amendment was to the commentaries of Article 5, to provide better guidance on the taxation of services performed by a PE. Lastly, the PE status of a satellite “footprint” was also included in the OECD MTC (OECD 2017:117-122; Sokolov 2011:28).

Increased use of international e-commerce through the World Wide Web (www) forced the OECD to subsequently improve and update the PE definition to include e-commerce (OECD 2017:151; Dunahoo 2008:38). It is important to note that as e-commerce transactions increased, so did tax avoidance schemes.

Taking the above changes into consideration and to curtail the artificial avoidance of PE status, in 2015 the OECD published 15 Base Erosion and Profit Shifting Action measures (OECD, 2013). Of these, Action 1: Addressing the tax challenges of the digital economy and Action 7: Preventing the artificial avoidance of PE status, cover matters pertaining to PE’s. Consequently, Article 5 of the OECD and UN MTC was updated in 2017 to include the measures recommended in the BEPS reports (OECD 2017:11).

The history of the allocation of business profits and PE developments is important and provides a perspective to understanding the PE concept.

Given the work that the OECD has done through reports and updates to the PE concept, it is hoped that these changes will ultimately aid in achieving the OECD’s purpose. This purpose is defined in the OECD MTC as “to provide a means of settling on a uniform basis regarding the most common problems that arise in the field of international juridical double taxation” (OECD 2017: 9; Whittaker 1982:39).

1.4 Background to the UN MTC

In reaction to the OECD MTC, the United Nations developed its own MTC in the early 1980’s, namely “The United Nations Model Double Taxation Convention between Developed and Developing Countries” (UN MTC), which represented a compromise between the source and residence taxation principal, giving taxing preference to the source country (UN 2017: vi; Mosquera 2011:149; Whittaker 1982: 44).

The above MTC was developed by an Ad Hoc Group of Experts (the name was later changed to the “Ad Hoc Group of Experts on International Cooperation in Tax Matters”) who were appointed by the United Nations Economic and Social Council (ECOSOC) and was based on the principals used in the OECD MTC, but with significant differences (UN, 2017: v; Souza de Castelo Branco 2011:47).

In 2017, the UN published the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (UN 2017: v) to assist with the practical implementation of the MTC. The report focused on the negotiation of double tax treaties (UN 2017: v).

The UN MTC had many goals, some of which are in line with the OECD MTC whilst others were specific to the UN MTC. Ultimately, when compared with the OECD MTC, a compromise was warranted and achieved in the determination of the goals of the UN MTC (Whittaker 1982:46).

The main goal was to eliminate double taxation between contracting parties with a focus on developed and developing countries’ double tax treaties (UN 2017: iv; Whittaker, 1982:39). Souza de Castelo Branco reaffirmed that the main purpose of the UN MTC was to provide support in the conclusion of tax treaties in order to ultimately prevent double taxation between developed and developing countries (Souza de Castelo Branco 2011:47).

In the 1990’s, due to the changing world in which the MTCs function and with reference to the frequent OECD updates, the Ad Hoc Group of Experts decided to perform ongoing reviews on the UN MTC (UN 2017: vii). This led to new versions being published in 1999 and 2001. Since 1998, the UN MTC has aligned to the changes made by the OECD MTC and been widely criticised by many due to this alignment (Rohatgi 2002:60). The current version of the UN MTC (2017) takes into account the BEPS measures as introduced by the OECD (UN 2017: xi).

In contrast to the OECD, the UN does not update its MTC as regularly and, as such, various timing differences exist (UN, 2014: xiii; Busato 2011:34). Given the timing differences, the “United Nations Committee of Experts on International Taxation” has specifically stated that the commentaries made by the UN do not endorse the commentaries made by the OECD and that they should be considered separately from each other. This, in turn, reaffirms the independence of the MTCs and the differing goals (Busato 2011:56).

When comparing the OECD and UN MTCs, with specific reference to the allocation of business profits and the PE concept, various differences exist. Whilst the basic definition of PE's is similar, differences between the exclusion and inclusion criteria are present and this can directly be attributed to the main function and purpose of the MTC (Whittaker 1982:49). These differences are exclusively examined in this study.

1.5 Meaning of the PE concept in South Africa

The South African meaning of the concept of PEs was only included in South African domestic law as a result of recommendations by the Katz Commission in 1997 (Katz Commission, 1997; Olivier 2002:878). The term PE is defined in section 1 of the Income Tax Act, 58 of 1962 as defined from time to time in the OECD MTC. The PE concept is referred to in section 6 quad, 8F, 9, 9D, 10(1)(h) & (l),23L, 23M, 24I, 25D, 31, 41, 49D, 50D, and the Eight Schedule of the Income Tax Act, 58 of 1962 (58, 1962).

1.6 Research problem

The UN MTC was written to benefit capital importing countries (UN 2017: iv; Cockfield, 2003:404; Sprague & Hersey 2003:306), whilst the OECD MTC was written to benefit capital exporting countries (Olivier & Honiball 2011:271).

In terms of Article 7 of the OECD and the UN MTC's, the presence of a PE in a source state is critical for the source state to tax business profits attributed to a PE. Therefore, it is important to determine whether there are differences in the PE concept in the OECD and the UN MTCs. This in return will advise the users, which of the MTC's should be used when negotiating in their double tax treaties.

The above analysis of meaning of the PE concept in Article 5 is of utmost importance as many source countries (mainly developing countries such as South Africa) often negotiate double tax treaties based on the OECD MTC that favours residence taxation, rather than the UN Model that favours source taxation.

Analysing the challenges pertaining to the treaty negotiating capacity of developing countries was therefore also of critical importance in this study in order to make recommendations to assist in resolving this constraint, with the hope that it would increase the source taxation of business profits for future tax treaties and for renegotiating older tax treaties.

1.7 Research question

The research question was whether taxing business profits under the UN MTC provides a more beneficial position for developing countries versus the OECD MTC. Answering this question entailed investigating the differences between the PE concept in both of the MTCs. Finally, matters pertaining to the negotiating capacity of the contracting parties were also reviewed as part of the study to a lesser extent.

1.8 Objective of the study

The first objective of this study was to compare the definition of the PE concept in Article 5 of the OECD and UN MTC to determine which of the two provides a more beneficial allocation of tax between contracting parties.

Finally, after this evaluation, a conclusion is given as to which MTC developing countries like South Africa should apply when negotiating Article 5 of its tax treaties.

1.9 Comparative study

A comparative analysis was performed between the OECD and UN MTC's, with specific reference to the meaning of PE concept.

1.10 Hypothesis

The UN MTC offers better taxing rights for business profits for source countries when compared to the OECD MTC that largely benefits residence countries.

The UN MTC casts a wider net in its definition of PEs. The OECD MTC does not cast such a wide net in its definition of PEs and therefore does not allocate as much of the taxing rights of business profits to source countries when compared with the UN MTC.

1.11 Scope of the Study

The study covered the definition of the PE concept in the UN and OECD MTCs. No reference was made to other MTCs such as the United States MTC (United States Treasury, 2016), SADC MTC (Southern African Development Community, 2016), the African Tax Administrative Forum (ATAF) MTC or the East African Community (EAC) MTC (African Tax Administration Agreement, 2009; EAC, 2000).

1.12 Methodology

The researcher selected a qualitative methodology, which entailed reviewing various literature sources in order to obtain an overall understanding of the reasons, opinions and motivations relating to the topic. The researcher therefore reviewed and analysed both the UN and OECD MTC's, commentaries, books, Articles and court cases relating to the topic.

1.13 Structure of the study

Part 1: Introduction

Part 2: Analysis of Article 5 in the OECD and UN MTCs

Part 3: Conclusions

2 Analysis of Article 5 of the OECD and UN MTCs

2.1 Article 5(1) of the OECD AND UN MTC

The general definition of a PE in Article 5(1) in both the UN and OECD MTCs is a "fixed place of business through which the business of an enterprise is wholly or partly carried on". This definition has been left unchanged since it was last updated in the 1977 update of the OECD MTC (OECD 2017:117).

The above PE definition can be considered the basic definition for determining the existence of a PE (Seerna Ceballos 2011:61; Rohatgi 2005) and is included in most double tax agreements (DTAs). Whilst the basic PE definition has been criticized by many in the international community for failing to harmonise international tax practices (Seerna Ceballos 2011:61), many have praised the definition due to the fact that it creates certainty as investors will be aware of the jurisdiction in which the business activities will be taxed (Olivier & Honiball 2011:335).

The basic definition, also called the physical PE, can be subdivided into three elements:

1. It must be a "place of business"
2. It must be "fixed" and
3. "The enterprise's activities must be carried on through this fixed place of business".

Before a PE, as defined in Article 5, can come into effect, an enterprise needs to exist. No exhaustive definition of an enterprise has been included under Article 3 of the OECD and UN MTC's, but nonetheless, an enterprise exists when a business is operated in a jurisdiction (OECD 2017:29 & 95; Oliver & Honiball 2011:323). The OECD has, in paragraph 4 of the commentary on Article 3, further stated that the term "business" is subject to the domestic law of the contracting country (OECD 2017:95). South African domestic law does not have a definition for the term "enterprise" and so one must refer to the ordinary meaning supported by local and international case law (Income Tax Act of 1962, 1). The Oxford Advanced Learner's Dictionary (2010:489) defines an enterprise as "a company or business" and mirrors what is stated in the OECD MTC.

Olivier and Honiball (2011:324) conclude that from the perspective of Articles 7 and 5, a business does not physically have to be conducted from the residence country for it to be considered an enterprise. It is further submitted that a business must be a tax resident from a South African taxing perspective. Section 1 of the Income Tax Act defines residence with respect to a company as one that is incorporated or has a place of effective management in South Africa (Collett 2003:627).

Therefore, from a South African perspective, the enterprise must be a set of activities that ultimately performs actions to make a profit, while being a resident of the republic. The mere existence, through management and incorporation, without the actual performance of activities, can be used as reference to state whether an enterprise exists (Olivier & Honiball 2011:325).

Finally, it is also important to note that the facts and circumstances in combination with the specific country's domestic law need to be considered as well as the guidelines provided by the OECD, to ultimately conclude whether the current trade performed could constitute an enterprise (OECD 2017:118).

2.1.1 Place of business

The first element of the general definition of a PE in Article 5(1) requires the existence of a place of business. The OECD MTC states that a place of business consists of the tangible material assets whether or not it is directly used by the PE in achieving its goals. Seerna Ceballos (2011:63) determined that the existence of any debtor or creditor account and any intangible assets cannot be considered in the determination as to whether a PE exists. Instead, it is tangible assets which include all "premises, facilities or installations" (OECD 2017:118) and physical objects, premises, equipment and accessories (Castro 2011:131) that can be considered in determining whether a PE exists. Paragraph 12 of Article 5(1) of the OECD commentaries also defines a place of business as having an available location or unused amount of space at its disposal.

This element will be complied with, irrespective of whether or not the legal title to the premises, facilities and installations is owned by the foreign enterprise (OECD 2017: 118; Seerna Ceballos 2011:62; Olivier 2002:871).

From the above, it is evident that a place of business, as a minimum set of requirements, entails a portion of space or a physical presence through which its trade is performed, as this directly relates to the "establishment" in the PE definition. Both the UN and OECD MTC's require this space to be at the disposal of the enterprise. The OECD does not define the term space for the purpose of determining the existence of a PE (Castro 2012:131; Olivier & Honiball 2011:336).

Firstly, paragraph 12 of the commentary on Article 5(1) provides that the enterprise does not need to be wholly or exclusively carried on through this demarcated physical space, being the premises, facilities or installations (OECD 2017:119). Olivier and Honiball (2011:336) explain further that the definition of a PE goes beyond the traditional brick and mortar definition, it does not need to be fixed to the ground, and it is required to be stationary. Therefore, space can be defined as an available area whether fixed to the ground or not, through which the enterprise performs its activities. The productive character of the enterprise is not a function or requirement for the PE to exist, but the PE must, in essence, contribute to the overall economic growth of the enterprise as a whole (UN 2017:146; Seerna Ceballos 2011:64; Olivier & Honiball 2011:335).

Secondly, a PE can only exist through a place of business if it is functional (Seerna Ceballos 2011:63). A PE can only be functional, when it serves the business activity, whilst not being subjected to the business activities. In laymen's terms, the place of business must be used by the enterprise in the process of generating economic benefits, and not be exchanged for economic benefits (such as trading stock) (Seerna Ceballos 2011:63). Therefore, looking at the first element, an available functional location is required whether or not it is owned by the enterprise.

2.1.2 Fixed place of business

The second element of the general definition of a PE in Article 5(1) requires a place of business to be fixed. This element is subject to a location test and a duration test. The location test or locus test (Pinto 2018:23) requires a business to be connected to a certain geographical point in the source country. In other words, there must be a direct link between the place of business and a certain geographical space at the disposal of the enterprise (OECD 2017:121; Seerna Ceballos 2011:64). This element, however, does not require the business to be rigid and fixed

to one spot (Olivier & Honiball 2011:338). The Canadian case of *Blue Jays Basketball Club and Another v Ontario* determined what is considered to be a fixed place of business. The court case specifically referred to the time a company spends in a specific place as well as what type of activities are performed at the place of business. It was determined that a place of business must be connected with a specific geographical point in accordance with the provisions of the court case (*Blue Jays Basketball Club and Another v Ontario (Minister of finance)*, C41861 7 ITLR 591).

According to Seerna Ceballos (2011:65), the location test can be summarized as a qualified connection between the enterprise's place of business and the soil or seabed within the jurisdiction of the tax treaty. This refers back to the available portion of space. If no specific and designated place of business exists, no PE exists, irrespective of the duration that the PE is operated in the source country (Olivier & Honiball 2011:338; Ribeiro 2009:298).

It should be stressed, however, that an enterprise used only intermittently or for an incidental purpose and that is not present at a specific designated space, does not constitute a PE (OECD 2017:119). Paragraph 14 of the commentary on Article 5(1) of the OECD MTC provides the example of a sales person that engages with clients at their residential addresses, thereby moving from home to home on a regular basis (Ribeiro 2009:300). In this example, the customers' homes are not at the disposal of the enterprise consequently the location test does not apply and therefore a PE does not exist (OECD 2017: 120).

A second example is that of a painter working for an extended period in the home of a client. The painter spends the complete employment period at the client's residence, and performs the entirety of its actions at the client's residence, until the completion of the contract. In contradiction to the previous example, the painter performs his whole business at one specific location. Although the premises are not at the disposal of the painter, the sole location in which his business is performed can be constituted as fixed place of business (OECD 2017:120; Olivier & Honiball 2011:338; Olivier 2002:872).

The OECD 2012 Discussion Draft on attribution of business profits states that the term at the disposal of includes considerations of (1) the power to use the premise, owned by the enterprise or another company and (2) used for a continuous and extended amount of time (OECD 2012:6).

The determination as to whether a PE exists is complicated by an enterprise making use of different locations within its lifespan, confounding the use of the location test. When the physical presence definition is strictly applied, two PE's will exist (OECD 2017:120). Paragraph 22 of the commentary on Article 5(1) of the OECD MTC provides that the locations within which the business operate must be considered as a coherent whole in a geographical and commercial sense. In other words, both of the locations should be regarded as a single PE (OECD 2017:120). An example provided in the commentary is that of a mining company having more than one mining area. The mine must be regarded as a geographical and commercial coherent whole and all of the premises are regarded as one single PE (OECD 2017:121; Ribeiro 2009:302; Castro 2012:133).

A further example provided by the OECD is that of a painter who works in a large building for a number of non-connected clients, thus having a number of non-connected projects. As the painter does not work in a single space and not under a single project, the building cannot be regarded as a commercial and geographical coherent whole and can therefore not be regarded as a PE (OECD 2017:121; Ribeiro 2009:302).

Ultimately, the location test must be evaluated against the context within which the business operates (Seerna Ceballos 2011:65-66; Olivier & Honiball 2011:338; OECD 2017:122).

The second aspect of the fixed required of a PE is the duration test or tempus test (Pinto 2018:25**)** which has to be applied in conjunction with the location test to determine the existence of a PE. This test adds to the location test and requires a measure of permanence. The permanence requirement is exemplified in the *Transvaal Associate Hide & Skin Merchants* (1967, 29 SATC 97) court case*,* where the existence of a PE was questioned due to the temporary nature of the activities in a source state. The court case held that the place where the dominant income-producing activities of the enterprise are situated can be considered the source of the income and as a result, all of this should be considered solely within the duration of the business. It can therefore be concluded that temporary enterprises are excluded from the duration test (Olivier & Honiball 2011:338; Miller & Oats 2014:192).

The lack of a fixed business location is complemented/supplemented by the duration test. An enterprise is regarded as being fixed and a PE, when it is performed at a fixed spot or if it is regarded as a commercially integrated project performed on behalf of one client (Seerna

Ceballos 2011:65). The permanence of the enterprise must be regarded within the natural life cycle of the enterprise (Olivier & Honiball, 2011: 338). It cannot be regarded as everlasting but must be seen as "indefinite continuing" (Seerna Ceballos 2011:66). Experience has provided possible time periods or a "rule of thumb" for determining whether a PE exists (Pinto 2018: 26; OECD 2017:122):

- If an enterprise conducts a trade in the source country for a period of six months or less, no PE is deemed to exist.
- If an enterprise conducts a trade in a source country for a period of six to twelve months, a possible PE exists.
- If an enterprise conducts a trade for more than twelvemonths, a PE is most likely rather than not to exist (Olivier & Honiball 2011:339; Miller &Oats 2014:193).

In the Canadian Court case, *R v Dudney (*Docket no A-707-98. Court of Appeal, Canada, 20 January 2000, reported at 2 ITLR 627), it was concluded that, without placing too much weight on the timeframe in which the business exists, a PE would also exist taking into account the terms and conditions placed in the contract under which it is created (Miller & Oats 2014:198).

Paragraph 29-30 of the commentary to Article 5(1) of the OECD MTC provides two exceptions to the basic definition (OECD 2017:123).

The first exception relates to an enterprise performing activities over extended broken and recurring periods. All the periods must be considered in combination and are then regarded as the natural life cycle of the enterprise. This contributes ultimately to determine whether or not it qualifies as a PE (Olivier & Honiball 2011:339; Miller & Oats 2014:192). Paragraph 29 of the commentary to Article 5(1) provides an example of an oil drill which can only drill for a limited period of time at one single position due to seasonal conditions. As a result, thereof, the combined periods need to be considered when determining the existence of a PE (OECD, 2017: 123; Olivier and Honiball, 2011: 339).

The second exception relates to an enterprise performing a trade solely within a source country (OECD 2017:123; Miller & Oats 2014:192). Enterprises in this exception only exist for short periods of time. This exception disregards the duration of the PE and regards an enterprise as

fixed, due to the connection with the source country being stronger than with the residence country. The source country is given the taxing right through a PE, as a result of the foreign enterprise's close connection with the source country (OECD 2017:123; Olivier & Honiball 2011:339).

From the above, the fixed element requires a degree of permanence, which is a result of a combination of the location and a duration tests, given the context within which the business operates. These requirements are not set in stone and exceptions to the general rule can exist and can also be applied.

2.1.3 Through which the business of an enterprise is wholly or partly carried on

The third element of the general definition of a PE in Article 5(1) requires that the activities of the enterprise be carried "through this fixed place of business". This requirement extends to foreign business partially carrying on its business through more than one place of business, as longs as it constitutes a "commercial and geographical whole" (OECD 2017:124; Ribeiro 2009:301).

Paragraph 36 of the commentary on Article 5(1) of the OECD MTC explains that an enterprise that has a fixed property in a source country but does not in any way maintain or repair the property, in case of damages or in the case of general repairs does not deem a PE to exist (OECD 2017:124; Olivier & Honiball 2011:340; Seerna Ceballos 2011:67-68).

In addition to this, the business of the enterprise in the source state does not need to be in line with that of the foreign head enterprise. It must only contribute to the business as an economic and geographical whole (OECD 2017:124; Ceballos 2011:67-68). It is furthermore explained that human intervention is not needed, whilst in most cases, a PE is deemed to exist when it is performed by personnel of the enterprise (OECD 2017:124; Seerna Ceballos 2011:67-68).

The 21st century has brought many changes, including increased importance in using electronic mediums of transacting. This level of growth is generally known as the Fourth Industrial Revolution. In reaction to this, the OECD has published the Base Erosion and Profit Shifting (BEPS) Action Plan 1: Addressing the challenges of the digital economy, which has concluded on the possible consequences with regard to a PE (OECD 2015). The furnishing of a service

or the supply of goods can now be supplied using an online profile, whilst being processed more effectively and efficiently in less time than the conventional method (OECD 2015:56).

As a result, the determination of a PE has become increasingly difficult. Foreign enterprises can communicate with or deliver services to their customers whilst not physically present in the source country (OECD 2015:67 and 79). The OECD had to adjust its MTC to be more in line with the above-mentioned. However, a discussion of Electronic PE's was not analysed as part of this dissertation.

It is evident from what has been discussed that a foreign enterprise must have a fixed portion of space available to them, whether or not owned by the enterprise, through which it wholly or partially performs it trade activities. All of the requirements must be complied with before a PE is deemed to exist. The requirements are not set in stone and should be evaluated against the context in which the foreign enterprise performs its activities.

The OECD and UN MTC, considering PE's, do not differ significantly with regard to the general definition of a PE in Article 5(1). However, subsequent paragraphs would have to be evaluated to determine whether or not any differences exist.

2.2 Article 5(2) of OECD and UN MTC

Paragraph 2 of the OECD and UN MTC provides a list of specific examples that are indicators for possible PE's as relating to the basic PE definition specifically under a "place of business" (UN 2017:153). This list includes a "place of management, a branch, an office, a factory, a workshop and a mine, gas well, a quarry and extraction of natural resources" (OECD 2017:31; Olivier & Honiball 2011:337). The OECD and UN MTC's provide that these examples of possible PE's have to adhere to the requirements stipulated in Article 5(1) (OECD 2017:127; UN 2017:153; Busato 2011:42; Pinto 2018: 19). It is important to note that this is a non-exhaustive list and further examples can constitute PE's.

Perhaps the one difference in the interpretation of Article 5(2) between the UN and the OECD MTC pertains to the phrase any other place of extraction of resources. Unlike the OECD Model, the UN MTC includes fishing vessels as a possibility of complying with any other place of the

extraction of resources. This inclusion is in line with the purpose of the UN MTC of providing a broader scope than that of the OECD (UN 2017:155).

In effect, fish is regarded as a natural resource and fishing vessels are considered a means of extracting natural resources from the ocean. Although the UN commentary (2017:155) allows the inclusion of fishing vessels, this interpretation is subject to negotiation between the contracting parties. This, in return, could include more enterprises in the PE inclusion criteria and produce a broader scope for source countries (UN 2017:155).

From the above, it can be concluded that Article 5(2) in the OECD and UN MTC's is mostly similar in its requirements, but with the exception that the UN MTC provides for the addition of fishing vessels. Article 5(2) is written in such a way that it gives preference to the source country. It should also be noted that this paragraph is subject to the provisions in subsequent paragraphs.

2.3 Article 5(3) of OECD and UN MTC

This provision in the OECD and UN MTC sets out a special PE rule for a building site, construction or an installation project, but its content differs significantly in the OECD and the UN MTC's (OECD 2017:31; UN 2017:11). This provision supersedes the basic PE definition and considers a PE to exist whether or not the basic definition is complied with (Sagmeister 2011:74; Souza de Castelo Branco 2011:50).

The construction contract principle was first included as part of bilateral treaties in the early 1930s. Bilateral treaties initially included a 12-month test and concluded that a PE was deemed to exist when a construction business performs a trade for short or intermittent periods of time (Sagmeister 2011:74).

2.3.1 Article 5(3) under the OECD MTC

The OECD 1963 Draft Convention included construction or installation projects as part of its positive list (inclusion list) under Article 5(2). However, in 1977, construction and installation projects were removed from the positive list in Article 5(2) and were set out separately in Article 5(3) (Otegui Pita 2011:246; Sagmeister 2011:73).

When analysing Article 5(3), it is important to keep the basic PE definition in mind as stated in Article 5(1) (Sagmeister 2011:74). Special focus is placed on a building site, a construction or an installation project, as it is difficult to determine if a PE exists as a result of the lack of permanence of activities of this nature by enterprises.

It is a commonly known fact that construction and installation sites are relocated from time to time, whilst the assembly of a final project can take place at numerous different locations (Miller & Oats 2014:202; Sagmeister 2011:73). According to Castro (2012:137), a place of business is considered to be permanent if it is not of a merely temporary nature. This is called the *contrario sensu* principle (Castro 2012: 137). The constant relocation of construction and installation activities directly causes the activities of an enterprise to be regarded as non-permanent (temporary). This is of particular relevance when referring to the duration test in the basic PE definition (Olivier & Honiball 2011:339; Sagmeister 2011:73). Due to this unpredictability, the OECD introduced a "special fixed period" provision, to be used when deeming a building site and a construction and installation project as a PE (Sagmeister 2011:74).

The OECD sets out the following activities as examples of what falls under Article 5(3): (1) a building site, (2) construction or (3) an installation project. The OECD commentary expands this list by including buildings, roads, bridges or canals, the laying of pipe-lines, excavating and dredging (OECD 2017:129; Ribeiro 2009:304). On-site planning and supervision services performed when constructing a building are also included in this section, and deemed to be a PE. Supervisory activities performed from a remote location do not form part of this inclusion (OECD 2017:129; Dehnen & Bacht 2005:446). The OECD MTC further deems a place of business (such as an office space or a workshop), used to service multiple construction projects, irrespective of its time frame, to be a PE (Sagmeister 2011:74).

The OECD Commentary on Article 5(3) can be interpreted in multiple ways. The multiple interpretations provide some perspective as to the ultimate application of this provision. The following interpretations can be followed to ascertain the application of the provision:

The first interpretation of Article 5(3) is that it is an extension of the basic PE definition in Article 5(1), and that it replaced the physical presence requirement with the fixed threshold requirement. The second interpretation (which has only recently been implemented and used by the OECD) creates a "deemed PE" (Ribeiro 2009:303). Thus, building sites, construction or installation projects are regarded as components of the basic PE definition, having much more certainty as to the existence of a PE (Sagmeister 2011:74).

2.3.2 Article 5(3) of the UN MTC and the variances when compared to the OECD MTC

The UN MTC, on the other hand, interprets Article 5(3) as an extension to Article 5(1), and it supersedes the requirements in Article 5(1) (Sagmeister 2011:75). As such, when the requirements of Article 5(3) are not complied with, the requirements of Article 5(1) are not considered to be sufficient when considering whether a construction or installation project is a PE. As such, no PE would exist if there is a lack in the fixed nature of the business (OECD 2017:31; UN 2017:11; Sagmeister 2011:75).

The UN MTC, being in line with its main purpose, provides a much broader scope of Article 5(3) than the OECD MTC (Busato 2011:44). The first difference is seen in the above interpretation.

The second difference is that the UN MTC includes in Article 5(3) the assembly of project as well as supervisory activities over and above the provisions in the OECD MTC (UN 2017:11; Daurer 2011:69-72).

The word assembly is defined as "the action of fitting together the component parts of a machine or other object, such as a vehicle or piece of furniture" (Oxford Advanced Learner's Dictionary 2010:73). This is in line with the other inclusions of creating or constructing a product. The assembly of a project is not explicitly included in the OECD MTC, but is imbedded in the commentary to the OECD MTC. Thus, the OECD can indirectly be considered similar to the UN MTC, whilst not being explicitly stated (Busato 2011:44; Daurer 2011:69).

In addition to assembly of projects, the UN also includes supervisory activities performed onsite or independently. The word supervise is defined as to "be in charge of, oversee, watch or direct the carrying on of work" (Oxford Advanced Learner's Dictionary 2010:1499). Activities, under supervisory activities, include the rendering of services as part the enterprise's day-to-day business through the enterprise's employees in connection with a fixed place of business (UN 2017:155). These added aspects make the UN provision broader than the OECD MTC and this is included under Article 5(3)(b) (Busato 2017:44; UN 2017: 155-156).

These activities are deemed to be a PE while not complying with the basic PE definition (Busato 2017:44). Supervisory services are regarded as a PE when they are performed for a period of 183 days within a 12-month period (UN 2017:11). The conditions are explicitly included in the UN MTC, while only being implicitly included in the provision in the OECD Commentaries. This is included in paragraph 132 of the Article 5 OECD Commentaries (OECD 2017:154). This provision has been the centre of debate amongst many developing countries, as some countries include this provision whilst others exclude it (UN 2017:157; Souza de Castelo Branco 2011:50)

The next difference between Article 5(3) in the OECD and UN MTC is the duration of a building site, construction or an installation project (OECD 2017:31; UN 2017:11). Given the difficulty of classifying an enterprise as a PE under the basic definition and due to "the enterprise being linked to the economic life of the source state" specifically referring to building sites, construction and installation projects, the OECD and UN MTCs introduced a fixed duration requirement for a building site, a construction or an installation project as well as the UN assembly and supervisory activities, to be classified as a PE (UN 2017:155 and 161; Daurer 2011:69).

In the OECD MTC, a 12-month fixed period threshold is used to determine whether or not a building site, a construction or an installation project is regarded as being a PE (OECD 2017:31; Ribeiro 2009:304). Therefore, when an enterprise performs its activities for a period longer than 12 months, it is regarded as a PE (Ribeiro 2009: 304). In the UN MTCs, a period of 6 months is sufficient for a PE to exist (UN 2017:11). The shorter time period allows for an increased scope-and-inclusion criterion in comparison with the OECD.

Under negotiating, the UN MTC further provides the opportunity to extend the Article 5(3) even further by also including a project or activity being incidental/not intentional related to the sale of any machinery or equipment. This activity will be regarded as a PE when its activities are performed over a period shorter than 6 months and the revenue received exceeds ten percent of the value of the machinery (UN 2017:156).

The activities considered under Article 5(3), extend to the activities performed by subcontractors. When subcontractors act in the name of the foreign enterprise for the fixed periods determined in Article 5(3), the building site, a construction or an installation site, will be regarded as a PE of the foreign enterprise for both the UN and the OECD MTC (OECD 2017:128; Ribeiro 2009:305). An important factor to consider is that the place of business, used by the subcontractor, must be at the disposal of the foreign enterprise before it can be considered as a PE. The subcontractor is only acting as an extension of the foreign enterprise (OECD 2017:126; Ribeiro 2009:305)

When reviewing the duration of a PE, each worksite (or collection of contracts concluded to finalise the project) should be considered in isolation and previous work should be disregarded (OECD 2017:129; UN 2017:157; Ribeiro 2009:304). This is of importance as the PE has to be regarded as a “coherent whole in a commercial and geographical whole” (UN 2017:157; OECD 2017:129). The activities at a specific worksite will have to be considered to determine the fixed period as determined under Article 5(1).

Where enterprises split or divide their business among several separate connected companies, whilst performing their activities under each country for a period of less than 12 or 6 months, with the main goal of not falling into Article 5(3), the OECD and UN included an anti-abuse provision in Article 29(9) (OECD 2017:50 and 129; UN 2017:55 and 158).

The anti-abuse provision regards an enterprise to be a PE when two elements are complied with. The first element requires activities to be performed for a period exceeding 30 days but not more than 12 months (OECD 2017:129; UN 2017:158). The second element requires activities to be performed by “a closely related enterprise” using various different project-or-building sites to complete the same project (OECD 2017:129; UN 2017: 158). This anti- abuse provision then regards the various different project sites as one single PE, with the effect of curtailing the use of such schemes.

A PE is deemed to exist from the date that the building site, a construction or an installation site is prepared by the contractor up until the date of completion or permanent abandonment of the project (Sagmeister 2011:82, 83; Ribeiro 2009:304). Temporary interruptions are regarded as normal and must be taken into account when determining the 6- or 12-month period (UN 2017:160; Sagmeister 2011:84; Ribeiro 2009:304).

From the above, it is clear when considering Article 5(3) of the OECD and the UN MTC, that the OECD MTC is focused on benefiting the residence state, whilst the UN is aimed at benefiting the source state.

2.4 Article 5(4) of OECD and UN MTC

Both the OECD and the UN MTCs contain certain exclusions to the basic PE definition. These exceptions are found in Article 5(4) of the OECD and UN MTC (OECD 2017:31, 132; UN 2017:12; Ribeiro 2009:308; Pinto 2018:31). Paragraph 58 of the OECD commentary to Article 5(4) explicitly states that although the activities in these exceptions "are complacent with the requirements of being a fixed place of business through which a business is performed, they are not strong enough to constitute a PE due to the nature of the activities" (OECD 2017:132; Aivazian 2011:89).

Although the exclusions to the PE concept are generally considered to exclude activities of preparatory or auxiliary nature, it should be noted that before the changes brought about by Action 7 of the OECD BEPS Project were incorporated in the 2017 OECD and UN MTC, not all the sub-paragraphs of Article 5(4) included the exception for activities of an ancillary or preparatory nature.

The terms ancillary and preparatory only applied to paragraph (e) and (f) of Article 5(4). Activities are ancillary when they "provide necessary support to the primary activity or operation of an organization, system, etc" (Oxford Advanced Learner's Dictionary 2010:47) and preparatory when "serving as or carrying out preparation for a task or undertaking" (Oxford Advanced Learner's Dictionary 2010:1154).

It is evident, solely from the definition of ancillary activities, that these activities are not core to the functioning of the business and only provide supporting services (Ribeiro 2009:308). The

OECD MTC adds to this by stating that preparatory activities are undertaken when the enterprise is in the phase of contemplating the introduction of certain activities within a specific tax jurisdiction (Sprague & Hersey 2003:299). Furthermore, ancillary activities are not fundamental to the existence or furtherance of the business, but only aid in the performing activities as part of the trade of the enterprise (OECD 2017:133; Pinto 2018:31).

It is evident from the above definitions that the activities which are preparatory or ancillary are not part of the essence of the business of the enterprise and are therefore not significant to the ultimate functioning of the business (Olivier & Honiball 2011:342). This point is supported and specifically addressed by the OECD as it provides a non-exhaustive list of activities regarded as ancillary and preparatory. The activities listed are considered not to be essential to the functioning of the business in making a profit. In other words, the activities are distant from the core functioning of the business acting productively (OECD 2017:132; Oguttu 2009:215).

It should be noted though that the earlier versions of the OECD MTC (Mexico and London Models) made reference to the productive character of the activities. These activities, when profitable, whether or not ancillary or preparatory, will be taken into account in the taxable calculation of the business as a whole (Aivazian 2011:89). When the activity contributed to the profitability of the enterprise as a whole, it would be taxed in the source country (ignoring the ultimate function of the activity) and created various problems (Aivazian 2011:89).

This provision was subsequently removed in the 1963 version of the OECD MTC, as it resulted in various fluctuations of an enterprise's PE status. Many authors indicated that this was a test of motive and not of fact, and went on to say that in some circumstances, due to the mere administrative burden surrounding the application of the PE concept, it would not be worthwhile assessing the existence of a PE due to the fact that the cost exceeded the benefit derived therefrom; in other words, the administrative feasibility (Aivazian, 2011:89).

The current structure of Article 5(4) has remained unchanged since its inclusion in OECD MTC in 1963. The effect of the exclusion narrows the basic PE definition and it is often referred to as the negative list. Each case, however, has to be evaluated against the background of the specific factors in which it operates (OECD 2017:133).

Neither the OECD MTC nor UN MTC subjects all of the exclusions to the PE concept to the ancillary and preparatory test (Aivazian 2011:102). This created opportunities for artificial avoidance of PE status. The OECD/G20 Report on Action 7 (OECD 2015:12; Pinto 2018:32, stated the following: "Article 5(4) is modified to ensure that each of the exceptions included therein is restricted to activities that are otherwise of a 'preparatory or auxiliary' character'". In light of the recommendations, Article 5(4) was subsequently changed, making all of the activities, in the OECD and UN MTC, subject to the ancillary and preparatory requirement (UN 2017:172; Aivazian 2011:102).

Apart from that change that was affected in both the 2017 OECD and UN MTCs, there are some differences in the subparagraphs to Article 5(4) in both models which need to be pointed out (OECD 2017:31; UN 2017:12; Ribeiro 2009:308).

2.4.1 Article 5(4)(a)

Article 5(4)(a) excludes from the PE concept "the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise". Essentially, this deals with the continuous use of the facilities in the acquisition of goods and merchandise. In the OECD MTC, usage specifically relates to storage, display or delivery of goods or merchandise owned by the enterprise. The Italian Supreme Court ruled that the storage and delivery of goods are of a preparatory and ancillary character, when owned by the enterprise (*LuxCo v Italian Tax Authorities*, 2015 IT no. 5649 SC (*Corte Supreme di Cassazione, CC*); Pinto 2018:31).

A determination must first be made, however, as to what constitutes goods and merchandise. The Oxford Advanced Learner's Dictionary (2010:646) defines goods as "things or possessions" and merchandise as "goods to be bought and sold" (2010:928). It is evident from these definitions that all current and non-current assets are included and so the term is therefore much wider than what is included in trading stock (Aivazian 2011:96; Pinto 2018:32).The best example provided in this regard is that of a warehouse (OECD 2017:133; Olivier & Honiball 2011:341).

The UN MTC differs from the OECD MTC in the sense that it does not include the delivery of goods and merchandise in Article 5(4)(a).The UN MTC disregards this provision that directly excludes a warehouse used for delivery and commercial purposes and subsequently provides a larger inclusion criterion compared with the OECD MTC (UN 2017:172; Daurer 2014:72; Olivier & Honiball 2011:341). Aivazian (2011) and Daurer (2014) attributed this difference to the view taken by developed countries that regard delivery services as generating profits in the source country, whilst this statement is supported by the continuous connection and the nexus the activity has to the source country (UN 2017:184; Aivazian 2011:96-97; Daurer 2014: 72).

2.4.2 Article 5(4)(b)

Article 5(4)(b) excludes from the PE concept, “the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery” (OECD 2017:31; UN 2017:12). Article 5(4)(a) and 5(4)(b) differ in principle as Article 5(4)(b) relates to the maintenance of a business’s own stock and merchandise whilst Article 5(4)(a) relates to the acquisition of stock or merchandise by an enterprise (OECD 2017:133; UN 2017:174; Olivier & Honiball 2011:343).

The OECD (2017:134) states further that both Article 5(4)(a) and 5(4)(b) exclude activities performed on a premise not at the disposal of, or easily reached by the enterprise. In other words, the enterprise must have control and access to the stock or merchandise. Aivazian (2011:98) agrees, stating that the mere existence of stock is not sufficient for an enterprise to be considered a PE.

The difference that the UN MTC has from the OECD MTC is that the UN MTC excludes the delivery of merchandise and goods which, by implication, expands the inclusion scope of the UN MTC and results in a larger tax base for the source country (Aivazian 2011:98).

2.4.3 Article 5(4)(c)

Article 5(4)(c) in both the OECD and UN MTCs excludes from the PE concept, "stock or merchandise held by one party that is solely for the purpose of processing by another". It is therefore important to determine what the meaning of processing entails. The ordinary meaning of processing is to "perform a series of mechanical or chemical operations on (something) in order to change or preserve it" (Oxford Advanced Learner's Dictionary 2010:1168). Aivazian (2011:98) adds that it entails changing the most essential features of the product or the conversion of raw material into something else. In other words, some form of variance or change needs to take place for it to constitute processing (Aivazian 2011:98; Olivier & Honiball 2011:342).

As is the case with Article 5(4)(a) and 5(4)(b), this premise must also be at the disposal of the enterprise. The OECD MTC expands the meaning of at the disposal of in this regard, by including maintenance or inspection of the merchandise and stock (OECD 2017:135; Olivier & Honiball 2011:342). The OECD and UN MTC's do not differ with regard to this example.

2.4.4 Article 5(4)(d)

Article 5(4)(d), in both the UN and OECD MTCs, excludes from the PE concept "the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise". There are two parts to this definition, the first being the purchase of goods or merchandise and the second being the collection of data.

The complete example must be considered in the light of the core purpose of the business and must be evaluated within the context in which the business operates (OECD 2017:136). In this sub-paragraph, data is regarded as being similar to goods. Paragraph 69 of Article 5(4) of the OECD Commentaries expands the limits of this paragraph to include insurance companies and newspaper bureaus with the specific purpose of collecting and collating data (OECD 2017:136). Aivazian (2011:99) states that the most evident practical examples of this paragraph are liaison offices or representative offices.

Therefore, if an office is used solely for the purchasing of goods or merchandise (similar to the provisions in Article 5(4)(a)) or the business is used to gather data (no other change is made) for use by another party, the activities will be regarded as excluded from the definition of a PE (still have to be measured against the preparatory and ancillary requirement). Whilst the collection of data is not considered to be a PE *per se*, the processing of information in any manner would then be regarded as a PE. The OECD does not differ from the UN when analysing this example.

2.4.5 Article 5(4)(e)

Article 5(4)(e) of the OECD and UN MTCs acts as a safety net and excludes from the PE concept all activities not specifically included under any of the other paragraph. The provision states "the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity". This includes, amongst others, activities solely for the purpose of advertising or scientific research (OECD 2017:137; Miller & Oats 2014:204).

As with the previous sub-paragraphs, this must be analysed and measured within the context in which the business operates to determine whether or not it is of an ancillary or preparatory nature (Olivier & Honiball 2011:342). This example does not differ between the OECD and UN MTC with regard to the wording of the example.

2.4.6 Article 5(4)(f)

Article 5(4)(f) excludes from the PE concept activities operating in conjunction with "the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e)". Whether the activities operate together or apart, it does not change the application of paragraph 4 in its totality. Such activities shall be excluded from the definition of a PE, if they are considered as ancillary or preparatory (OECD 2017:138). This exclusion is normally used when Article 5(1) is not applicable or when it is not included in the DTA (OECD 2017:138).

Article 5(4)(f) is therefore subject to the previous paragraphs discussed. As there are some differences between the various paragraphs of Article 5(4) in the OECD and UN MTC, these differences have to be taken into consideration when interpreting the Article 5(4)(f) of the UN and OECD MTC. The UN commentary elaborates further by stating that countries making use of the UN MTC can opt to leave out sub-paragraph (e) and (f) from their DTA's (UN 2017:182). This resulted in a smaller exclusion criterion and ultimately a more beneficial taxing position for the source country.

It is evident from the above that various differences exist between the OECD and UN MTCs pertaining to paragraph 4 and this will ultimately aid when deciding which MTC is to be used as the basis of its DTA (UN 2017:184).

2.4.7 Article 5(4.1) of OECD and UN MTC

This provision was included in both the OECD and UN MTC in 2017 after a recommendation was made in the OECD/G20 Report on Action 7: Preventing the artificial avoidance of PE status (OECD 2015:12). The sole purpose of the Article is to prohibit the splintering or fragmenting of an enterprise, with the sole purpose of benefiting from the exceptions to the basic PE rule (OECD 2017:31; UN 2017:12).

The report published by the OECD on the BEPS Action Plan 7 was specifically published to prevent multi-national enterprises (MNE) from splitting their organizational structure in such a manner to obtain maximum tax benefits (OECD 2015:12).

This paragraph, when applied correctly, results in disregarding the Article 5(4) exclusions to the PE concept "if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same contracting state". The MTC's include two separate cases, when considering whether or not this paragraph applies (OECD 2017:140; UN 2017:185).

Article 5(4.1) will be applicable in the following two cases as provided in both the OECD and UN MTC:

I. The first case specifically applies when an enterprise already has a PE and an additional activity (regarded as either being ancillary or preparatory) within the same country is exercised. The OECD indicates that these additional activities normally constitute complementary activities but the application of this rule disallows the classification of these assets as being exempted from the basic PE definition (OECD 2015:13).

All of the income with regard to the PE and the complementary functions are considered a coherent whole in a geographical and economic sense (OECD 2015:13). Therefore, the PE and the complementary functions will constitute a PE and will be taxed in the source country.

II. The second case specifically applies where no current PE already exists within a source country. All of the activities currently performed in the source state are regarded as either preparatory or ancillary when considered in isolation, but when considered together, a different picture is painted. Article 5(4.1) disallows the classification of these activities as being ancillary and preparatory under paragraph 4. These activities are seen as a geographical and economic coherent whole when considered together (OECD 2015:121).

No difference exists between the OECD and UN MTC's with regard to Article 5(4.1). The only difference between these MTC's can be noted back to the various paragraphs of Article 5(4), as the UN MTC has an increased (broader) scope. The UN MTC as a result is therefore more beneficial to source countries.

2.5 Article 5(5) of the OECD/UN MTC and Article 5(6) of UN MTC

Both the OECD and UN MTC provide for a deemed dependent agency PE. The agency concept was first included in the Model Convention published by the League of Nations in 1927. The Model Convention excluded activities performed by bona fide independent agents (Sprague & Hersey 2003:331; Feuerstein 2011:107; Jones, Ward & Torrione 1993:163). This agency PE concept as it applied then differs significantly from the current principle (explained below) as an

enterprise was deemed to exist when an agent had a fixed place of business in the source country (Sprague & Hersey 2003:331).

In 1929, the fiscal committee of the League of Nations proposed four element criteria to be used when contemplating the existence of an agent PE (Jones, Ward & Torrione 1993:164; Sprague & Hersey 2003:331-332). The criteria proved to be insufficient and were subsequently removed. They were replaced with a fixed rule or principle, supported by various possible scenarios in which an agent is deemed to exist (Sprague & Hersey 2003:332).

In 1930, the fixed establishment requirement was removed by the League of Nations and the supporting scenarios were reduced to bring them in line with the removal of the fixed establishment requirement (Sprague & Hersey 2003:334).

In 1958, the OEEC included the agent PE definition, similar to what is included in the current MTCs. This principle stated that the agent "has and habitually exercises in that state an authority to conclude contracts in the name of the enterprise" and also included activities that must be dependent from a legal and economic point of view (Sprague & Hersey 2003:335; Jones, Ward & Torrione 1993:166).

At this point it is worth mentioning that the agency theory can be evaluated within a civil and a common law context. The agency principle will be analysed within a civil law context, however, as the OECD and UN MTCs incorporate a civil law approach in their commentaries (Feuerstein 2011:110; Olivier & Honiball 2011:210; Jones, Ward & Torrione 1993:179). The civil law approach regards the agency to be either direct or indirect, whilst the common law approach does not differentiate between direct and indirect representation. This makes the civil law approach much more compatible with the OECD and UN approach, given the dependent and independent provisions, when compared with the common law approach (Olivier & Honiball 2011:210; Jones, Ward & Torrione 1993:178; Feuerstein 2011:110).

The common law impact will be discussed first. When considering contracts concluded by an agent who is acting on behalf of another foreign enterprise and in the foreign enterprise's name, it will ultimately result in the agreement being legally binding on the principal foreign enterprise (Feuerstein 2011:107; Olivier & Honiball 2011:210; Jones, Ward & Torrione 1993:178). However, when reviewing civil law principles, the same cannot be interpreted, especially when

the agent acts in its own name. The foreign principal will not be held liable when the agent acts in its own name, and as a result, the contract will not be legally binding on the foreign enterprise (Feuerstein 2011:109; Jones, Ward & Torrione 1993:178).

When analysing the agency concept, reference should first be made to the basic PE definition as “a fixed place of business, through which the business of an enterprise is wholly or partly carried on” (OECD 2017:31). Given this, it would then be possible to avoid the existence of a PE, as the foreign enterprise is not physically occupying a fixed brick and mortar building nor does it have a place of business at its disposal (OECD 2017:31; Feuerstein 2011:107).

As the agent does not feasibly contribute to the economy, no fixed PE is therefore deemed to exist (economic and geographical coherent whole). Due to the possibility of avoidance through using a PE, the agency provision was included under Article 5 to address this statement. This provision deems an agent to be a PE when it habitually performs certain activities on behalf of a foreign principal enterprise (OECD 2017:141; Feuerstein 2011:107; Sprague & Hersey 2003:330).

Therefore, whilst the foreign enterprise does not have a physical presence in the source country, the agent does have a physical presence in the source country’s jurisdiction. This results in the foreign enterprise having a certain level of economic presence in the country, either directly or through the actions of a dependent agent.

Various changes as well as extensions were included over time to address fluctuations in economic and business conditions. One prominent example is the development of the service and hospitality industry that has led to the inclusion of yet another additional provision. A threshold was further introduced that regards services performed by employees (or other persons receiving instructions) of a foreign resident as a PE, as soon as the duration of such services exceeds a specific period of time (specific to each Treaty). This was regardless as to whether the services were performed through a fixed place of business (Alessi, Wijnen & de Goede, 2011).

The existence of an agency PE is dependent on meeting the requirements in Article 5(5). These requirements are as follows:

a) the activities need to be performed by a person,

b) the person must act on behalf of the foreign enterprise and in the name of the foreign enterprise

c) the person must habitably/routinely conclude contracts, or act as the agent of the principal when concluding contracts

d) the contracts must be in the name of the enterprise to either transfer ownership or for granting the use of a property

e) the contracts must be concluded without material modification (OECD 2017: 32, 143; Sprague & Hersey 2003:328).

These requirements (discussed below) focus solely on the person concluding the contact and do not in any way focus on the "when" and "where" (Sprague & Hersey 2003:328).

2.5.1 The activities need to be performed by a *person*

This requirement necessitates a *person(s)* to perform the action. The definition of a person can be found under Article 1 of the OECD and UN MTC, and includes any "individual, company or any other body of persons" (OECD 2017:29; Castro 2011: 138). The OECD MTC further indicates that agents do not have to be residents of the source country when performing their functions (OECD 2017:141). In addition to the definition of a person, a direct or indirect relationship must exist between the agent and the foreign principal, whilst an employee-employer relationship is not specifically needed (OECD 2017:141; Feuerstein 2011:110; Miller & Oats 2014: 205; Castro 2011:138).

2.5.2 The person must act on behalf of the foreign enterprise and in the name of the foreign enterprise

This requirement specifies that a person needs to perform the actions on behalf of the foreign enterprise and that the agent must therefore have the authority to conclude such contracts (Olivier 2002:875; Feuerstein 2011:111). Sprague and Hersey (2003:330) determined that these transactions are dependent on the "power and the discretionary authority" of the agent. The authority provided to the agent can be either circumscribed or restricted (Feuerstein 2011:110). The OECD adds to this definition by stating that an agent can only act on behalf of a principal when the enterprise is directly or indirectly influenced by the actions of the agent and are bounded by any agreement that are to be concluded between the agent and the third party involved in the business activities within the source state; in other words, this condition thus includes the power of the agent (OECD 2017:142; Feuerstein 2011: 112).

The OECD MTC takes into account the active involvement of the foreign enterprise, whilst considering the lack of active involvement of the foreign enterprise as the granting of authority over its activities (Feuerstein 2011:111). Castro (2011:139) determined that merely being present at a negotiation is not sufficient enough to be constituted a PE, as no direct or indirect action of the agent influences the foreign principal (Castro 2011:139; OECD 2017:142).

Authority is not defined in the OECD MTC and its commentary. The conventional meaning of authority is "the power to make decisions act in a specified way, delegated from one person or organization to another" (Oxford Advanced Learner's Dictionary 2010:83). Feuerstein (2011:110) regards authority as being either internal or external. Internal authority is the actions between the principal and the agent, whilst external authority is the actions between the agent and a third party. External authority will be applicable when analysing this provision in the OECD and UN MTC.

Skaar (1991:497) concluded that when an agent performs actions similar to those of the foreign enterprise, a PE is deemed to exist. On the other hand, a PE does not exist when the agent's activities are dependent on the supervision and control of the foreign enterprise (Skaar 1991:497; Feuerstein 2011:113). Before a PE is deemed to exist, the facts and circumstances must be weighed and evaluated against the requirements (Miller & Oats 2014:205).

Therefore, an agent is deemed to act on behalf of the foreign enterprise if the agent acts with a measure of authority and independence, whilst not being under the sole supervision and control of the foreign enterprise.

2.5.3 The person must habitably/routinely conclude contracts, or act as the agent of the principal when concluding contracts

This requirement takes into account the activity of habitually[1]concluding contracts[2] on behalf of the enterprise. This element consists of two separate sub-elements. The first is that a contract must be concluded habitually and the second requires an agent concluding contracts on behalf of the principal (OECD 2017:32, 143; Sprague & Hersey 2003:328).

Firstly, a contact has to be habitually concluded by the agent. This element requires a measure of frequency, whilst not being influenced by the nature of the contract (OECD 2017:142; Feuerstein 2011:115; Miller & Oats 2014:206; Olivier & Honiball 2011:347). The action performed by the agent must have an influence on the business activities of the foreign enterprise by directly contributing to the conclusion of an external contract with the contract being of a "substantial nature" (OECD 2017: 143; Miller & Oats 2014:206).

Secondly, the agent must conclude a contract. This will be subject to the laws presiding in the specific country and must have a substantial influence on the activities of the foreign enterprise as indicated above (OECD 2017:142). The OECD provides specific situations as to when an agent concludes a contract on behalf of a foreign enterprise. The first situation mentioned in paragraph 87 of Article 5(5) of the OECD commentaries regards a contract to be concluded within the source state, irrespective of whether it is actually signed within the source country itself. The state in which the elements of the agreement are decided on and finalised is seen as the state in which the agreement is concluded (OECD 2017:142; Feuerstein 2011:116).

The second situation regards a contract to be concluded when the agent acts on behalf of the foreign enterprise, whether or not the laws of the country require specific actions to be performed. In addition, the OECD commentaries also regard a contract to be concluded within a source country, even if domestic-specific rules led to the contract being concluded outside of the source country (OECD 2017:142; Feuerstein 2011:116). The mere fact that the agent has

the authority to conclude contracts is not enough to comply with this requirement. The authority needs to be physically exercised by the agent before it can be regarded as an agent concluding an agreement (OECD 2017:142; Feuerstein 2011:116).

2.5.4 The contracts must be in the name of the enterprise to either transfer ownership or for granting the use of a property

This requirement specifies that contracts must be concluded in the name of the enterprise or alternatively, must require the transfer of ownership or the granting of a right. The OECD does not require the contracts to be literally concluded in the name of the foreign enterprise. Feuerstein (2011:113) determined that a legally binding contract will be sufficient to comply with this element, whilst one has to refer back to the civil and common law principles. This element therefore has a legal element and does not focus on factual and economic circumstances (Feuerstein 2011:115).

2.5.5 The contracts must be concluded without material modification

This requirement necessitates the contract to be concluded without material modification. Firstly, a determination must be made as to the concept of materiality. Secondly, a determination must be made as to what is regarded as modification (OECD 2017:143). The Oxford Advanced Learner's Dictionary (2010:915) defines material as "(law) (of evidence or a fact) important and needing to be considered; significant or relevant, especially to the extent of determining a cause or affecting a judgement". Modification is defined as "the act or process of changing something in order to improve it or make it more acceptable; a change that is made" (Oxford Advanced Learner's Dictionary 2010:953). In other words, a significant change cannot be made to an agreement that was concluded on behalf of the foreign enterprise.

The OECD indicates that the requirements in the MTC are written to not only create enforceable rights and obligations between the principal and the third party, but also give effect to the agreement between an agent and a third party (OECD 2017:144).

The UN MTC reads similar to the OECD, but with minor differences. The first difference is that paragraph 24 of Article 5(5) of the commentaries to the UN MTC indicates that the term "routinely concludes activities without material modification" is not essential in determining the existence of a PE (UN 2017:194). Therefore, it is irrelevant as to whether or not material modifications are made to the contract. The only essential element that needs to be complied with is the existence of authorized recurring actions performed on behalf of and in the name of a foreign enterprise.

The second difference is that the UN MTC has an additional Article 5(5)(b) under which habitual activities of maintaining stock or merchandise of a foreign enterprise as well as delivering stock or merchandise on a regular basis to clients in the source country are included in the UN MTC, whilst this is absent in the OECD MTC (UN 2017:13; OECD 2017:32). This approach in the UN MTC is in line with the exceptions to a PE in the UN MTC, as it does not include delivery services when acquiring or maintaining stock or merchandise (OECD 2017:31; UN 2017:12).

The addition of paragraph (b) to Article 5(5) in the UN MTC provides a broader scope than what is included in the OECD MTC. A larger inclusion in the UN MTC will ultimately lead to a larger tax base in the source country and be more beneficial to a source country (UN 2017:194; Busato 2011:52; Daurer 2014:72). The UN commentaries broaden the scope further by including activities such as the advertising and promotion of goods or services, conducted on behalf of the foreign enterprise under paragraph (b) of Article 5(5) (UN 2017:195).

2.6 Article 5(6) of the UN MTC: Insurance PE's

Another area of alteration between the OECD and UN MTCs can be found in Article 5(6) of the UN MTC (which is not in the OECD MTC). This provision deems a PE to exist when an enterprise provides insurance to clients or collects premiums on behalf of a foreign enterprise in the source country, excluding re-insurance of clients (UN 2017:14; Olivier & Honiball 2011:346; Daurer 2014:72).

The UN commentary indicates that this provision is specifically included as insurance agents do not normally have the one-sided authority to conclude contracts on behalf of a foreign principal (UN 2017:196; Olivier & Honiball 2011:346). As the agent does not have the unilateral

authority to act on behalf of the foreign enterprise, the agent will not comply with the requirements of Article 5(1) and therefore no PE is deemed to exist (UN 2017:195-196; Daurer 2014:73).

The requirements under Article 5(6) necessitate that the agent has to (1) collect premiums in the source country or (2) insure risks in the source country through an agent (Olivier & Honiball 2011:346; Miller & Oats 2014:208).

Paragraph 28 and 29 of Article 5(6) of the UN commentary indicates further that certain countries include this provision even if the actions are performed by an independent agent. The inclusion is left to the negotiation between the contracting countries. This addition is due to the nature of the business, leading to the inability of distinguishing between dependent and independent agents, while supported by the risks associated with the business, as well as the ease of representing such a business (UN 2017:196).

In conclusion, the UN MTC has a much larger tax base and will therefore ultimately provide a larger taxing right that will benefit the source country in the long run, when compared with the OECD MTC.

2.7 Article 5(6) of the OECD MTC and Article 5(7) of the UN MTC

Article 5(6) of the OECD MTC deems a dependent agent to be a PE when it concludes contracts on behalf of the foreign enterprise. Independent agents acting in the ordinary course of business are excluded from the definition of a PE (OECD, 2017:32, 146; UN 2017:13).

In determining whether or not this provision applies, a determination must first be made as to what constitutes independent as well as to whether such an independent agent is acting in the ordinary course of their business.

2.7.1 The agent must be independent

The OECD suggested possible indicators to be used in determining whether or not an agent is seen as independent. The indicators must be weighed against the facts and circumstances in which the enterprise functions and are not set in stone (OECD 2017:148).

The first indicator takes into account whether or not the agent is subject to the supervision and control of the foreign enterprise. Otherwise stated, the amount of freedom with which the agent can perform its activities. When more freedom is given to an agent, it will ultimately result in an agent acting more independently (OECD 2017:147; Feuerstein 2011:118; Olivier & Honiball 2011:347).

The second indicator takes into account whether the foreign enterprise relies solely on the skills and knowledge of the agent. Feuerstein adds that an independent agent will in most cases rely on its own knowledge and skill when performing an assignment (OECD 2017:147; Feuerstein 2011:118).

The third indicator considers the party ultimately bearing the risk (OECD 2017:147; Miller & Oats 2014:206; Feuerstein 2011:121). Under normal circumstances, when an agent is integrated with the foreign entity's operations, bearing little to no risk, it will result in the agent being dependent and *vice versa.* This indicator not only includes the inventory risk, but also the risk of making possible losses (OECD 2017:147; Miller & Oats 2014:206; Feuerstein 2011:122).

The fourth indicator takes into account the type of remuneration received for the rendering of services. This remuneration can either be fixed or variable. When an agent receives variable remuneration and this remuneration is contingent on the specific functions and risks borne by the agent, the agent is considered to be independent from the foreign enterprise. When the remuneration is a fixed amount, it will not be influenced by the risk borne by the enterprise, and is similar to remuneration received by an employee. In this regard, it can therefore be stated that the agent is not acting independently (Feuerstein 2011:121-122).

The fifth indicator looks at the activity of the agent and whether or not it relates to the gathering and provision of information to the foreign enterprise. In this regard, an agent will be seen as dependent when it requires the final approval of the foreign enterprise (Feuerstein 2011:118).

The last indicator evaluates the number of foreign enterprises serviced by the agent and the time frame in which the service is rendered. Should the agent provide a service to a single client over a period of time, it will be regarded as being dependent on the foreign principal and it will then be compliant to paragraph 5 (Feuerstein 2011:119; Miller & Oats 2014:206).

Whilst the indicators are used in determining whether or not an agent is acting independently, various restrictions can be imposed on the agent by the foreign principal, resulting in a subsequent limitation of its scope. In determining whether or not the agent is dependent, one must refer to the applicable actions within the limited scope (OECD 2017:147; Feuerstein 2011:123).

2.7.2 The independent agent must be acting in the ordinary course of their business

This element requires the activities of the agent to be performed in the ordinary course of its business. Should an agent perform activities on behalf of the foreign enterprise which are not in line with the customary business operations, it will not comply with the requirements in Article 5(6) of the OECD MTC and Article 5(7) of the UN MTC, and will be deemed to be a PE under the dependent agent clause (Feuerstein 2011:122; Olivier & Honiball 2011:346).

The agent's individual sphere of business should be compared with the common sphere of business in which the principal functions (Feuerstein 2011: 122). A common test used is to compare the operations of the agent with similar businesses in the same industry to determine whether or not an agent conducts a separate business to that of the foreign enterprise.

The MTC does allow intermediate activities to be performed, on a non-regular basis, in addition to the actions performed to the foreign enterprise (Feuerstein 2011:123; Miller & Oats 2014:206). There must be a visible change of activities before one can comply with the requirements (OECD 2017:148). In essence, an agent is not considered to be a PE when its activities are performed separate from its principal entity.

The OECD MTC excludes activities performed exclusively or almost exclusively on behalf of a person or someone closely related to that person from the definition of an independent person. Should an enterprise perform such activities, it will be regarded as being dependent on the

foreign enterprise (OECD 2017:32). A determination must, however, be made as to what is regarded as "closely related".

Closely related can be regarded as being connected. Connected parties are defined as a narrow relationship between the agent and the principal. The OECD MTC indicates that Article 5(6) must be read in conjunction with Article 5(7). Should an agent solely perform activities on behalf of a single client, it would be regarded as not being independent and would therefore be subject to the deemed PE principle as stated in Article 5(5) (OECD 2017:147).

Examples of what can be considered as being independent agents include activities performed by (1) a broker, (2) general commission agent or (3) another agent of an independent structure (Olivier & Honiball 2011:345; Feuerstein 2011:116). In a South African context, an independent stockbroker is also regarded as an independent nature and a PE is not deemed to exist. This was confirmed in the case of *SIR v Downing* (1975 (A) SA 518 at 523A).

The independent agent provision in the UN MTC can be found in Article 5(7). The Article is similar to the OECD MTC. It should be noted, however, that the previous UN MTC made it much easier to comply with the independent agent requirements under Article 5(7). In the 2017 version of the UN MTC, the provision was removed resulting in it now being similar to that of the OECD MTC partly as a result of the BEPS actions (UN, 2017: 201).

The basic principle is therefore similar in both the OECD and UN MTC; the indication of activities performed independently in the ordinary course of its business will not be regarded as a PE (UN 2017:13).

Feuerstein added to the above by stating that activities performed by an agent that are ancillary or preparatory, will be subject to Article 5(4) of the OECD and UN MTC (OECD 2017:31; UN 2017:12). Therefore, should an agent's activities be limited solely to ancillary or preparatory activities, it will not constitute a PE as a result of the remoteness in tracing the income to the core activities of the enterprise (OECD 2017:142; Feuerstein 2011:107).

Taking the complete dependent and independent agent provision into account, with reference to the exclusions in Article 5(4), the UN MTC results in a much larger inclusion base for source countries compared to the OECD MTC. All of the above must be weighed against the facts and circumstances present with regard to the specific enterprise for a complete determination to be made (Feuerstein 2011:121).

2.8 Article 5(7) of the OECD MTC and Article 5(8) of the UN MTC

The general rule in both the OECD and UN MTCs is that the mere existence of a subsidiary in a country does not, in itself, deem a PE to exist in a source country (OECD 2017:32; Miller & Oats 2014: 209; Le Gall 2007:179). This emanates from the assumption that the subsidiaries are legal independent persons. Paragraph 115 of Article 5(7) of the OECD commentaries indicates that the situation will not be influenced when a subsidiary is solely or partially managed by the foreign parent company (OECD 2017:150; Le Gall 2007:185; UN 2017:201).

A PE does not exist as a result of ownership, control or association (Rohatgi 2002:78). The above principle was established in an Italian court case between the *Ministry of Finance (Tax Office) v Phillip Morris* (GmbH) (2002, No 7682/02).

However, the case of *Ministry of Finance (Tax Office) v Phillip Morris* (GmbH) (2002, No 7682/02) also concluded that activities of a single subsidiary company could be regarded as a PE of a foreign enterprise in certain situations. Le Gall analysed the work done by the OECD in justifying the categorization of enterprises as a PE in certain circumstances (Le Gall 2007:181).

2.8.1 Le Gall's analysis of circumstances under which a subsidiary can create a PE

Le Gall first analysed the words "in itself". These words determined that a parent company can have a PE in a source country when it is subject to (a) the independent agent rules in Article 5(6) of the OECD MTC or (b) if the activities of a foreign enterprise through the use of a local subsidiary or its premises (Le Gall 2007:179; Schoueri & Günther 2011:69).

2.8.1.1 A subsidiary can be subject to dependence agency rules

Dependence will have to be evaluated by measuring various *indicators.* Three indicators can be used when determining dependence relationship between the subsidiary and the foreign enterprise, inspired by the case of *Donetto v. S.A.R.L. De Gestion Pierre Cardin* (Donetto v. S.A.R.L. De Gestion Pierre Cardin, No. 600136/03, 2004 WL 1218882). The three indicators are discussed next.

(a) Indicator 1 of the dependence of a subsidiary

This indicator takes the personality of the subsidiary into account, through the common ownership of shares. In other words, when an enterprise cannot act independently, it will be regarded as a branch of the parent company and will therefore be a PE of the foreign enterprise (Le Gall 2007:190; Schoueri & Günther 2010:69). The independence of a subsidiary is influenced by the relevant laws of the tax jurisdictions, supplemented by court cases. Factors to be considered include the existence of a separate set of accounting records, tax returns and separate bank accounts (Le Gall 2007:193). The mere management of the subsidiary is not sufficient to constitute dependence, but control must be exercised economically and financially over the enterprise (OECD 2017: 150; Feuerstein 2011:118).

When a parent company controls all or a substantial amount of the actions of the subsidiary, without the decisions being subject to the discretion of the subsidiary, it will result in the subsidiary being dependent on the parent company. This situation is supported by a lack of available financial, material and human resources, at the disposal of the subsidiary (Le Gall 2007:186; Feuerstein 2011:118).

An example, provided by Le Gall (2007:188), was that of a bankruptcy case. In this example the parent company was held liable and pursued for the outstanding amounts of the subsidiary as a result of the subsidiary not being able to pay. The above claims were supported in the *Auto Train Corp* court case (Le Gall 2007:188) 1987 810 F (2d) 270, 276 (D.C. 1987)). This was further substantiated by *Société Zimmer Ltd v Ministre de l'Économie (des Finances et de l'Industrie, International Tax Law Reports,*2010 772 F (12 ITLR 739), where a PE was

considered to exist in the case of a subsidiary when its actions legally bind the principal entity, whereas the parent company was held liable.

(b) Indicator 2 of the dependence of a subsidiary

This indicator should be made to the compatibility of the groups' organisation (Le Gall 2007:186). In determining the measure of dependence between the subsidiary and the parent company, the *Dominion* court case (*Dominion Bridge Co Ltd v The Queen* (1975 C.T.C. 263, affirmed by [1977] C.T.C.554) provided much needed principles.

This court case concluded that a subsidiary and parent company are considered dependent when they work and act as a single entity. A subsidiary and parent company are seen as a "single entity" when they significantly operate towards achieving a single goal (Le Gall 2007:196). As a result, the dependability will increase as the parent company and the subsidiary increase their interactions with each other.

This point was further strengthened in the *Motorola Inc v Deputy C.I.T* (2005 95 I.T.D. 269 (Delhi): 2005 96 TTJ (Delhi) 1) case. This court case determined that dependency was directly influenced by the interchangeability of employees within the subsidiary and parent company, including the benefits provided by the parent company to the employees of the subsidiary. This increased the compatibility and dependency of a subsidiary on a parent company (Le Gall 2007:197).

(c) Indicator 3 of the dependence of a subsidiary

This indicator looks at the non-standard financial relationship between the parent company and the subsidiary. When a subsidiary is financially reliant on the parent company, resulting in transactions not being at arm's length, whilst benefiting one or both of the parties in the transaction, it is considered that this influences the dependence of the subsidiary (Le Gall 2007:186). Arm's length is defined as obtaining an excessive benefit from another party, when compared with similar situations concluded between non-connected parties (Olivier & Honiball 2011:838).

Should the subsidiary thereafter conclude any non-arm's length contract on behalf of the parent company, not being an independent agent, this would deem the subsidiary to be a PE (OECD 2017:150; Miller & Oats 2014:209; Le Gall 2007:202; Schoueri & Günther 2011:69).

The facts and circumstances specific to each enterprise must be weighed against the context within which the subsidiary operates to determine whether, or not, a PE exists.

2.8.2 A subsidiary could create a PE of its parent if space is availed at the foreign companies disposal

The activities of a foreign enterprise through the use of a local subsidiary or its premises could create a PE for the foreign enterprise. Should a foreign enterprise have a fixed place at its disposal, being at the premises owned by the subsidiary, a PE would exist. This is in line with the provisions under Article 5(1) of the OECD and UN MTC.

Given these requirements in determining the existence of a PE, two interpretations can be followed in determining the existence of a PE within a subsidiary.

The first approach categorises a subsidiary as a separate legal PE, also called the physical PE approach (Sagmeister 2011:74; Muizelaar 2004:241). The risks, assets and liabilities would be carried by the subsidiary (Le Gall 2007:202-203; Burgers 2009:61). In this regard, transfer pricing rules and the arm's length principle must also be accounted for when trading with the parent company (Le Gall 2007:211; Burgers 2009:59).

The second approach deems a PE to be a separate activity from the subsidiary. The PE is a subset of the foreign parent company (Le Gall 2007:202). Under this approach a PE can be an agent of the foreign parent company and will have to comply with the requirements of Article 5(5) (Muizelaar 2004:243; *Ministry of finance (Tax Office) v Philip Morris (GmbH)*) (*Ministry of Finance (Tax Office) v Philip Morris (GmbH), No 7682/02 (25 May 2002))*. A determination must be made as to what income, assets and liabilities are attributable to the parent company and the subsidiary, respectively (OECD 2004:17; Le Gall 2007:202-203). This approach places the taxability on the shoulders of the parent company (Le Gall 2007:203; Muizelaar 2004:243).

The same provisions applicable to parent-subsidiary relationships are applicable to various companies within a group. Should the entity, trading in the source country, become subject to the provisions under Article 5(1), it would be regarded as a PE (Miller & Oats 2014:209; Feuerstein 2011:118-119).

When more than one PE relationship exists between both a parent and subsidiary or between various companies of the same group, each relationship should be seen in isolation (UN 2017:201). Therefore, should Company A and B have an agreement, as well as Company C and B, each relationship should be analysed separately to determine whether or not a PE is deemed to exist (Miller & Oats 2014:209; *Ministry of Finance (Tax Office) v Philip Morris (GmbH), No 7682/02 (25 May 2002);* Le Gall 2007:202).

The OECD and UN MTC are mostly similar with regard to this matter, but some differences exist. The first difference is the fact that the UN MTC makes reference to artificial structures and the use of these structures to evade taxation in its commentaries. This MTC therefore refers back to the term substance over form (UN 2017:202).

The OECD and UN provide an example in this regard. The example includes a multinational company making its premises available to another company in the group, which will constitute a PE when the other company performs its activities through this place of business (OECD 2017:150-151; UN 2017:202).

This example is in contradiction to the activity where a company delivers a service to another company in the group, and the place at which the services are delivered is not at the disposal of the company delivering the service. In this example, the company will not be considered a PE. These examples indicate that one should take into account the actions of the enterprise within its broader general background (OECD 2017:150-151; UN 2017:203).

After considering several sources, it is evident that there is no difference between Article 5(8) of the UN MTC and Article 5(7) of the OECD MTC. The only difference can be found when referring back to the previous paragraphs in the various MTCs when incorporated with this provision.

2.9 Article 5(8) of the OECD MTC and Article 5(9) of the UN MTC

Article 5(8) of the OECD MTC and Article 5(9) of the UN MTC are similar in structure. The “closely related to an enterprise” rule is specifically relevant in Article 5(4.1) (OECD 2017:31; UN 2017:12), the anti-fragmentation rule and in Article 5(6) (OECD 2017:31; UN 2017:13) the independent agent provision (UN 2017:203).

Closely related is loosely defined in both MTCs as having control over another enterprise, or when two enterprises are controlled by the same party (OECD 2017:32; UN 2017:14). It is important to evaluate the use of this word against the terms used in the previous MTCs. Gillespie (2018) evaluated this word against the terms connected and associated. These words were used in the 2014 and 2015 OECD discussion drafts, respectively (OECD 2014:19-21; OECD 2015:37-39). The difference between connected and closely related is easier to spot than the difference between associated and closely related due to the ambiguous nature of the use thereof (Gillespie 2018:30).

Both of the terms associated and closely related relate to the control over a business, while the only difference between the terms lies in the fact that the term closely related is much more specific as it provides specific thresholds with which one should comply (Gillespie 2018: 31). While all these terms refer to the same central idea, the specificity of the use of a specific term will aid in the application of the MTC and clear any uncertainty.

It is important to note that the provisions refer to the words “shall be considered” indicating that it is a mandatory requirement, while providing two specific sets of stands to be complied with before one is considered to be closely related.

The first example provided by the MTC covers special circumstances giving an enterprise control not through the ownership of an interest in an enterprise (OECD 2017:151). The example provided in paragraph 120 of Article 5(8) of the OECD commentaries refers to an enterprise having control due to a special arrangement, for instance through a contractual arrangement (OECD 2017:151; UN 2017:203). These arrangements are not specified by the MTC and can be considered to be non-exhaustive (Gillespie 2018: 31).

The second example provided by the MTC, includes an enterprise owning 50% or more of the shareholding or the beneficial ownership of an enterprise, effectively giving it control. These provisions do not only include interests directly amounting to 50%, but also any indirect interest amounting to 50% (OECD 2017:151; UN 2017:203).

The OECD and UN MTCs are similar and must be considered within the context of the other provisions in both the MTCs.

3 CONCLUSION

It is evident from this dissertation that many differences exist between the OECD and UN MTCs (Busato 2011:33). The respective MTCs (being the OECD and UN) ultimately aim to achieve their main goals by benefiting either the source or residence states. The OECD MTC benefits the residence state, whilst the UN MTC benefits the source state (Olivier & Honiball 2011:271).

The most significant differences between the OECD and UN MTCs can be summarised as follows:

- The first difference is in Article 5(3) of the UN MTC. It ultimately benefits source states, is the reduction of the 12-month threshold to a 6-month threshold, when considering the existence of a PE as a construction site as well as installation-and-assembly projects (OECD 2017:31; UN 2017:11; Olivier & Honiball 2011:337).
- The second difference is found in Article 5(3)(b) of the UN MTC. The UN has an additional Article 5(3)(b) which creates a PE through the furnishing of services, especially consultancy services, over and above the OECD MTC provisions. These services will be included when they are performed for a certain time period, whilst ultimately benefiting the source state (UN 2017:11; Olivier & Honiball 2011:337).
- The third difference is found in Article 5(4) of the UN MTC. The UN MTC excludes the delivery of goods and merchandise as part of the acquisition and maintenance of goods or merchandise (OECD 2017:31; UN 2017:12). It is important to note that this must still be evaluated against the possible ancillary and preparatory nature of an activity. The

UN MTC ultimately benefits the source state, whilst the OECD benefits the residence state.

- The fourth difference is found in Article 5(5) of the UN MTC and includes the activity of habitually maintaining stock and merchandise on behalf of the foreign enterprise (part of the agency principle). This provision is not included in the OECD MTC. The UN MTC therefore benefits the source country through the widening of the inclusion criteria, whereas the OECD benefits the residence state (OECD 2017:32; UN 2017:13).
- The fifth difference is found in Article 5(6) of the UN MTC, which is absent in the OECD MTC. This provision regards agents as PEs when they insure third parties (but excluding reinsurance of third parties) and collect premiums on behalf of the foreign enterprise in the source state. This ultimately benefits source states (OECD 2017:32; UN 2017:13).

Based on the theoretical aspects, using the UN MTC solely will result in a more beneficial taxing position for the source state. Using the OECD MTC will result in a more beneficial taxing position for the residence sate. In effect, this reaffirms the hypothesis included in Part 1 of this dissertation.

This statement was generally supported by Bland (2013:107) in his practical evaluation of SADC countries in which he concluded that SADC countries do not make use of the provisions in the UN MTC but mainly use the OECD MTC.

Blake (2013:107) attributes the lack of including UN provisions to the reluctance of the developing countries to lose possible foreign direct investment (FDI). The SADC countries believed that the benefit of the short-term FDI would be an offset against the sacrifice of tax revenue and the nett effect would even out (Bland 2013:107). Blake concluded further that the non-inclusion of these provisions could be attributed to international practices specifically making use of the certain provisions, whereas developing countries might lack negotiating capacity (Bland 2013:107).

Therefore, whilst the OECD and UN MTCs are written for the benefit of their respective goal countries (being either developed or developing countries), solely from an academic perspective, the practical application of these MTCs could differ significantly from its academic

counterpart. This must therefore be considered and evaluated by investors when determining in which country they plan to invest (Souza de Castelo Branco 2011:50).

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