The Agency Permanent Establishment

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I. Introduction to the agency clause and its role within Art. 5 OECD Model

If the PE threshold only consisted of the basic rule on PEs, i.e. a fixed place of business made of bricks and mortar, a foreign enterprise could simply avoid a PE in the other State by engaging salesmen or other representatives who would then perform the business activities which would otherwise need to be undertaken by the foreign enterprise itself through a fixed place of business. Thus, such intermediaries would participate in the other State’s economy on behalf of the foreign enterprise for which they are acting. Since the foreign enterprise is not participating itself in the other State’s economy but still benefits from it through persons acting on its behalf, the agency clause was included in Art. 5 OECD Model as a deeming rule.

As mentioned above, the basic rule of Art. 5 is a fixed place of business as defined in para. 1. Para. 2 provides some explicit examples of fixed places of business such as an office, a warehouse, a branch, etc. Para. 3 further deems a PE to exist where an installation or construction project lasts for more than 12 months. Para. 4 provides a list of preparatory or auxiliary activities which are considered so remote from the actual realization of profits that it would not be feasible to allocate any profits to such PE. Since, for the purposes of para. 5, the activities of the agent acting on behalf of the foreign enterprise will be attributed to the latter, the exceptions listed in para. 4 generally also apply to the activities performed by that agent on behalf of the foreign enterprise.

The exact wording of paras. 5 and 6 reads as follows:

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person – other than an agent of an independent status to whom paragraph 6 applies – is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised

In 1899 the concept of the “ständiger Vertreter” was used for the very first time in a double tax treaty, namely in the treaty between Prussia and Austria/Hungary. On a multilateral level, it was not until 1929 that the League of Nations first mentioned the Agency PE in one of its reports: “When a foreign enterprise regularly has business relations in another country through an agent established there, who is authorized to act on its behalf, it shall be deemed to have a permanent establishment” (League of Nations, Report to the Council of the work of the first Sess. of the Committee, Document C.516.M.175.1929.11, Geneva, 26 October 1929). However, the Agency PE was included in neither the Mexico (1943) nor the London (1946) Model Convention. In 1958 an agency clause was introduced in the Model Convention by the Fiscal Committee of the OEEC. While the wording of that paragraph was slightly modified, its content was literally adopted by the 1963 OECD Model and remained unchanged in all following OECD Models until today.

Para. 23 of the 2010 OECD Commentary on Art. 5.
through a fixed place of business, would not make this fixed place of business a
permanent establishment under the provisions of that paragraph.

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

The introductory words of para. 5 make clear that the agency clause is to be applied
as an alternative test to the basic PE rule. The agency clause is therefore only to
be examined if no PE exists under paras. 1 and 2. Where the agent’s activities
are carried out through an existing fixed place of business of the foreign enterprise,
the intermediary’s activities would be attributed to that existing PE. Finally, para. 7
clarifies that a subsidiary may not in itself be deemed to be a PE of the parent company
and vice versa.

Notwithstanding the genuine tax policies standing behind the agency clause,
its wording frequently leaves room for ambiguous interpretation amongst tax prac-
titioners, some of them even advocating the abolishment of the agency clause. Although
the Commentary to the OECD Model tried to clarify the provision’s intentions,
a lack of clarity remained. This paper seeks to reduce the existing ambiguity
and tries to promote a more uniform interpretation of one of the probably most contro-
versial provisions of Art. 5 OECD Model. The Agency PE’s threshold will be
primarily examined under the 2010 OECD Model and its Commentary. Reference
to the UN Model will be made where relevant. The allocation of profits to an Agency
PE or the remuneration of the intermediary is not within the scope of this paper.

II. The concept of agency: civil law vs. common law

Being bilateral agreements, tax treaties and their interpretation are, as a matter of
principle, governed by the Vienna Convention on the Law of Treaties concluded

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3 No reference is made to the requirement that a fixed place of business needs to be at the dis-
posal of the intermediary or the foreign enterprise in the other State. Rather, the 1963 Com-
mentary already clarified that the decisive criterion is whether the intermediary has the aut-
hority to bind the foreign enterprise’s participation in the economy of the other State.
4 Para. 35 of the 2010 OECD Commentary on Art. 5.
5 In order to avoid any misunderstandings due to different meanings under domestic laws of
the term “agent”, hereinafter the term “intermediary” will be used instead.
6 See Vogel and Lehner, Doppelbesteuerungsabkommen (Munich: Verlag C.H. Beck, 2008),
Art 5 rec. 122; Pleijsier, “The Agency Permanent Establishment: The Current Definition –
7 See e.g. Görl, „Die Vertreterbetriebsstätte der Doppelbesteuerungsabkommen – ein Geburts-
fehler des Art 5 OECD-Musterabkommen“ in: Strunk/Wassermeyer/Kaminski, Unterneh-
mensteuerrecht und Internationales Steuerrecht. Gedächtnisschrift für Dirk Krüger (Bonn:
Stollfuß-Verlag, 2006), p. 124; Wassermeyer, “Kritische Anmerkungen zur Vertreterbetriebs-
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in 1969. A tax treaty, however, further provides a close linkage between the tax systems of the two States concerned. Where technical expressions are used in a tax treaty they should normally be the reflection of the expressions used under the domestic law of the contracting parties\(^8\). As regards the concept of agency, a non-tax law concept is applied in a bilateral tax treaty, whereas the Contracting Parties might apply that concept in different ways domestically. This typically holds true for civil law and common law countries.

In contrast to common law, civil law distinguishes between direct and indirect representation, i.e. whether the intermediary acts in the name of the foreign enterprise or in its own name\(^9\). In the case of direct representation, the intermediary acts in the name of the foreign enterprise and the foreign enterprise is therefore bound vis-à-vis the third party. Legal rights and obligations under the contract concluded with the third party are binding upon the foreign enterprise and not upon the intermediary. This is not the case for indirect representation: the intermediary acts in its own name and therefore the foreign enterprise cannot be bound by the contract concluded with the third party. From a civil law perspective, a subsequent agreement would be required between the foreign enterprise and the intermediary in order to bind the foreign enterprise under the contract.

In common law legal systems, the acting of the intermediary on behalf of the foreign enterprise in most instances binds the foreign enterprise vis-à-vis the third party. Typically, no distinction between direct and indirect representation is made. Whether the foreign enterprise may be disclosed or undisclosed to the contract concluded by the intermediary does generally not make a difference. Even if the third party does not know about the existence of the foreign enterprise when entering into the contract with the intermediary only the foreign enterprise and not the intermediary may be sued by the third party. The decisive criterion is that the intermediary is authorized by the foreign enterprise to act on behalf of the latter.

In conclusion, if an intermediary concludes a contract in its own name but for the account of a foreign enterprise the foreign enterprise will usually be bound by the contract under common law, whereas under civil law only the intermediary and not the foreign enterprise will be bound by such contract\(^10\). Further conflicts may arise in situations where an intermediary is appointed under common law and concludes a contract in its own name but the contract itself is governed by civil law, and vice versa. Since the OECD Model seems to predominantly incorporate a civil

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9 Since 1958 the agency clause requires that the intermediary openly executes its authority to conclude contracts in the name of its foreign enterprise. Although qualification conflicts arose in the past (and still arise today) from the two different approaches under civil and common law, the agency clause became a commonly applied PE concept.
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law concept without clearly expressing the same in its Commentary, tax practitioners from common law countries may find it difficult to follow the Agency PE concept as provided for by the OECD.

III. Is there an Agency PE?

Based on the above, an Agency PE can only exist if the criteria of para. 5 are met and those of para. 6 are not. In this regard, para. 6 should not be understood as an exception to para. 5. As mentioned in the Commentary, para. 6 rather was inserted for the sake of clarity and emphasis and covers a different situation from para. 5, namely cases where the intermediary does not operate the business of the foreign enterprise but must be regarded as an independent entrepreneur of his own.

1. Person

The term is defined in Art. 3 para. 1 letter a) OECD Model and includes individuals, companies and any other bodies of persons. Thus, partnerships, foundations, etc. are also covered by the term, either because they are bodies corporate for tax purposes (i.e. companies) or because they constitute other bodies of persons. Persons who can create an Agency PE further do not need to be residents of the State in which they act or to maintain a place of business in that State. It is also irrelevant whether the person is liable to tax (limited or unlimited) in that State or considered an agent under the relevant domestic law.

The agency concept requires a legal relationship between an intermediary and a foreign enterprise, i.e. two separate persons. If an entrepreneur acts as his own intermediary, an agency relationship therefore cannot be established and no Agency PE can exist. The result should be the same in the case of an executive of a corporate entity or a partner of a partnership since such persons do not represent the enterprise but act as the enterprise itself. A PE could exist under the basic rule in these cases, however. Where different partners act on behalf of the same body of persons, a single Agency PE threshold should apply. Such partners would commonly also co-operate under a common management (locally or abroad) or be treat-

11 Para. 36 of the 2010 OECD Commentary on Art. 5.
12 Para. 2 of the 2010 OECD Commentary on Art. 3.
13 Para. 32 of the 2010 OECD Commentary on Art. 5; see also BFH, 13 February 1974, I R 219/71, BStBl. II 1974, p. 361: an intermediary authorized to conclude contracts in the name of the foreign enterprise on board of a ship (which is not a fixed place of business) constitutes an Agency PE for the foreign enterprise in the State in which the ship is registered.
ed as a single entity for accounting purposes. If a body of persons is found to have a PE, each of the partners would be liable to tax in the other State. Whether the activities of a partner will be attributed to the body of persons of which he is part should depend on the capacity in which such partner acts. The answer is different for employees of the same company: employees cannot act on behalf of their employer without obtaining a power of attorney or another contractual authorization. Accordingly, each employee would need to be considered as a separate person.

2. **Authority to conclude contracts**

The authority to conclude contracts does not need to be a general one but can be circumscribed or restricted. The crucial question is whether the intermediary has enough power to bind the foreign enterprise upon the contracts the intermediary concludes.

With regard to the term “authority to conclude contracts” it does not seem entirely clear whether the authority between intermediary and foreign enterprise is meant (internal) or the authority a bona fide third party would assume to exist when it concludes a contract with the intermediary (external). The OECD Model and its Commentaries do not provide detailed guidance on this issue. One could interpret the wording “has […] an authority” in a way that the actual internal authority formally granted by the foreign enterprise should be decisive but this seems to be a vague approach. In the author’s view, the scope of authority as it has been formally granted should not be decisive but rather the way the authority is actually exercised by the intermediary. If, for instance, the activities of an intermediary only having authority to collect orders which are subject to further approval of the foreign enterprise go beyond such an authorization and the intermediary concludes orders on behalf of the foreign enterprise, an Agency PE should result if the foreign enterprise does not reject such unauthorized dealings of the intermediary and a bona fide customer would assume that the authority was actually granted and rely on the latter.

Also, the OECD Commentary considers a lack of active involvement by the foreign enterprise as an indicator of a grant of authority to the intermediary. Such a lack of active involvement can be found where the intermediary negotiates the terms and conditions of a contract with the third party and the foreign enterprise formally signs the outcome of such negotiations, i.e. the contract. Nonetheless, such

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18 The 1963 Commentary already acknowledged that also in practice it appears unlikely that any dependent intermediary has a completely unfettered authority to conclude contracts. The view that there must be a general authority was rather taken in older treaties, especially in US and UK treaties.
19 Under German civil code “Duldungsvollmacht”.
20 Para. 32.1 of the 2010 OECD Commentary on Art. 5.
negotiations must be conducted to a broad extent\textsuperscript{21}. Also, a foreign enterprise should not be deemed to be bound by the contract if the terms of the contract, as concluded by the intermediary, clearly state that the acceptance of the same is subject to the further approval by the foreign enterprise, i.e. this pre-condition is openly communicated to the customer. It is essential, however, that the foreign enterprise also makes use of this caveat in practice.

From a common law perspective, a bona fide third party does not seem to be as relevant as in civil law because, as mentioned earlier, even if the foreign enterprise is undisclosed and not known to the third party the contract can nevertheless be binding upon the foreign enterprise. Thus, the internal authority seems to be more relevant in common law systems whereas in civil law systems the external authority prevails. Notwithstanding the foregoing, in principle there should be no difference whether the intermediary executes an authority to conclude contracts binding on the foreign enterprise by way of a formal agreement or by way of the foreign enterprise’s conduct\textsuperscript{22}. Rather, it should be decisive that the foreign enterprise is ultimately bound by the intermediary’s actions and, further, that a bona fide third party would assume that the intermediary’s actions create an obligation of the foreign enterprise\textsuperscript{23}. This of course refers to both internal and external authorization, whereas in the author’s opinion external authority in the form of a bona fide third party should not be able to create an Agency PE on a stand-alone basis because for a foreign enterprise being bound by the actions of the intermediary an internal authorization must still be given.

Contracts concluded by the intermediary must further cover the business proper of the foreign enterprise\textsuperscript{24}.\par

\textsuperscript{21} Para. 33 of the 2010 OECD Commentary on Art. 5 which requires that all elements and details of a contract be negotiated by the intermediary. In this regard, the decision of the Italian Supreme Court in \textit{Philip Morris} held that the mere participation of representatives of an Italian enterprise in phases of the negotiation or conclusion of contracts with no power of representation should be considered to be an authority to conclude contracts in the name of a foreign enterprise for the purposes of assessing the existence of an agency PE in Italy. The decision was widely criticized by the OECD and even led to an amendment to the Commentary in 1995 to which Italy expressed its formal reservation. Even though Italy adopted its own domestic PE definition in 2004 that is similar to the OECD Model, a high level of uncertainty remains due to Italy’s conflicting position with the OECD.

\textsuperscript{22} In both cases an authority was actually granted, but in different ways. See Vogel and Lehner, \textit{Doppelbesteuerungsabkommen} (Munich: Verlag C.H. Beck, 2008), Art 5 rec. 115; Staringer, “Kommissionärsstrukturen im internationalen Konzernvertrieb”, \textit{SWJ} (2010), p. 413.


\textsuperscript{24} Para. 33 of the 2010 OECD Commentary on Art 5; see also CE 20 June 2003, no. 224.407, \textit{Interhome AG}: The foreign parent company was engaged in the search and negotiation of new mandates from property owners whereas its subsidiary was engaged in receiving and assisting clients, the administrative tasks, the cleaning and the maintenance of the houses. The French Supreme Administrative Court held that the intermediary did not act within the sphere of the parent company’s business when it executed rental agreements on behalf of the foreign parent company.
The OECD Model does not consider the situation where the intermediary’s authority might be limited or where the intermediary receives detailed instructions from the foreign enterprise. Skaar proposes to apply a business activity test in such situations: where the intermediary also performs activities like locating customers, explaining the conditions of the contract and finally concluding the contract on behalf of the foreign enterprise, it appears obvious that the main parts of the business were conducted by the intermediary and the constitution of an Agency PE seems to be justified. To the contrary, where the foreign enterprise’s instructions to the intermediary are so detailed that the power exercised by the intermediary cannot reasonably be classified as an “authority” but rather as a messenger function, an Agency PE should not exist. If the intermediary does not have the right to exercise its own business judgement but is subject to complete supervision and control by the foreign enterprise, e.g. by electronic communication, the intermediary’s signature itself should not be sufficient nexus to the other State.

As regards the mere prolongation of an existing contract, the foreign enterprise will be bound to certain rights and obligations for the future. The same applies where an intermediary has the authority to make decisions regarding warranty cases concerning equipment which was sold by the foreign enterprise to the third party beforehand. If the intermediary has the power to impose certain rights and obligations on the foreign enterprise comparable to the conclusion of a contract the same consequences should result.

It is worth noting that under the UN Model, an Agency PE can also be triggered by a person who maintains a stock of goods or merchandise for delivery, i.e. it is not required that the intermediary actually concludes contracts on behalf of the foreign enterprise.

3. in the name of the enterprise

As already outlined in the above, the phrase “in the name of” is significant in civil law countries for the question of whether the foreign enterprise (direct representation) or the intermediary (indirect representation) is bound by the contract concluded with the third party. The Commentary qualifies this condition by stating that the intermediary does not literally have to conclude the contract in its own name; it is sufficient that the contract is binding upon the foreign enterprise. Whether the contract concluded by the intermediary is binding upon the foreign enterprise is significant in civil law countries for the question of whether the foreign enterprise (direct representation) or the intermediary (indirect representation) is bound by the contract concluded with the third party. The Commentary qualifies this condition by stating that the intermediary does not literally have to conclude the contract in its own name; it is sufficient that the contract is binding upon the foreign enterprise. Whether the contract concluded by the intermediary is binding upon the foreign enterprise is significant in civil law countries for the question of whether the foreign enterprise (direct representation) or the intermediary (indirect representation) is bound by the contract concluded with the third party. The Commentary qualifies this condition by stating that the intermediary does not literally have to conclude the contract in its own name; it is sufficient that the contract is binding upon the foreign enterprise.

27 Para. 32.1 of the 2010 OECD Commentary on Art. 5. The OECD obviously tried to reduce the Agency PE’s structural deficit of predominantly having its roots in civil law by putting more emphasis on the requirement of “binding” the foreign enterprise and therefore opening the Agency PE to common law countries as well. Inconsistency remains, however, as long as the wording of the Convention does not correspond with the intentions of the Commentary.
enterprise will usually depend on the law which governs the contract: while a civil law reader will tend to read the term “bind” in the context of direct and indirect representation, a common law reader would probably not recognize such a distinction because under common law, only in rare cases would the intermediary and not the foreign enterprise be bound by the contract. From a civil law perspective it can be argued, however, that the foreign enterprise does not necessarily need to be legally bound by the intermediary’s actions but it is sufficient that the foreign enterprise is ‘factually’ bound to the contract concluded by the intermediary, as was argued in Interhome AG. The argument could be that in situations where all the characteristics of an Agency PE are fulfilled except for the actual signing of a contract on behalf of the foreign enterprise an Agency PE can exist according to para. 33 of the Commentary. Further, it could be argued that according to para. 32.1 of the Commentary that for binding the principal on a contract the intermediary does not literally have to conclude the contract on behalf of the foreign enterprise in order to bind the foreign enterprise. Such arguments do not appear convincing in the author’s view. As already mentioned above, para. 32.1 was inserted to open the agency clause for common law practitioners and not to broaden its application: as the first drafting of para. 5 was undertaken in French and thus follows a civil law concept according to which an intermediary can only bind the foreign enterprise if it concludes contracts in the name of the foreign enterprise, it is clear that the intended requirement in the OECD Model was that the foreign enterprise must be bound to the contracts concluded by the intermediary in legal terms. With the insertion of para. 32.1 this principle was not altered but further substantiated: it was made clear that the intermediary does not have to literally conclude the contract ‘in the name of’ the foreign enterprise because under common law, the contract can be legally binding on the foreign enterprise even if not concluded in its name. This, again, makes explicit reference to the question whether a contract is binding on someone else in legal terms. Consequently, the Commentary should not be understood as broadening the scope of the agency clause to cases where a foreign enterprise is ‘factually’ or ‘economically’ bound to a contract. It should be decisive if the contract concluded by the intermediary is binding the foreign enterprise in legal terms under the commercial law of the relevant jurisdiction which was also the view followed by the French Supreme Administrative Court in Zimmer Ltd. In this case, the company Zimmer Ltd, established under British law and the registered office of which was situated in Great Britain, sold its products in France through the intermediary of a French distribution company,

30 Supreme Administrative Court, 31 March 2010: Zimmer Ltd, Revenue de Jurisprudence Fiscale (RJF) 6/10 No. 568.
Zimmer SAS, which changed to the status of sales commissionaire. The French company transferred to the British company its fixed assets, its stock and its customer base. Not taking any significant risks as a commissionaire, the remuneration of Zimmer SAS was consequently lower than the distributor’s margin taxable in France. While both the Administrative Tribunal and the Administrative Court of Appeal based their judgments on the question if the foreign enterprise entered into a ‘de facto’ obligation when the contract was concluded by the intermediary which resulted in Zimmer Ltd having an Agency PE in France based on the specific circumstances of the case, the French Supreme Administrative Court (Conseil d’Etat) applied a purely legal approach. The Court considered decisive that from a legal point of view, the intermediary was bound vis-à-vis the third party under the contract and not the foreign enterprise. In contrast to the Court of Appeal and a previous decision in Interhome AG, the French Supreme Administrative Court left aside the extent to which the de facto circumstances indicated that the foreign enterprise and not the intermediary was actually involved in the contract. It was therefore reaffirmed that under a civil law system a commissionaire cannot constitute a PE for the foreign enterprise.

4. habitually exercises in a Contracting State

Like the basic rule PE, the Agency PE also requires a certain degree of permanency and sustainability which is expressed by the requirement that the intermediary executes its authority habitually and not only in isolated cases. Importantly, the Commentary provides that whether an authority is habitually exercised depends on the frequency of the exercise and the nature of the contracts. As an example, while many contracts in the insurance business have a rather small order value but are concluded on a frequent and standardized basis, contracts in the construction business usually have larger volumes but require more acquisition activities and are concluded less frequently. From this example, it can be seen that a single and generally valid threshold cannot be defined precisely, which is a rather unsatisfying result. Some take the position that the frequency threshold of the Agency PE should be aligned with the requirement of a permanent presence expressed in Art. 5 para. 1 OECD Model which also seems to be supported by the Com-

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31 Amongst other elements, in the case of Zimmer Ltd the intermediary was able to negotiate prices without prior authorization from the foreign enterprise.
32 A tax authority’s power to re-characterize a transaction if the facts do not correspond with the formal legal arrangement agreed upon will, however, not be affected by Zimmer Ltd.
33 Para 33.1 of the 2010 OECD Commentary on Art 5.
The draftsmen of the agency clause obviously had in mind to provide some parallel PE concept to the basic PE rule where a person carries on business in some kind of movable place of business. In the author’s view, such an analogy should rather have a supplementary function and should never replace a thorough analysis on a case-by-case basis taking into account the usual lifecycles of the contracts concluded and the overall business of the foreign enterprise.

It is also expressed in the literature that the mere intent of the foreign enterprise to grant the intermediary an authority to conclude contracts on a long-term basis could be sufficient evidence for the duration test. Considering the exact wording of Art. 5 para. 5 OECD Model and its Commentary, however, it is required that the intermediary executes the authority to conclude contracts. Accordingly, the mere grant of authority should not be relevant as long as such authority is not executed by the intermediary.

Since a certain connecting factor to the other State must exist, one of the basic requirements for an Agency PE is that the intermediary involves the foreign enterprise in business activities in the other State, i.e. the authority must be physically exercised therein. If the intermediary executes its authority in the territory of another State by means of electronic communication and is not physically present in the PE State, an Agency PE should not exist since the location where the activity of the intermediary is executed is considered decisive. The conclusion can therefore not be relevant.

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36 Para 33.1 of the 2010 OECD Commentary on Art 5: “[…] the same sorts of factors considered in para 6 would be relevant in making that determination.”
37 See Piltz, “Wann liegt eine DBA-Vertreter-Betriebsstätte vor?”, ISIR (2004), p. 181; Germany stresses that a certain degree of permanency must especially exist in situations where the intermediary is neither a resident in the other State nor obtains a fixed place of business in the other State (see para 45.9 of the 2010 OECD Commentary on Art 5). Notwithstanding the foregoing, only the days and the frequency the intermediary executes its authority should be decisive and not the intermediary’s days of physical presence in that State: it would appear unreasonable if a person having a habitual abode in the other State would be treated less favourably than a person travelling to the other State merely to execute his authority and both persons would execute their authority on the same frequent basis for the same foreign enterprise.
39 Para. 32 of the 2010 OECD Commentary on Art. 5.
40 As an example, where a foreign enterprise grants an authority to an intermediary with the intention of being represented by that intermediary for several years in the future, but is unsatisfied with the intermediary’s performance during the conclusion of the very first contract and therefore terminates the engagement with the intermediary, such a situation should not lead to an Agency PE for the foreign enterprise because the intermediary executed his authority in an isolated case only. See also: Netherlands Supreme Court, 10 March 1982, no. 20,933, BNB 1982/127.
be drawn that it should be of no relevance where the third party is located or where the contract itself is executed\textsuperscript{41}.

5. **not limited to activities of para. 4**

No Agency PE should exist where the intermediary is authorized only to perform activities or to conclude contracts covering activities which do not go beyond the scope of those mentioned in Art. 5 para. 4 OECD Model. It is worth noting, however, that once an Agency PE exists, all activities performed by the intermediary on behalf of the foreign enterprise will be included in the PE, i.e. also activities mentioned in para. 4\textsuperscript{42}. In the case of downsizing an affiliated commissionaire to the activities mentioned in para. 4, tax authorities will regularly require comprehensive documentation showing that the remuneration of the intermediary actually represents the now reduced scope of functions and risks. Since the requirements of para. 5 regularly are not fulfilled by an ordinary commissionaire, however, such discussions should fall within the sphere of Art. 9 rather than Art. 5 OECD Model.

6. **[no] broker, general commission agent or any other agent of an independent status**

The terms “broker” and “general commission agent” are obviously considered synonymous with independent agents. These terms are not defined in the treaty and are therefore subject to the provisions of Art. 3 para. 2 OECD Model.

The Commentary seems to acknowledge the fact that brokers\textsuperscript{43} or general commission agents generally do not execute the business of the foreign enterprise but a separate entrepreneurial activity\textsuperscript{44}. The inclusion of brokers and general commission agents appears to have its origin in common law because under civil law a broker or general commission agent as a rule cannot bind the foreign enterprise.\textsuperscript{45}

It is further required that the intermediary be independent from the foreign enterprise both legally and economically.\textsuperscript{46} Although the requirement of being dependent is not explicitly mentioned in para. 5, the independence test is a cornerstone of the agency clause itself and therefore not relevant only to para. 6.

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\textsuperscript{41} See Skaar, *Permanent Establishment. Erosion of a Tax Treaty Principle* (Deventer/Boston: Kluwer Law and Taxation Publishers, 1991), p. 527: the agency clause was principally designed for sales contracts and is therefore inadequate for services/construction works because the latter involve the foreign enterprise in business activities in the other State rather than the conclusion of the contract.

\textsuperscript{42} Para. 34 of the 2010 OECD Commentary on Art. 5.

\textsuperscript{43} Brokers generally never conclude contracts but only bring the parties together.

\textsuperscript{44} Para. 36 of the 2010 OECD Commentary on Art. 5.

\textsuperscript{45} See Roberts, “The Agency Element of Permanent Establishment: The OECD Commentaries from the Civil Law View (Part One)”, *Intertax* (1993), p. 405: from civil law perspective, independent intermediaries who under common law concepts may bind the foreign enterprise should be excluded from the application of para. 6.

\textsuperscript{46} Para. 37 of the 2010 OECD Commentary on Art. 5.
6.1. The control exercised by the foreign enterprise over the intermediary’s activities

Importantly, the Commentary states in para. 38.1 that the control which an enterprise exercises over its subsidiaries in its function as a shareholder is considered irrelevant for the question of legal dependence. A further indication can be found in para. 38.4 where the OECD also clarifies that if the intermediary’s scope of authority is clearly restricted and limited to a certain scale of business, such circumstances are deemed to be irrelevant in determining dependency. Apart from these negative examples, the Commentary remains silent about positive cases of legal dependence.

The question arises, however, what kind of legal relationship between a foreign enterprise and an intermediary is meant in principle. In order to cease independence, the intermediary would need to be dependent upon the foreign enterprise by way of a contract. The mere power to issue instructions to the intermediary is a qualifying aspect of agency itself and does not necessarily prove the intermediary’s dependency upon the foreign enterprise.

Accordingly, the intermediary must be subject to the foreign enterprise’s instructions and such instructions must go beyond a certain fundamental scope of instructions being covered by the agency itself. Such a fundamental scope would generally be exceeded if the foreign enterprise issues detailed instructions to the intermediary regarding the way the latter exercises its authority in a way similar to an employee-like relationship. An independent intermediary would typically rely on its own knowledge and expertise when making decisions on how to execute the tasks he was contracted for by the intermediary. In a parent/subsidiary relationship, however, it will often be the case that the parent company will execute some control over the subsidiary. It seems appropriate that the activities of the parent company should be limited to a high level of control, such as reviewing the subsidiary’s financial results but excluding instructions on the way the subsidiary carries out its daily business which would substantially restrict the subsidiary’s economic independence. In practice, the fundamental scope would likely be considered exceeded where e.g. a majority of a subsidiary’s board of directors consisted of the parent company’s personnel and such personnel were also involved in the decision-making process of the parent company.

Since the Commentary requires detailed instructions to be issued to the intermediary there must be an acceptable degree to which the foreign enterprise may


48 Para. 38.3 of the 2010 OECD Commentary on Art. 5.

49 See Caridi, “Proposed Changes to the OECD Commentary on Art. 5: Part II – The Construction PE Notion, the Negative List and the Agency PE Notion”, European Taxation (2003), p. 44.

50 Para. 38 and 38.3 of the 2010 OECD Commentary on Art. 5.
issue directives to the intermediary regarding the way the latter should carry out its activities and the results to be expected from its activities. It is not sufficient for dependency that the intermediary is required to provide the foreign enterprise with substantial information, unless such information is provided in the course of seeking approval from the foreign enterprise. In practice, undertakings of the foreign enterprise like the setting of certain quality or ethical standards or other targets such as sales targets and corresponding on-site inspections to verify the intermediary’s compliance with such standards and targets should therefore not restrict the intermediary’s dependency for purposes of this provision. Based on this view, the setting of such a framework by the foreign enterprise should not be considered relevant to the question of independence as long as the intermediary is able to perform its day-to-day business activities on an independent basis.

6.2. The number of foreign principals

From an economic perspective, is it clear that an intermediary who acts on behalf of only a single foreign enterprise for long period of time could be highly dependent upon that enterprise. The Commentary therefore stresses that the number of foreign enterprises also should be a relevant factor in determining independence, but not the decisive factor. Rather, all facts and circumstances of the specific situation must be considered. Exclusivity may also exist where the intermediary serves several foreign enterprises but the foreign enterprises act in concert and – being a de facto single foreign enterprise – control the way the intermediary carries on its business. Clearly, under the intermediary’s agreement with the foreign enterprise, the intermediary will be legally bound to follow the instructions of the foreign enterprise. It seems questionable whether legal dependence will increase if the foreign enterprises act in concert and issue the same directives to the intermediary. As mentioned above, the issuance of instructions is an element of the concept of agency itself. It should therefore not further influence the intermediary’s legal dependency (or independence) that the instructions are directed in concert. It appears more appropriate to relate the existence of several foreign enterprises acting in concert to the question of economic dependency.

51 Para. 38.5 of the 2010 OECD Commentary on Art. 5.
53 Para. 38.6 of the 2010 OECD Commentary on Art. 5.
54 In practice, supporting evidence for tax authorities to claim dependency could be cases where the foreign enterprise prohibits the intermediary from also providing its services to other enterprises. Documentation of the intermediary’s attempts to offer its services to other enterprises could therefore be supportive of the intermediary’s independent character. On the other hand, an intermediary may conduct its business autonomously from its exclusive foreign enterprise, e.g. where the intermediary finds itself in a strong bargaining position with the foreign enterprise.
55 Para. 38.6 of the 2010 OECD Commentary on Art. 5.
In contrast to the OECD Model, the UN Model clearly states that an independent status can no longer be claimed if the intermediary’s activities are devoted wholly or almost wholly to a single foreign enterprise. The UN Commentary goes even further, claiming the same result for an intermediary acting only on behalf of affiliated enterprises. Some tax treaties concluded between developed and less-developed countries have incorporated the above concerns.

Exclusivity is also considered a very important factor in case law. In the US case *Taisei Fire & Marine Insurance Co.*, the IRS claimed that independence could no longer be found to exist where the foreign enterprises of the US intermediary acted in concert and de facto represented a single enterprise. It is worth mentioning that apart from the four unrelated foreign enterprises, the US intermediary was not acting for any other foreign enterprise. The IRS based its view on a very strict interpretation of Treasury Regulation §1.864-7(d)(3)(ii), which provides that when determining the intermediary’s independence the fact that the intermediary acts exclusively or almost exclusively for one foreign enterprise must be taken into account. In its factual analysis, however, the court rejected the IRS’s view that the four foreign enterprises acted in concert. The court further noted that even if this was the case, exclusivity in itself should not be understood as having a threshold function for the question of whether the intermediary can still be considered independent. The IRS did not appeal the decision. Making explicit reference to this decision, a Canadian court recently reasoned in *American Income Life Insurance Company v. The Queen* that, notwithstanding the fact of exclusivity, the assessment of the intermediary’s legal and economic dependence upon the foreign enterprise will depend on a number of factors which will be part of a factual analysis of the specific case.

On the other hand, countries like Austria and Spain take a rather narrow view on exclusivity: Austrian tax authorities deem an intermediary to be dependent solely due to the fact that its activities are performed over its lifetime for only a single foreign enterprise and not for third parties. For an intermediary to be independent, Spain requires a disassociation from the foreign enterprise, both in legal and financial terms, and further expresses the view that the general performance of me-

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56 The reason for such wording may derive from the expression of concern by less-developed countries that, in the case of insurance businesses, insurance agents would likely be considered independent if such addition were not be inserted. It can be argued whether risks being covered by the insurance are situated in the intermediary’s country and profits from the insurance premiums should be taxable in the intermediary’s country accordingly.

57 See the tax treaties Germany concluded with Bangladesh, Estonia, Indonesia, Kuwait, Latvia, Pakistan and Thailand.


59 2008 TCC 306; 2008 DTC 3631 (TCC).

60 Case law of India, France and the Netherlands seems to support such views.

diation or agency activities is required, which requirement cannot be met by acting on behalf of only a single company.\textsuperscript{62}

In the author’s view, the question of exclusivity should be examined from a legal point of view only. The intermediary’s economic situation may often be completely beyond the foreign enterprise’s influence and should therefore not be applied as a criterion if that foreign enterprise has a PE in the other State. Instead, the foreign enterprise should be in the position of being able to actively influence such criteria. Views that an intermediary should not be considered dependent merely because it performs business activities other than the services provided to the foreign enterprise\textsuperscript{63} should therefore also not be followed.

6.3. The entrepreneurial risks borne by the intermediary

One of the most relevant aspects of the independence test is the question whether the intermediary has to bear its own business risks. This would commonly not be the case where the foreign enterprise’s and the intermediary’s business interests merged and the intermediary was integrated into the business of the foreign enterprise\textsuperscript{64}. An independent intermediary is regularly responsible for the results of its works and would perform such works by using its own production factors such as capital\textsuperscript{65} and labour or by using its own infrastructure\textsuperscript{66}. The intermediary further has to bear its own costs and to be responsible for any losses incurred\textsuperscript{67}. An independent intermediary’s remuneration would always reflect the specific functions and risks borne by the same and would typically vary depending on the success of its undertakings. On the other hand, a fixed remuneration could imply that the intermediary does not bear the risks arising from its activities\textsuperscript{68}.

\begin{itemize}
  \item See DGT response no. 0609-97, 3 April 1997.
  \item BFH, 30 April 1975, I R 152/73, BStBl II 1975, 626; BFH, 23 September 1983, III R 76/81, BStBl II 1984, 94; BFH, 14 September 1994, I R 116/93, BStBl II 1995, 238.
  \item See Piltz, “When is there an Agency Permanent Establishment?”, Bulletin – Tax Treaty Monitor (2004), p. 200: financing activities of the foreign enterprise, like the granting of loans could possibly be neglected if these activities were restricted to the intermediary’s start-up phase only. Over a long period of time, the intermediary should not have to rely on the financial support granted by the foreign enterprise in order to express its own entrepreneurial undertaking.
  \item If the foreign enterprise provided offices, etc., to the intermediary, a fixed place of business PE might be constituted by the foreign enterprise; see: para. 10 of the OECD Commentary on Art. 5.
  \item In Interhome AG the French Supreme Administrative Court held that an intermediary could not be considered independent if it receives regular subsidies from the foreign enterprise to compensate for the insufficiency of the fees that it received for its activities (CE 20 June 2003, no. 224.407, Interhome AG).
  \item A guaranteed minimum remuneration should, however, not be \textit{per se} an indicator for the intermediary’s dependence because such contractual arrangements may also be a common feature among independent third parties.
\end{itemize}
With regard to business restructurings, the downsizing of an affiliated company from a distributor to a mere commissionaire will generally make the tax authorities suspicious if the commissionaire is still purported to have an independent status. Often, such business restructurings will be driven by the aim of centralizing risks at the level of the parent company or holding companies. Since risks and functions cannot be separated, however, it has to be thoroughly assessed which functions the affiliate performs after the restructuring. For an independent status, the affiliate must bear its own economic risks connected to the functions performed which will also have to be reflected in the affiliate’s remuneration recognizing the possible transfer of marketing intangibles, goodwill, clientele, etc, to the parent company. A foreign enterprise, however, should not be put under general suspicion when downsizing an affiliated intermediary because there may be legitimate business reasons for such restructuring. Also, it generally cannot be assumed that an independent intermediary would be in the position to reject being downsized from a fully fledged distributor to a commissionaire or claim compensation for such downsizing.

7. [not] acting in the ordinary course of their business

Referring to the exact wording of para. 6, it is to be assessed whether the intermediary’s activities are within the scope of its own, customary business operations. According to the Commentary, the ordinary course of the intermediary’s business must be examined in view of the business customarily carried out within the intermediary’s group of business. Where the intermediary also performs other business activities apart from acting as an intermediary, such other business activities are not relevant to the comparison. As a general example, the Commentary states that a commissionaire would no longer act in the ordinary course of its business if he also concluded contracts in the name of the foreign enterprise and, thus, switched from indirect to direct representation. Thus, the intermediary’s business sector’s common sphere of business should be compared with the intermediary’s individual sphere of business on a business line level. It would not be reasonable if an intermediary that was previously engaged only in the business of manufacturing

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69 See OECD, Transfer Pricing Aspects of Business Restructurings: Discussion Draft for Public Comment, 19 September 2008 to 19 February 2009: such restructurings primarily involve the application of transfer pricing rules and/or the existence of, and the attribution of profits to a PE after the conversion.

70 The intermediary’s acting within its ordinary course of business would generally be supporting evidence that the intermediary conducts a business separate from the foreign enterprise and that he should not be considered executing the business of its foreign enterprise.

71 Para. 38.8 of the 2010 OECD Commentary on Art. 5.

72 Para. 38.7 of the 2010 OECD Commentary on Art. 5.

73 BFH, 14 September 1994, I R 116/93, BStBl II 1995, 238. Several members of a comparable group conducting similar activities are considered sufficient: BFH, 23 September 1983, III R 76/81, BStBl II 1984, 94.
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would no longer act in the ordinary course of its business because he started a new business line of commissionaire services or switched the business line completely or the business line itself changed due to structural reasons\textsuperscript{74}. Other business lines conducted by the intermediary should therefore not be part of the comparability analysis\textsuperscript{75}.

Depending on the case, it will be difficult in practice, however, to determine an intermediary’s business group and the habitual activities of such a group\textsuperscript{76}. In general, it should be borne in mind that one of the fundamental ideas of para. 6 is that an intermediary should not constitute a PE for the foreign enterprise if its business is to be considered separate from the foreign enterprise’s business. With regard to a business undertaking, the very intention of any entrepreneur will regularly be the realization of profits. An alternative approach therefore could be to not only compare the specific business activity of the intermediary with activities carried out by fellow intermediaries, but also to examine whether the intermediary acts within its own entrepreneurial undertaking which e.g. could be expressed by the intention of realizing profits\textsuperscript{77}. Similarly to the question of exclusivity, the constitution of a PE should not depend on facts and circumstances which are beyond the foreign enterprise’s control. It should consequently not depend on the existence of comparable business sectors to determine whether an intermediary acts within its ordinary course of business and whether or not a PE is constituted. For such situations, the OECD also suggests that complementary tests may be used concurrently or alternatively\textsuperscript{78}. In conclusion, it appears reasonable to test the intermediary’s activities against the activities of intermediaries with the same type of business line\textsuperscript{79} and – if such comparables are not available – to examine whether the intermediary is conducting its own, genuine entrepreneurial undertaking separate from the foreign enterprise’s sphere of business.

If a fully fledged distributor were downsized to a mere commissionaire but de facto continued the same functions despite a contractual shift of such functions, the affiliate should be assumed to be acting outside its ordinary course of business.


\textsuperscript{75} Para. 38.8 of the 2010 OECD Commentary on Art. 5.

\textsuperscript{76} E.g. FG Cologne, 7 July 1993, 6 K 4693/87, EFG 1994, 138; the Court had to obtain an external analysis from the Chamber of Commerce to be able to answer this question.

\textsuperscript{77} See Wassermeyer, Doppelbesteuerung: DBA, (Munich: Verlag C.H. Beck, loose-leaf), Art 5, rec. 231: an arm’s length remuneration paid by the foreign enterprise could be further evidence supporting that the intermediary was acting within the commercial interests of an entrepreneur conducting a business separate from the foreign enterprise.

\textsuperscript{78} Para. 38.8 of the 2010 OECD Commentary on Art. 5.

\textsuperscript{79} I.e. compare insurance brokers with insurance brokers, ship brokers with ship brokers, etc.
For business restructuring activities, it is therefore vital that the intermediary performs functions which correspond to the contractual arrangements.

**IV. Summary and concluding remarks**

As discussed above, a foreign enterprise can only constitute a PE in an intermediary’s State if the intermediary concludes contracts being legally binding on the foreign enterprise. Whether the foreign enterprise will be legally bound by the contract concluded by the intermediary will depend on the legal system which governs the contract of representation. In other words, agency nexus can be created by indirect representation under a common law legal system but not under a civil law legal system. In the case of *Zimmer Ltd* the French Supreme Administrative Court substantiated this view. The affirmative response among tax experts is perfectly understandable in this regard since the Court’s strictly legal approach appears to be closer to the intentions of the OECD Model and is also more comprehensible than other interpretations which employ a rather economic approach.

The OECD Commentary tries to provide clarification in this regard, however apparently still leaving room for interpretation as can be seen in *Interhome AG*. Since the Commentary is not binding on the Contracting States but only the wording of the tax treaty itself, it is the author’s view that ambiguity could be further reduced by implementing the intentions of the OECD Commentary in the very wording of the OECD Model: the requirement that the intermediary must have “an authority to conclude contracts in the name of the enterprise” should be replaced by the requirement that the intermediary must have “an authority to conclude contracts legally binding on the enterprise”. Whether a contract concluded by the intermediary is legally binding on the foreign enterprise would then be examined under the domestic commercial laws which govern the agency contract.

It appears reasonable to conclude that only a person authorized to conclude contracts legally binding on the foreign enterprise and habitually exercising such authority in a Contracting State may be deemed to constitute an Agency PE for the foreign enterprise in that State. Conversely, an independent person acting in the ordinary course of its business should not constitute an Agency PE for the foreign enterprise regardless of whether or not the contracts concluded by that person are binding on the foreign enterprise.

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80 If the intermediary acts outside its own responsibilities it will be more likely that the intermediary is considered to carry on the business of the foreign enterprise rather than its own separate business; see CE 20 June 2003, no. 224.407, Interhome AG.

81 See also Staringer, “Kommissionärsstrukturen im internationalen Konzernvertrieb”, *SWI* (2010), p. 413: such an approach also appears consistent with the intent of Art. 5 para. 5 OECD Model which is based on the actual conclusion of contracts.