rX8A BARKER, S.C. The conception of permanent establishment of business profit in international tax treaties

Law of Taxation

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The concept of permanent establishment and the apportionment of business profits in international tax treaties

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I The concept of "permanent establishment"

A. Introduction.

With the exception of France,[1] International Bilateral Tax Agreements are not to be viewed as an imposition of tax, they merely serve to arbitrate between two or more competing jurisdictions claims to tax the same wealth. In fact, a bilateral taxation agreement can only alleviate the tax payer's liability to pay taxes arising under a country's domestic law. In France, however, an international bilateral taxation treaty is regarded as being part of the domestic law. Therefore a person or a company may be taxed under the articles of the treaty notwithstanding the fact that there is no corresponding provision in the revenue code.

Briefly international double taxation occurs where the person being taxed resides in one country, and his wealth, or at least a part thereof, is in another country and the treasuries of both countries are seeking to levy a claim on the wealth, and if nationality is accepted as a criterion (as it is in America) there may in fact be three claims to tax the same wealth. In general these competing claims arise from the interaction of two main principles of taxation, namely; the residence principle and the source or origin principle. Under the residence principle one of the taxing treasuries claim that it is

[1] Due to the limited amount of material available the countries named, as examples, throughout this text may not necessarily be the only examples. But as far as it is within the writers knowledge the position is as stated.

entitled to charge the person tax on all his income, whereever it arises, because that person is a resident of that country,[2] and under the source or origin principle the taxing treasury claims that it is entitled to charge the person tax for it in their jurisdiction that the income arose [3].

While agreement between the two countries as to the adoption of either principle as a basis of jurisdiction to impose a particular tax solves a preliminary problem in securing relief from double taxation, it, raises at the same time, the difficult theoretical problem of allocation.

Problem of allocation

The problem of allocation arises where the taxpayer maintains more than one residence similtaneously or successively during a taxable period. Or similarly, if the principle of source is determined upon as the criterion, a problem of allocation arises where the economic source of the taxable income is in more than one country during a taxable period and the items producing the income are not clearly allocable to one or several sources within a single country.

This problem becomes more pronounced when the taxing authorities are faced with taxing the income of an industrial, commercial or agricultural enterprise which is established in two or more countries. Hence the solution lies in finding further, more suitable criteria to determine

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[2] See S.165(1) Land and Income Tax Act 1954.

[3] See S.165(2) Land and Income Tax Act 1954.

the different degrees of economic allegiance owed by a part of a business to the respective states.

It is to this end in an attempt to resolve this problem that most countries including New Zealand, in the absence of a bilateral treaty to the contrary seek to impose tax on income derived by non-resident enterprises ("carrying on business") within their boundaries Section 167 Land and Income Tax Act 1954 states in part.

> S167(1) Subject to sections 168 and 169 of this Act, the following classes of income shall be deemed to be drived from New Zealand.
>
> (a) Income derived from any business wholly or partly carried on in New Zealand:
> (The emphasis has been added).

However most international tax treaties have disregarded, as too imprecise and uncertain, the "carrying on business" test and substituted therefor a "permanent establishment" test to determine whether or not an enterprise of one treaty country shall be taxable within the other contracting country. New Zealand's Double Taxation Agreements like most Agreements generally provide, on a reciprocal basis that the industrial and commercial profits ("Business Profits") of a New Zealand enterprise shall not be taxable in the other contracting State except insofar as they may be attributed to a permanent establishment within that State.[1] The right of the source country to tax an enterprise only if a permanent establishment exists within that state does not, of course, affect the resident state's right to tax the same income, albeit subject to any appropriate credit for overseas tax paid thereon.[2] But the concept does mean that the source country will tax if, and only if a permanent establishment exists in that country.

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[1] The Articles of N.Z. Double Taxation Relief Orders defining the concept of "permanent establishments" are reprinted as appendices A,B,C,D,E,F,G & H respectively of this paper.

[2] See S170 Land and Income Tax Act 1954.

It is therefore extremely important for a manufacturer to determine whether or not a permanent establishment can be said to exist within a particular taxing jurisdiction. The definitions of "permanent establishment" in New Zealand's existing treaties are broad and in most circumstances present little difficulty; but the definition in some instances for example, as they relate to agencies, are not so explicit as one would wish and raise questions which cannot be answered with assurance.

It is against this background that I propose to examine;

(1) the evolution in international tax treaties of the definition of the concept of permanent establishment.

(2) Some problems surrounding the present OECD Draft Convention.

(3) Judicial decisions relating to the concept of permanent establishment.

(4) Tax treaties between Developed and Developing countries.

(1) The historical evolution in international taxation treaties of the concept of permanent establishment.

It is useful to recount comparatively briefly the history of Bilateral Tax Conventions for the concept of permanent establishment originated from the early attempts by countries to allocate income equitably between taxing jurisdictions and to facilitate trade and the flow of capital between those countries. It was not until the 1920's that the high rates of tax and the expansion of trade between countries made international co-operation in the field of taxation imperative. The problems faced by international traders following the first World War are summarized by Mitchell B Carroll in the follwing tems:

> "Many countries exercised jurisdiction over the entire income of individuals and companies resident in their territory, including income from sources in other countries, and, conversely, countries extended their jurisdiction over foreign enterprises on any possible basis and to the fullest extent conceivable. The overlapping of claims of different jurisdictions on the same incomeor property resulted in confiscatory levies. The grasping of revenues was tending seriously to obstruct efforts to restore trade, and business enterprises were so restricted by the network of tax liabilities that they hesitated to assume the risk of foreign commerce."[1]

The realization of this impediment to business interests was manifested by an appeal made by the International Chamber of Commerce to the League of Nations at the end of World War I. It was this appeal that gave impetus to international conferences and studies of double taxation problems by the leage of Nations Committee of Technical Experts and its lineal descendants.

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[1] Carroll, Mitchell B "Prevention of International Double Taxation & Fiscal Evasion - Two Decades of Progress under the League of Nations."

(a) The work of the League of Nations.

Studies were undertaken by the International Chamber of Commerce and the Finance Committee of the League of Nations for the purpose of formulating some general principles deviding the tax burden equitably between the country in which a taxpayer was domiciled or resident on the one hand and the country in which (the source of the income arose on the other.) The Council of the League of Nations in 1922 assigned the study of double taxation and tax evasion problems to a group of officials from seven different European Countries[1].

By 1925 the various studies had progressed far enough to enable this group of technical experts to reach a measure of general agreement on certain fundamental principles underlying a more equitable distribution of taxation between the competing countries. Practical resolutions were proposed in the report giving effect to these principles. One such resolution was that proposed for the purpose of allocating industrial and commercial profits between countries.

> If an enterprise has its head office in one state and in another has a branch, an agency, an establishment, a stable commercial or industrial organization, or a permanent representative, each of the contracting states shall tax that portion of the net income produced in itsown territory.[2]

Thus the concept, although very crude, of permanent establishment, which had first been formulated in the 1922 bilateral agreement between Germany and Austria, was firmly established.

[1] The group consisted of top official of the fiscal administration of Belgium, France, the United Kingdom, Italy the Netherlands, Switzerland and Czechoslavakia. America was included in 1927.

Further studies led in 1928 to the publication by the group of Model Draft Convention for the avoidance of international double taxation and fiscal évasion. These Model Conventions wereused extensively by governments in concluding bilateral agreements since that time, and have promoted a considerable measure of uniformity in international tax law. The provisions dealing with the allocation of income read in part as follows.

> "Income....from any industrial,commercial or agricultural undertaking.....shall be taxable in the state in which the permanent establishments are situated. The real centres of management, branches, mining, and oilfields factories, workshops, agencies, warehouses, offices, depots, shall be regarded as permanent establishments. The fact that an undertaking has business dealings with a foreign country through a bona fide agent of independent status (broker, commission agent etc) shall not be held to mean that the undertaking in question has a permanent establishment in that country. Should the undertaking possess permanent establishments in both contracting states, each of the two states, shall tax the portion of the income produced in its territory.."[1]

No positive attempt was made in the report to define what constituted a permanent establishment. The list given in the definition can only be described as guidelines for what may be deemed to be examples of permanent establishments. As the Commentary on Article V of the Draft Convention points out, a rule such as this will vary according to the nature of the undertaking. If an enterprise, for example, has a factory in one state and a sales branch in another the apportionment may be effected by allocating the "manufacturing" profits to the state in which the factory is situated and the "merchanting" profits, (that is to say the difference between the foreign sales price and the home-market price, less transport costs) to the state where sales branch is located. Other suggested bases of apportionment were the

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[1]Op cit. per. article V of Protocol of Draft Convention

amount of capital invested in each state, relative gross turnover, number of employee's and the amount of wages paid. However the Report does not clearly state when a permanent establishment shall be found to exist.

Following this report, the League ofNations formed a permanent Fiscal Committee to study the problem of international taxation. Between 1929 and 1946 this Committee held some ten sessions and it appears obvious from all their reports that there are deficiencies in the definition of permanent establishment. The definition of permanent establishment given in the 1933 revised draft of the Model Convention considerably expanded those of the previous conventions in an attempt to clarify the circumstances in which a permanent establishment could be said to exist. The definition submitted in this Convention was adopted almost without alteration in the Model Bilateral Convention of Mexico (1943) and London (1946).[1] For the sake of brevity I shall refer to these two latter Conventions as the Mexico Draft and the London Draft.

It is interesting to note that the revised draft of the 1933 Convention departs from the previous drafts in the method of allocating income. Whereas the 1928 Model Convention provided that if a foreign enterprise maintained a permanent establishment within a country, that country would be entitled to tax the entire income of that enterprise if the income arose from sources within its boundaries, the 1933 revised draft makes it clear that only the income attributed to the permanent establishment would be subject to tax. Article V of the Protocol of the Mexico (1943) and London (1946) conventions[2] state:

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[1] It will not, therefore, be reproduced in this text, but reference may be made to the reproduction of the Mexico and London Draft post at page

[2] London and Mexico Model Tax Conventions - Commentary and Text" - League of Nations document No.C88 M88 1946.

"1. the term "permanent establishment" includes head offices, branches, mines and oilwells, plantations, factories, workshops, warehouses, offices, agencies, installations, professional premises and other fixed places of businesshaving a productive character.
2. A building site (chantier de construction) constitutes a "permanent establishment" when it is defined to be used for a year at least or has been in existence for a year.
3. The fact that an enterprise established in one of the contracting states has business dealings in another contracting state through an agent of genuinely independent status (broker, commission agent, etc) shall not be held to mean that the enterprise has a permanent establishment in the latter state.
4. When an enterprise of one the contracting states regularly has business relations in the other state through an agent established there who is authorised to act on its behalf, it shall be deemed to have a permanent establishment in that state.

A permanent establishment shall, for instance, be deemed to exist when the agent:
A. Is a duly accredited agent (fonde de pouvoir) and habitually enters into contracts for the enterprise for which he works; or
B. Is bound by an employment contract and habitually transacts business on behalf of the enterprise in return for remuneration from the enterprise; or
C. Is habitually in possession, for the purpose of sale, of a depot or stock of goods belonging to the enterprise;

5. As evidence of an employment contract under the terms of B above may be taken, moreover, the fact that the administrative expenses of the agent, in particular the rent of premises, are paid by the enterprise.
6. the fact that a broker places his services at the disposal of an enterprise in order to bring it into touch with customers does not in itself imply the existence of a permanent establishment for the enterprise, even if his work for the enterprise is, to a certain extent, continuous or is carried on at regular periods, and even if the goods sold have been temporarily placed in a warehouse. Similarly, the fact that a commission agent (commissionnaire) acts in his own name for one or more enterprises and receives a normal rate of commission does not constitute a permanent establishment for any such enterprise, even if the goods sold have been temporarily placed in a warehouse.
7. A permanent establishment shall not be deemed to exist in the case of commercial travellers not coming under any of the preceding categories.
8. The fact that a parent company, the fiscal domicile of which is one of the Contracting States, has a subsidiary in the other State does not mean that the parent company has a permanent establishment in that state, regardless of this fiscal obligations of the subsidiary toward the state in which it is situated."

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These three Model Conventions of 1933, 1943 and 1946, were very instrumental in bringing some semblance of uniformity to the post war bilateral conventions that had been executed. But there still existed considerable areas of uncertainty, and it was the realization of these impediments to business transactions that prompted the creation of the Fiscal Committee of the Organization for European Economic Co-operation (OEEC) by the OEEC Council in 1956 to study fiscal questions relating to double taxation[1].

(b) the Fiscal Committee of OEEC

The Fiscal Committee was instructed by the Council of OEEC to submit a draft Convention for the avoidance of double taxation, together with concrete proposals for the implementation of such a Convention. In the four reports prepared by this Fiscal Committee between 1958 and 1961 and published in 1963 the Committee proposed in a twentyfive Article Draft Convention the "Elimination of Double Taxation". Since the establishment in September 1961 of the Organization for Economic Co-operation and Development (OECD) under which its mandate was confirmed, the Fiscal Committee has agreed upon six new Articles which it has embodied in the Draft Convention.

In 1974 the Committee of Fiscal Affairs (the lineal descendant of the Fiscal Committee) published a revised text of most of the articles and commentaries. However some of the 1963 text and commentaries have not been revised as yet (including Article 5 defining the concept of permanent establishment) and remain restricted. The revised text has not yet, been approved by the OECD Council

[1] refer OECD Report, Draft Double Taxation Convention on Income and Capital (Paris 1963) p.87

Article 7 of the OECD Draft Double Taxation Convention provides that the profits of an enterprise of one contracting state may be taxed in the other contracting State only if the enterprise carries on business in that other State through a permanent establishment situated there, and then only so much of the profit as is attributable to the permanent establishment. In other words the taxability of the "business profits" of a foreign enterprise is dependent upon the presence of a permanent establishment in the taxing country. Thus the definition of "permanent establishment" is an essential concept for the application of the Convention and is one of the most important provisions in any tax treaty. Because of the degree of harmonization already achieved through the work of the League of Nations it is obvious that the Tax Committee of the OEEC used the Mexico and London Drafts as a starting point, and there are undertones of the work achieved by the League of Nations throughout the OECD Draft.

The definition of the concept of permanent establishment is contained in Article 5 which states;

> 1. For the purpose of this Convention, the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on.
> 2. The Term "permanent Establishment" shall include especially
> a) a place of management;
> b) a branch;
> c)an office;
> d) a factory;
> e) a workshop;
> f) a mine, quarry or other place of extraction of natural resources;
> g) a building site or construction or assembly project which exists for more than twelve months.

3. The term "permanent establishment" shall not be deemed to include:

(a) The use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise.

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;

(c) themaintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary, character, for the enterprise;

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

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

6. the fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

2. General Comments and Comparison of Mexico/London Drafts and OECD Model.

Admittedly there exist some differences in form between the three Draft Bilateral Conventions although the divergencies in substance are relatively slight some of the divergencies, however, do require comment.[1] For convenience I will refer to the Drafts as the Mexico/London Draft and OECD Draft.

(i) Definition of permanent establishment - Paragraph 1.

The OECD Draft begins in Paragraph 1 by defining the concept of permanent establishment in a separate paragraph, bringing out the essential characteristic of permanent establishment viz that it has a distinct "situs", a fixed place of business, to the exclusion of a criterion as to its productive character of profitability. The Committee of Fiscal Affairs expressed the view that such a method lends more to clarity than does a definition hidden in a list of agreed examples[2]. The Mexico/London Drafts also bring out the requirement of "fixidness" under the guise "and other fixed places of business in paragraph 1 of Article V;

> Thus we must always begin with the primary proposition (presuming the deeming provisions of para 4 to be inapplicable) that a fixed physical basis is necessary before a permanent establishment will be considered to exist in a Contracting State.

The requirement that the business "have a productive character" was expressly rejected by the committee as it was thought such a character was axiomatic to any well run business organisation. The possibility of inserting profitability as a criterion was toyed with. But this too was rejected on the grounds that, an establishment

[1] Reference should also be made to the Comments published with the Draft Model Conventions p.70 et seq.

[2] Ibid @ P.70

may fluctuate between profits and losses in different financial years or, it may continually run at a loss, yet be vital to the producing of a profit for the business as a whole in such a case it would be unfortunate to not be deemed a permanent establishment. Any test based on the intention of the business as a whole to realise a profit was also rejected as it would impart a test of motive into a defined set of rules[1].

(ii) Agreed examples - Paragraph 2.

Basing itself on Article V of the Mexico and London Drafts paragrpah 2 of the OECD Draft lists the types of establishments that appeared originally in the 1928 Draft, and have been added to over the years by various treaty definitions. The list in paragraph 2, which is not intended to be exhaustive, gives situations which may be regarded a priori as constituting a permanent establishment. The object of paragraph 2 is to give a list of examples constituting a common basis on which contracting states can reach agreement. The Committee of Fiscal Affairs never intended the list to be exhaustive and most New Zealand Double Taxation Relief Orders contain an additional example:

> "a farm, or plantation, or an agricultural, pastoral or forestry property"[2]

Because of their importance to New Zealand's overseas economy this example has an equally strong claim to be included in this paragraph.

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[1] Ibid @ P.70-71

[2] refer appendixes C,D,E,F,G & H.

Most of the examples contained in Article V of the Mexico/London Drafts are included in paragraph 2; there is, however, one addition and several exemptions - There has been added to the OECD Draft

"a place of management"

which does not necessarily come within the term "office". On the other hand terms such as "head office" and "professional premises" have been omitted as it was thought such establishments would normally be a place of management. "Installations" has been left out as being a term so general as to be virtually meaningless.

Paragraph 2 of Article V of the Mexico/London Drafts relating to building sites, received greater refinement by the Committee of Fiscal Affairs and becomes paragraph 2(g) of the OECD Draft. The 12 month time limit has been kept although it does seem to be very arbitrary. The time limit did, however, become the subject of great debate at the first meeting of the Ad Loc Group of Experts on Tax Treaties between Developed and Developing Countries which I propose to discuss further on in this paper. It is to be noted that this limit doesnot prevent a country from raising a tax assessment before the twelve months has expired if it appears that the site or project is likely to last for more than 12 months. The period of 12 months may fall in part, into morethan one fiscal year.

The express mention of a time limit leaves open the possibility of dividing a project of this nature into seperate stages each of which is to be undertaken by a different subsidiary of a non resident parent company. Provided that each phase of the project performed by the various subsidiaries is of less than 12 months duration, it might be suggested that none of the activities of the subsidiary entities constituted a permanent establishment.

It is to be noted that New Zealand's Double Taxation Relief Orders with Sweden, Japan and the United Kingdom retain the 12 month time limit, whereas the Orders with Australia, Singapore and Malaysia have a 6 month time limit[1] and the aboveproposal would have to be altered accordingly.

However I would submit two factors that would threaten the success of such a proposal. Firstly paragraph 2(g) merely states that the term permanent establishment includes such a project if it exists for more than 6 months. It does not state that the project must exist for 6 months before constituting a permanent establishment. The second danger inherent in the proposal is to be found in the N.Z. Agreements with the United Kingdom (para. 4(a). and Singapore (para 4(a) and Malaysia (para) which provide:

> "an enterprise of one of the territories shall be deemed to have a permanent establishment in the other territory if -
> (a) it carries on supervisory activities in that other territory for more than twelve/six months in connection with a construction, installation or assembly project which is being undertaken in that other territory;"

If such a clause were to be included in the OECD Draft the proposed scheme would surely attract a presumption of supervision by the parent company over the separate phases of the activity and leave little doubt as to the conclusion that a permanent establishment exists.

The committee expressly rejected the term "warehouse" from paragraph 2, because an enterprise, the business of which is letting facilities for storage space or similar activities associated with warehouses, to a third person will be a permanent establishment under the general definition of paragraph 1 and need not be mentioned in paragraph 2. Paragraph 3 makes it clear that a warehouse is

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[1] refer appendicies C.D.E.F.G & H.

not a permanent establishment if it is used by the enterprise which controls it merely for the purpose of storage display or delivery of goods or merchandise belonging to the enterprise.

(iii) Marginal activities not permanent establishments Paragraph 3.

Under paragrpah 3 of the OECD Draft are a number of examples of forms of business activities which should not be treated as constituting permanent establishments even though theactivity is carried on in a fixed place of business. The reason that such activities are deemed not be permanent establishment is that they are merely marginal activities or auxiliary to some other enterprise carried on in the country. Considered seperately each of the listed activities is not ordinarily regarded as being productive of taxable income. There is no comparible paragraph existing in the Mexico/London Drafts. Their inclusion in the OECD is, it is submitted, self explanatory and does not require elaborating on. However, the paragraph does give rise to problems of construction.

The first difficulty lies with the prefatory words, that is the distinction between "shall not be deemed to include" as regard to the more decisive "shall be deemed not to include". The use of "shall not" was probably deliverate although the writer can find no comment on its use in any of the Commentaries. It is submitted that the present Draft used the "shall not" formula to mean that because there exists in a State one of the businessess mentioned in the sub-paragraphs, this does not, merely by the existence thereof, constitue a permanent establishment in that State. Whereas the phrase "shall be deemed not to include" would mean that the existence of one of the

named businesses would always exclude the existence of a permanent establishment in the State.

The second difficulty of construction posed by paragraph 3 arises from the repeated use of the word "solely" in the sub-paragraphs. What would be the position when a fixed place of business is utilized simultaneously for two or more of the activities which, if taken separately would not constitute a permanent establishment? For example paragraph 3 (d) provides that a permanent establishment shall not be deemed to include the maintenance of a fixed place of business solely for the purpose of purchasing goods or collecting information. What would be the position of a business carried on for the dual purpose of purchasing goods and collecting information? Or, the position of a business which not only uses the facilities for the purpose of storage, display or delivery of goods (paragraph 3(a) but also for the purpose of "preparatory activities" such as advertising (paragraph 3 (e).

One interpretation suggests the conclusion that a permanent establishment would be present for the purposes of the convention. Moreover this view is supported by the fact that the enterprise's presence in the host country would be more intense by virtue of the carrying on of both activities simultaneously thus justifying characterisation as a permanent establishment. On the other hand such a conclusion would not seem to be in harmony with the more liberal attitude to the question of commercial involvement in the host country evidenced in the elaborate provisions of the definition of what constitutes a permanent establishment contained in the OECD Draft.

Paragraph 3 (e) also poses several other problems as

to its application with regard to certain types of commercial involvement "of a preparatory or auxiliary character" the incidence of which is becoming increasingly common to international business.

Firstly sales assistance centres may be established to conduct market or scientific research, or they may supervise and support the activities of the distribution and agents operating in the region. It would seem that in some cases sub-paragraph (e) would exclude the activities of these centres from the scope of the definition of permanent establishment. It is uncertain, for example, whether the sale of research results conducted by one of these sales centres would be liable to tax in the host country or fall within the exemption. It would seem necessary in some instances to validate the claim for exemption from categorization as a permanent establishment by showing that the sale of research results was merely auxiliary to some other principal activity.

Service centres are now frequently being established by large international enterprises. These centres may have a supervisory function with regard to affiliated companies, agents ordistributors in the particular country concerned, or they may supply technical aid to the relevant bodies. It would seem that paragraph 3 (e) is sufficiently broad enough to protect many such service centres from taxation in the host country. However care would need to be exercised that decentralization of the enterprise had not occured to such an extent that the service centre constituted "a place of management" (paragraph 2 (a). In the same way an enterprise would have to watch that there is not a transition from what can be described as technical aid of a preparatory or auxiliary character to the practice of a true industry in such a manner that a

branch would be said to exist within paragraph 2 (b). After-sale servicing centres are frequently established to maintain or repair products sold in the region. Paragraph 3 (e) would often exclude such centres from constituting a permanent establishment in the region, but the situation might be complicated if such a centre were staffed by personnel permanently resident in the host country, and more especially so if the personnel could make use of a stock of spare parts or could forward orders for spare parts to the enterprise on behalf of customers.

However the writer cannot totally agree with Mr Parsons that the difficulty is irritating. There is, infact, a great deal of difference between a company merely storing good or merchandise in a wharehouse on a semi-permanent basis, and a company using the faculty as a means of supplying its agents or distributors. The transitory nature of the goods will be enough to attract a presumption of being a permanent establishment. The distinction between the two paragraphs must ultimately like in the authority of the agent or employee to conclude contracts. It is proposed to conside in more detail problems relating to this qualification under the discussion on paragraphs 4 and 5.

Parson[1] in his article suggests that the answer may turn on whether there is distinct charge for the services provided. This does seem a possible answer to an otherwise difficult problem. The writer would emphasize that if any taxation is to be levied against permanent establishment concerned only with providing these services to goods, under a warranty or otherwise, the levy can only be made on profits which might be expected to be derived from an independent enterprise carrying on the business

of providing such services. Levy cannot be made against the profit on the original sale of the goods in the taxing country.

As the same writer also points out Paragraph 3 of Article 4 of the New Zealand-Singapore Double Taxation Relief Order 1973[1] has been made a little more difficult to understandin that it is not easily reconciled with paragraph 5. Paragraph 3 (a) and (b) follow the OECD Draft Convention in providing that permanent establishment does not include facilities used for the purpose of storage etc of goods or merchandise (paragraph 3 (a) nor does it include the stock of goods or merchandise so stored (paragraph 3 (b). However paragraph 5 indicates that if a distributor for the enterprise is an agent or employee, the enterprise will be deemed to have a permanent establishmentfthat agent or employee has a general authority to conclude contracts for his principal or employer, or if he has a stock of merchandise from whom he fills orders which he receives. Although it is clear that it is the enterprise which must have the title to the stock of merchandise, however, it is not clear from whom the agent is to receive orders - customer or principal.

IV Agents of dependent status.

Paragraph 4 of the OECD Draft lays down special rules which moreover are almost in conformity with paragraph 4 of Article V of the Mexico and London Drafts - with regard to treating certain groups of persons as permanent establishment on account of the nature of their business activities, even though the enterprise may not have a fiscal place of business. The treatment of dependent agents or employees as permanent establishments was suggested in

[1] The following discussion equally applicable to Article II(m)(iv) and (v)(bb) of the N.Z.-Japan Double taxation relief Orde

the report of the Fiscal Committee of the League of Nations 1928 @ Page 12 but they emphasized the fact that the person must be dependent, both from the legal and economic point of view, upon the enterprise for which they carry on business dealings.[1]

The Mexico and London Drafts (Article V paragraph 4 of the Protocol) do not enumerate exhaustively when such agents are to be deemed permanent establishments, but merely give examples. The Committee of Fiscal Affairs thought it was desirable to define, as exhaustively as possible the cases where agents are deemed to be "permanent establishments".

This provision in paragraph 4 of the OECD is accompanied in paragraph 5 by one to the effect that the fact that an enterprise in one contracting state has business dealings in the other Contracting State through a Commission agent, broker or other independent agent shall not be held to mean that such an enterprise maintains a permanent establishment therein. The difficulty in interpreting these two provisions lies with whether the agent in one contracting State is selling on behalf of an enterprise established in the other contracting State or whether he is buying and reselling the products on his own account. The distinction is not always an easy one to make. The fact that the distributor purchases goods from a supplier for resale does not necessarily mean that the relationship between them is not one of principal and agent. The solution seems ultimately to depend on the degree of control that the enterprise exercises over the selling activities of the distributor.

It may be noted, that under all the New Zealand Double Taxation Relief Orders before 1966,[2] the possession

[1] Refer P 75 Commentary on OECD Draft Convention.
[2] Refer Appendix A,B,C & D.

by the agent of a stock of goods from which he habitually fills orders will suffice, in lieu of contractual authority to constitute the agent a permanent establishment. The four other New Zealand Agreements[1] follow the OECD Draft in providing that an agent will constitute a permanent establishment if he is independent and has authority to conclude contracts in the name of the non resident enterprise. But uncertainty[2] still exists as to what is "authority" to conclude contracts" and whether the mere formality that contracts must be approved at the "home office" is sufficient to bring an agent's activities within the excluding provisions. There is language in the commentary suggesting that a requirement of formal but meaningless approvals is not sufficient[3].

There are also dicta in Panther Oil & Grease Manufacturing Company of Canada Ltd v M.N.R.[4] that the court will concern itself with therealities of the agent's authority. Thus if his "recommendations" are "never turned down" the requisite authority will be inferred in spite of the prima facie appearance of subordination in the contract. Again in the Case 98 F.C.T.B.R. one member did not view the absence of a "strict" agent/principle relationship as excluding a finding that there was authority to contract if the contracts could be said to made on the taxpayers' behalf.

It would be advantageous to have a specific definition of approval which would clearly exclude mere acquiescent approvals to the contract by the non-resident enterprise. This could be acheived by specifying a test or criteria for determining the validity or reality of restrictions on an agent's or employee's authority.

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[1] U.K., Australia & Singapore & Malaysia refer appendicies E,F,G & H.
[2] Kragen, Curry, Parsons, Mangin
[3] supra.
[4] 57 DTC 494 @ pp discussed

It must be remembered that a country's right to tax attaches only to such industrial or commercial profits as are attributable to the permanent establishment.[1] Thus, the precise nature of the permanent establishment must be determined. If the permanent establishment consists solely of anagent as provided for in paragraph 4 then the only profits attributable to the permanent establishment are those that arise from contracts the agent makes in the exercise of his authority to conclude contracts. Obviously the converse is true, and profits from contracts not concluded by the agent will not be attributable to the permanent establishment. But what is the position if the agent has transmitted the relevant offer to his principal? The writer submits that such profits are still attributable to the permanent establishment.

(V) Agents of independent status - Paragraph 5.

Paragraph 5 indicates that business dealings carried on through an agent of independent status do not constitute the principal enterprise a permanent establishment.

Corresponding provisions are included in the Mexico/London Drafts (Article V paragraph 5 of the Protocol). All three drafts state, therein, that brokers and commission agents are agents of independent status. Similarly all three drafts exclude business dealings carried on with the co-operation of any other independent person carrying on a trade or business (for example forwarding agents) as constituting permanent establishments. Such agents must, however, be acting in the ordinary course of their business.

It might be suggested that an agent of "independent status" could habitually exercise an authority to conclude contracts in the name of the enterprise established in

[1] Article 7 of the OECD draft.

the other contracting state. Such action would not fall within the ambet of paragraph 4 because of the specific exclusion contained therein, of agents of an independent status. However the commentary on the OECD Draft[1] states in part as follows:

> "Where, for example, a commission agent not only sells the goods or merchandise of the enterprise in his own name but also havitually acts, in relation to that enterprise, as a permanent agent having an authority to conclude contracts, he would be deemed in respect of this particular activity to be a permanent establishment since he is thus acting outside the ordinary course of his own trade or business (namely that of a commission agent)".

In other words an "agent of independent status" who has authority to conclude contracts on behalf of the non resident enterprise ceases to be an "independent agent" and becomes a "dependent agent" constituting a permanent establishment.

In conclusion the writer agrees with other commentators[2] who have attempted to reconcile paragraphs 3,4 and 5 of Article 4 of the OECD Draft, and who state that when determining whether or not an agent constitutes a permanent establishment of a non-resident enterprise, it must be determined solely by reference to paragraphs (4) and (5). Unless the paragraphs are so confined there is an irreconcilable conflict between the three provisions.

VI Subsidiary Companies - Paragraph 6.

The Mexico/London Drafts (Article V, paragraph 8 of the Protocol) and paragraph 6 of the OECD Draft provide that the mere existence of a subsidiary company does not, of itself, constitute a permanent establishment of its parent company. This provision gives recognition to the

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[1] p.76.

[2] refer Magney (1975) 4 Aust T.R.4.
Parsons (1968) Br. Tax R. 122.

principle that, for taxation purposes, a subsidiary company is an independent legal entity with respect to its parent company. Even the fact that the subsidiary company is managed by the parent company does not constitute the subsidiary a permanent establishment of that parent.

However the subsidiary company will be deemed to be a permanent establishment of its parent company, if it carries on business activities within the provisions of paragraph 4. The comments made at the end of the discussion on paragraph 4 are again relevant in this context. The parent company is only subject to taxation on so much of the profit as is attributable to that permanent establishment for contracts it has concluded. This does not affect the separate taxation of the subsidiary company's own profits.

The same reasoning is applied to a parent company constituting a permanent establishment of its subsidiary. The parent company will be a permanent establishment if its activities fall within paragraph 4. The same rule also applies to two or more subsidiaries of the same company. However, New Zealand Inland Revenue Department always regard a subsidiary as a separate New Zealand entity and merely tax the profits of that subsidiary as a New Zealand resident company.

(3) Judicial decision onthe question:
"What constitutes a P E ?"

The main problem that has to be determined is what exactly does constitute a permanent establishment and the meaning of the treaty definition which in its OECD Draft form states that a permanent establishment means "a fixed place of business in which the business of the enterprise is wholly or partly carried on". The article provide examples of what may or may not substitute a permanent establishment but as thewriter has previously stated these examples were never intended to be exhaustive . Some of theexamples are helpful and provide clearly that an activity is or is not a permanent establishment, but others, such as "an office" are only generalizations and leave problems which are not resolved by the articles' wording. For example, the term "office" does not say what degree of ownership or control the non-resident company has to exercise over the office, or anything about how long such an office may operate before it becomes a permanent establishment.

It is against this background that the writer now proposes to consider the decisions of the various tax courts and tribunals of the United Kingdom, Australia, Canada and New Zealand relating to the question of what constitutes a permanent establishment and what effect these decisions have had on the interpretation of the expression. As far as the library resources disclose, there are very few cases which give guidance to what will constitute a permanent establishment. It is submitted that one possible reason for their absence is the width of the domestic law. For example, many of the leading cases which the English courts have been asked to determine, were decided under the domestic legislation. The question,

whether not the enterprise constituted a permanent establishment for the purposes of International Double Taxation Agreements has not been argued[1].

What decided cases there are, limit themselves either to vague generalities or specific discussion solely related to the instant case. I will, however, outline briefly the effect of some of the cases read. The examination isnot intended to be exhaustive, and the voluminous American decisions have been ignored as such a study would only serve to confuse the concept as applicable to the New Zealand circumstances.[2]

(i) The United Kingdom Cases.

The only English case the writer was able to discover which is relevant to the question was, Henriksen (H.M. Inspector of Taxes) v Grafton Hotel Ltd.[3]

The comments in this case, however, which are of relevance relate to the meaning of "permanent". In his judgment de Pareq L.J.[4] said that the word permanent was a relative term and not synonymous with everlasting. It is used in an inexact but very usual sense of indefinitely continuing.

Although these comments were really obiter they have been applied to the phrase "permanent establishment" in several cases[5] and now have a firm standing in the present law.

However this case is of little help in deciding the question of what constitutes a permanent establishment and the writer was unable to find any other relevant English case.

5refer No. 630 v M.N.R. (1959) 22 CanTax ABC 91 and Case 5 3 N.Z.TBR 49.

1refer Henriksen v Graften Hotels Ltd. (1942) 24 TC 455 (1960) AC 459.

2 refer to the Criticisms in Standfor L Review 1962 Vol 15p.128 Calif L Review 1964 Vol 52p306 Cornell L Quaterly 1962 Vol 47p529/ 314 Canadian Tax J. Volume V P. 344

3(1942 24 TC 455

4 Supra @ p.462.

(ii) Australian Cases.

There are only two[3] Australian cases which are of any significance in this matter. The first case is Case 110[4] the facts of which can be summarized as follows;

The taxpayer company was incorporated and resident in the U.K. but not registered in Australia as a foreign company. By two agency agreements drawn up, in identical terms, in 1937 the taxpayer company appointed a Victorian and a N.S.W. company its Australian distributors of articles mainly manufactured in the United Kingdom. The agreement provided that the Australian distributors were to be the sole agents, within a defined territory, for the sale of these articles. The agreements also specified that the taxpayer company should fix the prices at which the distributors would sell the articles they purchased from the taxpayer company, and that they should maintain adequate stocks for supplying customers. These two agreements remained in force as at the date of theassessment in question.

In 1946 the N.S.W. Company became a wholly owned subsidiary of the taxpayer company. The Victorian company remained independent of the taxpayer company.

In 1942 the taxpayer company acquired an interest in an Australian manufacturing company, which owned and operated a factory in N.S.W. for the purpose of manufacturing articles of the types in which the taxpayer company dealt. Therefore the taxpayer company ceased exporting the goods from the U.K. to the distributors. Instead it made arrangements whereby the goods were availabe from the

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[3] reference may also be given to Case 43 & Case 53 which are not of significance to the present paper 11 CTBR (ns).

[4] 5 CTBR (ns) 656.

Australian manufacturing company.

The original shareholders in the Australian manufacturing company (formed in 1935) were four competitors of the taxpayer company; under appropriate agreements the shareholders were each entitled to a quota of the Australian manufacturing company's output and their separate quotas bore their separate trade-marks. Thus the taxpayer company by acquiring a 10 per cent shareholding, became entitled to a quota equal to 10 per cent of the Australianmanufacturing company's output. The Taxpayer company appointed "x" as its nominee to the board of the Australian manufacturing co. X was also a director of the N.S.W. distributing company.

The manner of dealing with the articles from the Australian manufacturing company was complicated. Having advised its shareholders of its estimated future production for some months ahead the manufacturing company required in advance monthly orders from each shareholder up to its maximum quota. In the case of the taxpayer company, thequota was conveyed to the N.S.W. distributors (ie) its Australian subsidiary). The N.S.W. distributor then placed orders direct with the Australian manufacturing company together with advices as to whom the goods were to be consigned. The Australian manufacturing company dispatched the goods and sent advice notices to the consignees, the N.S.W. company and to the taxpayer company in the U.K. All the invoices, however, went direct to the U.K. taxpayer company. Then as per the 1937 agreement the taxpayer company fixed the price the N.S.W. company should pay for the goods.

Payment by the N.S.W. company was made to another Australian subsidiary of the taxpayer company which in

turn paid the Australian manufacturing company and accounted to the taxpayer company for the balance.

A stock of articles was kept by the NS.W. Company, but only for its own purposes and not for the taxpayer company.

The question for determination was whether the taxpayer company was "engaged in trade or business in Australia through a permanent establishment situated therein" for the purpose of a Double Taxation Agreement between the U.K. and Australia. The definition of "permanent establishment" in that treaty is identical to that contained in the New Zealand - Canada, andU.S.A. Agreements[1].

The Board of Review held, allowing the objection, that the taxpayer company was not engaged in trade or business in Australia through a permanent establishment situated therein.

Firstly it was said[2] that a branch or other fixed place of business contemplates an identifiable locus of operations and connotes something physical and separately identifiable as the place of business belonging to the non-resi ent enterprise. By this he meant the permanent establishment had to be such so that in a commercial sense it could be said,

> "There is the taxpayer company's branch" or "that is where the taxpayer company carries on its business in Australia".

He drew this concept of an identifiable and fixed location from the definition of the term "permanent establishment" in the context of that case, which was defined as

"a branch of other fixed place of business"

and this puts the case on an equal footing with the

[1] refer appendices

[2] per Mr J.L. Burke @ P.667 paragraph 22.

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New Zealand situation in that this is the definition which is used in most New Zealand Double Taxation Relief Orders, the exception being the agreement with Japan[1]. It is this definition in the New Zealand agreements which may infact cause some difficulties in showing that a permanent establishment exists for a transient branch of a non resident company.

It was also held that as the taxpayer company's nominee director on the board of the Australian manufacturing company, and who was also a director of its N.S.W. subsidiary, had no managerial duties and no form of local management by the taxpayer company was required, there couldn't be a "management" within the meaning of the term as used in the definition of permanent establishment.

Thirdly, because the manufacturing factory in Australia was owned by the Australian manufacturing company and was separate and distinct from the taxpayer company there was no "factory" of the taxpayer within the definition of permanent establishment. The factory's parent, the Australian manufacturing company was not a subsidiary of the taxpayer - although two members of the court (Mssrs Burke and Leslie)[2] thought this relationship in itself would not be sufficient to establish a permanent establishment.

Finally Mssrs. Leslie and Burke pointed out that the N.S.W. distributing company was not an "agency" because the taxpayer fixed the selling price and the distributing company did not fill orders on the taxpayer company's behalf from the stock of goods. Nor was the taxpayer company's other Australian subsidiary an agent

[1] see appendix D Article II (m) (iii)

[2] per Mr Burke P.668 paragraph 25 x Mr Leslie Pp 677

because it merely acted for the taxpayer in the receipt and payment of moneys for the articles.[1]

The only other relevant Australian case is Case 98[2] but as the definition of permanent establishment in the Australian / U.K. Agreement includes,

> "the use or installation of substantial equipment or machinery by, for or under contract with an enterprise of one of the Contracting States."

and in as much as the agrument revolves around this phrase, the case is irrelevant, because no New Zealand Agreement includes a comparable provision.

The facts of the case are; the taxpayer, a U.S. company, had carried on business through a branch in Australia. In 1953 it entered into an agreement with an English company with offices in Australia (and New Zealand). Under this agreement the English company was appointed the sole distributor in, interalia, Australia and New Zealand of a product, the trade mark of which was registered in the name of the American company in both Australia and New Zealand. The English company was granted a licence as sole independent contractor to manufacture the product ready for sale in Australia and New Zealand, and to sell and distribute the product in such territories, and for that purpose the English company was granted the full and exclusive licence to use in Australia and New Zealand in connection with the product the trade marks and trade names and licences relating to the product.

The U.S. company was to disclose to the English Company all the information concerning the manufacture of the product. Certain machinery was also lent by the American Company to the English company.

The English company was to receive a commission of 15 per cent of the net invoice of all sales and was to bear

[1] per Mr Leslie P.679 paragraph 9 & Mr. Burk P.675 para. 18&19.
[2] 7 CTBR (ns) 649.

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the cost of storage and dispatch. The U.S. taxpayer company was entitled to proceeds of sales less the cost of production, freight etc.

In 1954 a substantially similar agreement was entered into by the parties concerning the manufacture of a second product. However, the plant and machinery used in connection with the manufacture of the second product was owned by the English Company.

The question for determination was whether or not the American Companywas engaged in trade or business in Australia through a permanent establishment in Australia during 1954.

The Board of Review disallowed the taxpayer's claim on the ground that, inthe case of the first product, all the machinery belonged to the American Company and this was sufficient to constitute a permanent establishment. But in the case of the second product, the machinery was owned by the English company, and the Board thought that if the operations in connection with that product were the only ones concerned, it would be difficult to find that, in respect of those operations the U.S. company had a permanent establishment in Australia. However, since the Australian Income Tax (International Agreements) Act, provides that the entire income of a business carried on through a permanent establishment may be taxed, it was sufficient that a "permanent establishment" was found to exist in Australia. The net proceeds of thesale of both products was assessable.

Again a disparity with the New Zealand Agreements occurs. Only the Double Taxation Relief Orders with the U.S.A., Australia, Singapore and Malaysia[1] provide that tax may be imposed on the entire profits of the enterprise from sources within New Zealand if the enterprise is engaged

[1] refer appendices B, F,G & H.

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in a trade or business through a permanent establishment situated in New Zealand.

The other Agreements[2] only allow taxation of such profits as are attributable to that permanent establishment.

It is, therefore, interesting to speculate what the position would now be with regard to the New Zealand distributors, remembering that the New Zealand Double Taxation Relief Order with the U.K. was not signed until 1966.

(iii) Canadian Cases.

The writer discovered three Canadian cases that directly discussed the question of what constitutes a permanent establishment and two cases that are indirectly relevant.

The first case is No. 630 v Minister of National Revenue.[3]

In this case the Board followed the decision of the English Court in Henriksen v Grafton Hotel (supra) as to the definition of the word "permanent".

In this case the Appellant was an American construction Company which was working in Ontario in partnership with several other companies. The Appellant considered itself to be a U.S. based corporation and thus notsubject to taxation, whereas the Minister claimed that the Appellant had a permanent establishment in Canada and thus was subject to Canadian Income Tax.

The Board held that the Appellant was a member of a partnership functioning as such in Canada which had a permanent establishment there and thus this permanent establishment was sufficient to be deemed the permanent establishment of the Appellant, as it was this that the Appellant derived its profits. The income of the

[2] refer appendices A,C, D & E.
3 (1959) 22 Can. Tax A,B,C 91.

Appellant from this source was, therefore, taxable in Canada.

The decision in this case would seem to indicate that so long as a permanent establishment exists through which profits are made, then the ownership of such establishment is not of material consideration. However, since the case involves rather unusual facts and concerns a partnership and as the partners are the legal entities and not the partnership, then the company can be said here to partially own the establishment. Thus this case may be limited to its particular facts, and may not be deemed applicable to the case when a company derives its profits through an establishment of an entity in which it has no financial or similar interest.

The second relevant Canadian decision is that of Minister of National Revenue v Panther Oil and Grease Manufacturing Company of Canada Ltd[1]. In this case, the respondents, an Ontario corporation, had a factory in Ontario but its sales force throughout Canada was under the control of its head office in Texas. The company had a sales force in Quebec, and listed the name of an agent with his address and phone number in its letterheads. This agent carried on his duties in an office in his own home in a residential district and there was no sign or other indications that the respondent had an office there. The telephone was listed under his own name only, and he paid all the expenses of his office. In addition, each salesman had authority to decide on the Credit ratings of new customers and all signed orders were forwarded to the company's plant in Ontario. These orders were filled without question. On the basis of these facts the

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[1](1961) CTC 363.

Exchequer Court of Canada found that the company had a "branch" in Quebec, and consequently, by reason thereof, it had a "permanent establishment in Quebec.

This case discussed the actual meaning of the term "branch or other fixed place of business". It was held that the word branch is in no way limited by the second limb of this term, ie. "or other fixed place of business". Thus branch is left to its normal meaning according to common usage. It was also said[1] that the term "branch" could; "include a component portionof an organisation or system or a section, division, subdivision or department of a business" and thus in this particular case a sales division, although with no fixed establishment, but just a body of autonomous salesmen, constituted a permanent establishment. It appears on the authority ofthis case that there is nothing to prevent a taxpayer from having a permanent establishment without owning or renting a building or even occupying a building at all, as in this case.

This case would also seem to indicate that a company may have a permanent establishment if it merely rents property from which it operates its business, but it is not an authorative case on this point.[2]

A disturbing feature of this case is that at one point[3] thejudge regarded the question of whether or not the company could be said to have a permanent establishment by virtue of an "office". As the facts set out above show the only office was the division manager's carrying on his duties in a residential district in which there

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[1] per Thorson P. ibid P. 377
[2] refer Thorson P. ibid P. 378
[3] refer Thorson P. ibid P. 379.

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was no sign or other indication that the company had an office there. Because of the notice of appeal from the judgment in the M.N.R. v Sunbeam Corporation (Canada) Ltd[1]. the point was not directly decided. It is possible that due to this an inference may be drawn that such an office in a home does not constitute a permanent establishment.

However the weight a court may place on such an inference is questionable. A limiting feature of the case is that it merely relates to inter-province tax and not taxation between two dependent countries, and another limiting feature is the applicability of Canadian tax cases in a New Zealand Court. (Therefore any limitation on the authority of this case, is not certain.)?

The situation is confused even further by the third Canadian case Sunbeam Corporation (Canada) Ltd v Minister of National Revenue[2] which in certain respects goes against the above decision. The facts are somewhat similar to Panther Oil case. The taxpayer was an appliance and equipment manufacturer having its head office and factories in Ontario and distributing its products to wholesale distributors throughout Canada. To further its sales program the company employed four sales representatives, one of whom lived in Quebec. The sales representatives did not have authority to conclude contracts on the corporation's behalf nor did they maintain a stock of goods from which orders were filled, these being filled from the plant at Ontario. The Quebec representative had an office in his home but this did not carry a business sign nor was it listed in the business directory. However, he did keep a

[1](1961) CTC 45 appeal from the decision by Cameron J.

[2](1962) CTC 657.

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quantity of the taxpayer's goods on hand for use for demonstration and training purposes.

Thetaxpayer urged that its agent in Quebec, or his office, constituted a permanent establishment in Quebec, and this was denied by the Minister.

The case firstly decided that the word "establishment" contemplates a fixed place of business of the corporation or a local habitation of its own[1]. It also said the word "permanent" means that the establishment is a stable one and not of a temporary or tentative character. Therefore, it was held that the corporation did not have a fixed place of business of its own in Quebec and therefore it could not be said to have a permanent establishment in that province.

The decision then[2] emplys that for there to be a "permanent establishment" it must be a stable, identifiable location owned by the Company concerned and that business must be carried on from this fixed place. This would in effect prevent the application of the previous cases and would eliminate the possibility of claiming a transient enterprise, such as a touring theatrical unit, or a race-horse brought into the country for a series of races, as a permanent establishment.

It would appear that as this case is a decision of the Supreme Court of Canada it has greater authoritative value, as the previous two cases are from the Tax Appeal Board (Case No. 630) and from the Exchequer Court of Canada (Panther Oil).

There are two cases of substantially similar facts that are of a little help in deciding what constitutes a

[1] per Martland @ 661

[2] ibid

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permanent establishment. In American Wheelabrator & Equipment Corporation v Minister of National Revenue[1] the appellants company's executive offices and factory were situated in the U.S.A. One of the points outlined by Mr. Fisher of the Taxation Appeal Board in hisjudgment referred to the authority invested in the company's agent in Canada.

It was his duty to interview prospective customers and notify the company of their requirements, making rough sketches of the prospective customers' foundry cleaning room and suggesting the kind of equipment that might be installed in it by the company. All the suggestions were subject to reveiw by the company's head office and the agent had no authority to quote price to prospective customers, nor to contract withthem on behalf of the company. Therefore it was held the company did not have a permanent establishment in Canada.

In Ronson Art Metal Works (Canada) Ltd. v Minister of National Revenue[2] the facts were similar to those of above case but this case was decided on the basis of the Federal Income Tax Regulations. Again, the company's agent, who had worked from his own home had no general authority to contract for his employer andhad no stock of goods or merchandise from which he could fill orders. Again it was held that the agent did not constitute a permanent establishment of the company.

[1] (1951) 4 CTABC 345.

[2] 56 DTC 440.

(iv) New Zealand Cases.

Unfortunately these cases are also rare and the writer found only one case; 3 N.Z.TBR Case 5,[2]

This case concerns the determination by the Board of Review as to whether an Australian company had a permanent establishment in New Zealand by virtue of theatrical enterprises periodically carried on in New Zealand by the company.

The company employed no staff in New Zealand, except casual cleaners, ushers, stagehands etc apart from artists and executives bought to New Zealand from overseas. The touring shows had a tour manager who was merely a minion for the company executive in Australia with whom he was in constant contact for directions and instructions. Likewise no other member of the travelling group had any real authority.

In upholding the Objector's claim the Board adopted the definition of "permanent" as stated in the English case of Henriksen v Grafton Hotels Ltd.[3] and went on to say that this meaning was to be applied in the term permanent establishment. The Board said[4] that the establishment of a branch would import the carrying on of the company's business in an identifiable location not temporarily but permanently. In saying this the Board seem to say that the place of business would have to be a fixed place, and not of a transient nature, and decided that the touring show could not of itself or through various booking officeshired at various times constitute a permanent establishment. The main basis of the decision

[2] 3 NZTBR Case 5 P. 49.
[3] Supra.
[4] Supra at P.58 paragraph 27.

appears not to have been the transient nature of the enterprise but the fact that the touring concern was not provided for in the Australian agreement as it was in the Japan agreement[1]. On this basis that it has been specifically provided for in some agreements the Board said it cannot be implied or read into other agreements where in fact it does not exist.

[1] refer appendix D. Article II (i) (m) (iii).

Conclusion from Cases:

The effect of these cases is not really of any help. The English and Australian authorities, such as they are, limit what may constitute a permanent establishment by saying that it must have a degree of permanence, in that it must be stable and continuing and have a fixed or identifiable location. So that someone can point to it and say that is where the foreign enterprise carries on its business in this country. Although it is not clear, these authorities seem to suggest that the property constituting the permanent establishment needs to belong to or be in the possession of the company. The only relevant English case is Henriksen v Grafton Hotels and this only in so far as it provides that the word permanent did not constitute everlasting but is used as meaning indefinitely continuing. The significance of this statement is uncertain, as what time period can be seen to satisfy this definition of permanent is obviously open to conjecture .

The Canadian cases display a more flexible approach as to what may constitute a permanent establishment but the leading authority, thatis the Supreme Court decision in Sunbeam's case,[1] is a narrower decision than the other two decisions of Panther Oil an No.630[2] and limits their application. Sunbeam's case follows the English and Australian decisions in that for there to be a permanent establishment there must be a continuing activity in a stable, identifiable location, owned by the company concerned. However the other cases are more flexible

[1] Supra

[2] Supra

in that they state actual ownership is not necessary and state that a permanent establishment may be present without the necessity of a fixed identifiable location, as long as there has been some projection into the country of the company's activities.

The New Zealand case also appears to fall in line with the Canadian Supreme Court decision in that the permanent establishment needs to be a permanent or continuing concern carried on in a fixed and identifiable location. Prima facie this decision indicates that transient enterprises do not constitute permanent establishments but it is doubtful whether the view could be upheld in court now. The case was largely decided on the point that such touring concerns were not provided for in the Australian Double Taxation Relief Order, whereas they had been in the Japan agreement, and thus the Board saidthat if something is expressly provided for in one, then in the absence of such specific provision in another it could not be read in or inferred to that other agreement. Thus concept is a common maxim of statutoty interpretation, which, in its common usage, applies to the interpretation of many sections in domestic legislation. However, these treaties are primarily a manifestation of policy considerations, and as policy is apt to change between countries over a period of time, then such a rule of interpretation seems invalid, and it is doubtful if the court would now accept such an argument.

Such an argument may become more important with the growing activities of oil rigs operating in New Zealand territorial waters. Such rigs may move about from various locations and be deemed itinerant in that respect. But they have a fixed and identifiable location? The Commissioner

of Inland Revenue is obviously interested in the profits arisingfrom the operations as they do definitely have a New Zealand source and hence are taxable under the domestic law.

The combined effect of these cases is to suggest that to constitute a permanent establishment the enterprise would probably have to be in a fixed identifiable place under the control of the non resident company and that it must be a concern that is indefinitely continuing and not of an temporary nature. The degree of permanency cannot be measured solely by the time it takes to earn income in any particular place. It is to be noted that the consideration of whether a permanent establishment exists or not is only necessary if there is a Double Tax Treaty in operation between New Zealand and the country concerned. If there is no treaty then the ordinary source rules in the domestic law, s167, apply and once these rules have been satisfied the domestic revenue have the right to tax regardless of what is happening in the other country.

No analogy can be drawn from the domestic law concept of "fixed establishment" as defined in s2 of the Land and Income Tax Act 1954 when considering whether a permanent establishment exists or not. The two concepts have different functions. The purpose of the treaty concept of "permanent establishment is to provide a basis for liability to tax, whereas the concept of "fixed establishment" is used to determine the liability of a non-resident getting New Zealand interest under s167 (i)(jj) and s203 s (2) (b).

As a final point to this part of the paper reference should be made to Article 25 of the OECD Draft relating to mutual agreements between the taxing authorities. If the taxing authorities, when faced with a difficult case, were to communicate with the other taxing authority under Article 25, to ascertain its attitude and on this basis reach a solution acceptable to both sides, the chances of a taxpayer objecting would probably be reduced.

Mutual agreement provisions are embodied in all the New Zealand Double Taxation Relief Orders.

4) Tax Treaties between developed and developing countries.

The international double taxation agreements signed during the first half of this century were mostly signed between so-called developed countries of more or less equal economies. With the exception of the Mexico convention, at all the Conventions only the developed countries were heavily represented and the drafts give impetus to these countries' wishes, remembering that the purpose of the agreements is to facilitate trade and the flow of capital between the contracting states on a reciprocal basis. Contracting Countries were both investors and receivers of trade and capital from the other country, and the transactions were therefore, being carried out in both directions.

The increasing amount of investment and utilization of resources available in developing nations gave rise to a further scene in the evolution of international tax treaties. There were basically two reasons for a growing concern that was to be echoed by the United Nations Conference on Trade and Development during the mid 1960's. Firstly the flow of investment was in a single direction away from the developing countries. The second reason was essentially the same problem as that faced by the League of Nations in 1928. The Mesico and London Drafts gave adherence to the principle of residence as the dominating principle to which the developed countries continue to apply, while developing countries stick adamantly to the source principle in exercising authority to levy taxes.

There is, of course, strong support for a more beneficial treatment to be given to the developing countries so as to strengthen and not to weaken their resources.

It is too easy for a highly developed country (technically and economically) to take advantage of reduced technical capabilities of a developing country because of economic weakness and lack of experience in dealing with negotiations. History is full of examples of systematic bleeding of a developing country's resources to such an extent that their rate of development is curtailed almost to the point of being stagnant. Thus agreements between developed and developing countries, should be beneficial to the less developed country and yet not result in too great fiscal sacrifices by the developed country.

It was to this end that the Economic and Social Council on 4 August 1967 in its resolution requested:-

> "The Secretary - General to set up an ad loc working group consisting of experts and tax administrators nominated by Governments, but acting in their personal capacity, both from developed and developing countries and adequately representing different regions and tax systems, with the task of exploring in consultation with interested international agencies, ways and means for facilitating the conclusion of tax treaties between developed and developing countries, including the formulation, as appropriate, of possible guidelines and techniques for use in such tax treaties which would be acceptable to both groups of countries and would fully safeguard their respective revenue interests;[1]

In its resolution the Council also noted that tax treaties between developed and developing countries can serve to promote the flow of investment useful to development of the latter. They also recognise the need for favourable tax treatment to such investments on the part of the countries of origin.

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[1] Resolution adopted by the Economic and Social Council (1273 XLIII) cited from Annex I of Report of the UN Department of Economic and Social Affairs "Tax Treaties between developed and developing countries" (hereinafter called the first Report).

It is to be noted that the nineteen sixties had been designated as the first phase of the United Nations Development Decade. This resolution came at the dusk of the first development decade and heralding the work to be continued in the second Development Decade during the nineteen-seventies.

In response to the above resolution an ad loc group was appointed, its first Conference taking place in Geneva in mid December 1968. The Official document from this first meeting and subsequent conferences have been published in a series of five Reports[1] generally available.

Since the concept of "permanent establishment" is included among most important provisions in theagreements to avoid international double taxation it is appropriate that it was the first subject discussed at the December Conference.

(i) O.E.C.D. Draft as a starting point.

Not withstanding the fact that the OECD Draft had been the product of representatives from developed countries it was generally accepted by the Ad Loc Group as the best available framework for its discussions.[2]

This acceptance placed the developing countries at a slight disadvantage from the start. Since the concept of permanent establishment in the OECD Draft gives rise to greater fiscal sacrifices by the developing countries by decreasing the tax base, it is necessary to formulate a broader definition. Two members felt an entirely new solution based on the source principle must be sought.[3] But the agreement on the basis starting point does not, however, imply agreement with the definition of permanent

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[1] Ibid. the reports will be cited as first report etc as appropriate.

[2] first report point 18.

[3] first report point 19.

establishment contained in Article 5 of the OECD Draft, and all the members from developing countries felt that widening of this definition was essential. Therefore a number of amendments were introduced to the broaden the scope of the concept.

Members from several developed countries emphasized the mutual advantages of the concept of permanent establishment. Article 5 itself was a compromise between various viewpoints and it has to be modified in a number of treaties between developed countries and between developed and developing countries. These members warmed

> "against a tendency to erode the principle of permanent establishment"[4]

But they did recognise that the differing considerations should be balanced. Thus a very intensive discussion took place on the various amendments proposed to the OECD Drafts.

(ii) Proposed Amendments.

(a) Building construction or assembly projects

The discussion first turned to paragraph 2 (g) of Article 5 of the OECD Draft. India's delegate proposed that paragrpah 2 (g) be ameded to:

> "(g) A building site or construction or assembly project or supervisory activities in connection therewith, where such site, project or activity continues for a period of more than six months, or where such project or activity, being incidental to the sale of machinery or equipment, continues for a period notexceeding six months and the charges payable for the project or activity exceeds 10 per cent of the sale price of the machmnery or equipment" (emphasis is the writer's).

Taking firstly the proposal concerning building or construction or assembly projects continuing for six months (instead of twelve as specified in the OECD Model). This proposal found support from members of the developing countries and from some members from developed countries.[1]

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1 first report point 38.

But since this time limit is purely arbitrary, and since sub-paragraph (g) was merely an extension of the basic concept of permanent establishment in Article 5 (i) it ismore apt for debate in bilateral negotiations than an international conference. In fact many of the treaty agreements using the OECD Draft signed between contracting States as a basis, do adopt a six month time limit. New Zealand's agreements with both Singapore and Australia use a six month time limit.

The same argument applies to an Israeli proposal requesting only a three month time limit.[1]

More fundamental was India's second proposal, concerning the right to tax profits from installations if the installation's charges exceed 10 per cent of the sales price of the equipment. It was felt by some members from developed countries that the introduction of such a concept would be inconsistent with the requirement in Article 5 (i) of a significant and continuous business operation. It was also pointed out that such a provision would not be practical because the enterprise involved could easily adapt their practices to such a requirement and prevent the creation of a permanent establishment

Storage and Delivery of Good.

India also suggested the adding of a new sub-paragraph to paragrpah 2 which would read:-

> "(h) A warehouse or other facilities for the maintenance of a stock of goods or merchandise belonging to the enterprise from which orders are filled, whether such a warehouse or facility is managed by an employee of the enterprise or by an agent of the enterprise."

After discussion, the Group unanimously decided to

[1] Annex V of second report.

drop this proposal, because profits from such an enterprise would only be small, but more importantly it was pointed out that the presence of a stock of goods for prompt delivery facilitated the sales of the product thereby increasing the profits earned in the host country. However the Group decided to amend paragraph 3 (a) and (b) so as to eliminate the word "delivery" occuring in those two sub-paragraphs. Thus the case where deliveries were made from stocks of goods would not be specifically excluded from the definition of permanent establishment under paragraph 3 and at the same time paragraph 2 would not specifically include such cases, leaving the whole matter open to be resolved by bilateral negotiation. As the parties desire.

b) Dependent Agents.

The Group discussed the amendments proposed by members from developing countries, to paragraph 4 of Article 5 of the OECD Draft. Again India played a significant role and suggested replacing paragraph 4 with:-

(4)"A person acting in a Contracting State for or on behalf of an enterprise of the other Contracting State - other than an agent ofa genuinely independent status to whom paragraph 5 applies - shall be deemed to be a permanent establishment in the first mentioned State if:

(a)He has and habitually exercises in that state a general authority to negotiate and enter contracts for or on behalf of the enterprise, or

(b)He habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise for or on behalf of the enterprise, or.

(c)He habitually secures orders in the first-mentioned State exclusively or almost exclusively for the enterprise itself or for the enerprise and other enterprises which are controlled by it or have a controlling interest in it or which are under a common control."

There was general approval of expanding the OECD Draft to cover the first two situations as outlined in

(a) and (b), which are already included in anumber of other conventions[1]. Considerable discussion took place with regard to the use of "to negotiate and enter into contracts for and on behalf of the enterprise to the different legal consequences of "an authority to conclude contracts in the name of the enterprise". It is true that both terms were intended to describe the conditions under which the agent would constitute a permanent establishment of the principal, but there was some doubt as to which of the formulations best accomplished this.

It was thought that if the phrase "in the name of" was used as in the OECD Draft it might require the agent to disclose his principal by actually naming the enterprise,or it might be sufficient that the contracts signed by the agent did bind the principal. On the other hand there was also uncertainty as to whether the "on behalf of" formulation was sufficient to establish the legal liability of the principal.

At the conclusion of the discussion, the Group did generally agree on the following draft.

"A person acting in a Contracting State on behalf of an enterprise of the other Contracting State - other than an agent of an independent status to whom paragraph 5 applies - shall be deemed to be a permanent establishment in the first-mentioned state if,

(a) he has and habitually exercises in that State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for that enterprise; or

(b) He has no such authority, but habitually maintains in the first - mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.

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[1] Refer Article 4 (5) of the New Zealand/Singapore Double Taxation Relief Order appendix G.

It was agreed that the phrase "authority to conclude contracts "on behalf of " in clause (a) means that the agent had legal authority to bind the enterprise.

c) Independent Agents.

The Group then discussed the concept of the OECD Draft that treats as a dependent agent an agent who habitually secures orders ie) the iteraction of paragraph (4) and (5). Such activities would be covered by India's proposal in paragraph 4 (c)[1], in that an independent agent would lose his independence if his activities were exercised exclusively or almost exclusively on behalf of one enterprise or a member of an affiliated group of enterprises.

After a very extended discussion of this provision the following amendment replacing paragraph 5 of Article 5 was adopted.

> "An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker of an independent status, where such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise he would not be considered an agent of an independent status within the meaning of this paragraph."

It was stated that the agent's activities must be pursuant to an agreement with the enterprise, if he is to be within the foregoing amendment. One member from the developed country could not accept this amendment because it would induce enterprises to resort to artificial arrangements in order to bring their dealings with the agent outside the ambit of exclusiveness.[2]

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[1] Ibid.

[2] refer second report point 46.

In light of what was said in the Commentary on the OECD Draft it would seem that the provision was already qualified by the words "in the ordinary course of their business," which safeguards against such abuses.

Since thegroup did reach an agreement on the foregoing provision, India's proposal for paragraph 4(c) was withdrawn.

d) Insurance.

After the foregoing paragraph 4 had been generally agreed to the following new paragraph 4A was inserted.

> "4A An insurance enterprise of a contracting state shall, except in regard to reinsurance, be deemed to have a permanent establishment in the other state if it collects premiums in the territory of that state or insures risks situated therein through an employee or through a representative who is not an agent of independent status within the meaning of paragraph 5."

The situation of insurance agents was not dealt with in the OECD Draft and it was commonly thought that the definition of permanent establishment contained therein was not adequate to deal with ways in which insurance businesses were conducted. Thus it was widely agreed that if a non resident insurance company collects premiums in or insured risks within a country through an employee or a representative who did not have an independent status as defined under the amended paragraph 5 that company would be deemed to have a permanent establishment in the host country.

It is to be noted that some members from developing countries[1] thought that where an insurance company collected premiums or insured risks in a country, the source of income was in that country and the income should therefore be taxed on the basis of source regardless of whether an agent or employee was present or not. That is to say the situation was not an aspect of permanent establishment rules, but came under the same category as dividends,

[1] second report point 51.

interest or royalties. However such an approach is once again open to bilateral negotiations.

(e) Exclusions from permanent establishment

Processing of Goods.

The group discussed deleting sub-paragraph 3(c) of Article 5 of the OECD Draft, dealing with the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise.

Some members from developing countries wanted the paragraph deleted because the processing of goods was analogous to manufacturing and therefore contributed to the value of the goods and the profit realized by the seller, and therefore the taxable income was a proportion of the market price of the goods in international transactions.

In answer to this argument several members pointed out that the paragraph dealt with themaintenance of a stock of goods processed by the enterprise and not with profits from processing realized by that enterprise. The profits from the processing were taxable, but the titled to the goods always remained with the non-resident company and that company was not carrying on a business in their territory, and therefore could not be held liable for tax. As the members had specifically eliminated "delivery" from[1] paragraphs 3 (a) and (b) of article 5, and sub-paragraph (c) presupposes a "delivery" of goods and merchandise it was decided ultimately to make no changes to sub-paragraph (c).

[1] refer foregoing discussion on "Storage and Delivery of Goods".

Purchasing Office.

The Group discussed paragraph 3(d) dealing with the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise. Again it was agreed by some members that such activities contributed towards the ultimate sales profits. However it was agreed that the non-taxation of profits from purchasing was a concern which the host country could make in order to secure some other advantage in bilateral negotiations. By their acceptance of this sub-paragraph the developing countries were not foregoing their right to tax the profits attributable to the purchases as such.

Preparatory activities.

No changes oramendments were proposed to paragraph 3(e) of Article 5.

Public entertainers or Athletes.

The member from Israel proposed the following addition to paragraph 2 of Article 5 so that the term permanent establishment include:

> "An enterprise of one contracting state if it carries on the activity of providing the services of public entertainment or athletics and other services in the other contracting state".[1]

The country in which the services were performed could of course, tax the individuals under its local law or treaty provisions corresponding to Article 17 of the OECD Draft. However taxation of the corporation and thus the full profit derived from the services could be prevented by the treaty provisions.[2] Several treaty agreements already expanded the definition of the term "permanent establishment" to cover this situation[3].

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[1] refer Annex v first report.
[2] refer Case 5 3NZTBR. 49.
[3] refer NZ/Japan Double Taxation Relief Order Appendix D/

After an extensive discussion, there was wide support for the following amendment to Article 17 of the OECD Draft.

> "Notwithstanding the provisions of Articles 5,7, 14 and 15, incomederived by public entertainers, such as theatre, motion picture, radio or television artistes, and musicians, and by athletes, from their personal activities as such,or income derived from the furnishing by an enterprise of the services of such public entertainers or athletes, may be taxed in the Contracting State in which these activities or services are exercised."

This provision leaves untouched the taxability of the non-resident company. The profits of such a company are businessprofits regardless of the nature of the services rendered and therefore such profits shouldnot be taxed in the absence of a permanent establishment.[1]

Furnishing by the enterpriseof "other services"

The Group then discussed "other services" proposed in Israel's addition to paragraph 2. There was general agreement that only profits from services attributable to that country should be taxable. However, it was pointed out that certain services as for example consultancy services, after-sales centres etc were not specifically covered in the OECD Draft because those activities were not as important in 1963 as they have now become.

Two possible alternatives were put forward. Members from developing countries suggested the following addition to article 14.

> "14A Income derived from the furnishing of services including consultancy services by an enterprise of a Contracting State through employees or other personnel in another Contracting State shall be taxable in that other Contracting State but only to the extent attributable to such services in that other State.

[1] refer Second Report points 60 & 61.

Members from developed countries, on the other hand, felt that a time - limit should be included, and this was accepted by some members from developing countries. Therefore a time-limit approach was drafted as follows: adding a new sub-paragraph (h) to paragraph 2.

> "(h) the furnishing of services including consultancy services by an enterprise through employees or other personnel where activities of that nature continue within the country for aperiod or periods aggregating more than six months within any twelve-month period".[1]

Again the time-limit could be altered by bilateral negotiations to a period of not less than three month.

[1] refer second report points 69, 70 and 71.

II. APPORTIONMENT OF BUSINESS PROFITS

A. Introduction.

The allocation or apportionment of the profits of a business enterprise to its establishments situated in different countries presents one of the most difficult problems in the area of international taxation. This explains why the problem is still unsettled even today, although most of its aspects were analysed, and a number of the practical solutions adopted today were suggested by the Fiscal Committee of the League of Nations in the early 1930s and in the Model Conventions of Mexico (1943) and London (1946).

B. Summary of methods.

There are basically two methods of determining the profits of a permanent establishment, in addition to some hybrid solutions of limited application.

Under the "direct" method, or method of separate accounting, the profits of the establishment are computed as if the establishment were a separate enterprise dealing at arm's length with the enterprise of which it is a part. The use of this method requires themaintenance of separate books and records for the establishment. It may also require certain adjustments so determined where, for instance, those accounts record the invoicing of goods at prices different from those prevailing in the ordinary market.

Under the "indirect" method or method of fractional apportionment, the profits of the establishment are computed as a portion (usually, a percentage) of the entire profits of the enterprise. In view of the variety of activities in which an enterprise or its establishments may be engaged, and the differences in functions and importance of a particular establishment in the context of the enter-

prise as a whole, the validity of the results obtained with the help of this method depends to a large extent on the selection of allocation factors giving proper weight to those elements that are relevant in the particular case. Depending on the circumstances, the formula applied may emphasize turnover or receipts, the cost of labour and other expenses, the amount of capital employed in the enterprise, or other factors.[1]

Apart from the two methods summarized above, the profits of an establishment can be determined on a "presumptive" basis, for expample by applying to gross receipts such profit percentages as are normal in the particular industry, or using similar comparative data. Such procedures are not more than estimates designed to approximate actual operating results as closely as possible, and not specific methods of profit determination.

C. League of Nations: Multilateral Draft Convention

The earliest draft of a multilateral tax convention prepared by the Fiscal Committee of the League of Nations and published in 1933 dealt with the allocation of business income among various establishements of a business enterprise.[2] It is interesting to note that this early draft which was republished as a model for bilateral tax conventions in 1935,[3] already established the primacy of the "direct" method of profit allocation and thus set the pattern for all future draft conventions as well as most actual tax treaties.

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[1] Organisation for Economic Co-operation and Development, Draft Double Taxation Convention on income and Capital: reportof the Fiscal Committee (Paris, 1963), p. 87.

[2] League of Nations document C.399. M204. 1933 II A: annex to Fiscal Committee report of 1933.

[3] League of Nations document C.252. M124. 1935 II A: annex to Fiscal Committee report of 1935.

According to the League of Nations draft, there shall be attributed to a permanent establishment the net income which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions as the enterprise of which it is an establishment. This net income shall in principle be determined on the basis of separate accounts maintained for the establishment. In the event that the accounts prepared are inadequate, the tax authorities have power to determine the profits of the establishment with help of comparative data for the particular industry. Only as a last resort are the authorities permitted to use the method of fractional apportionment, and even if they must resort to that method because there is no other way of determining the profits of the establishment, they are held to select and apply the relevant apportionment factors so as to arrive at substantially the same results as those that would be obtained with the help of the method of separate accounting.

D. League of Nations: London and Mexico Model Conventions

The London and Mexico Model Conventions, which continued and concluded the work of the League of Nations Fiscal Committee, include identical rules with respect to the allocation of the income of industrial, commercial and agricultural enterprises and income derived from other independent activities.

Article VI "The allocation of the income of the enterprise mentioned in Article IV[1]' of the Convention shall be effected in the following manner:

1. In respect of industrial, commercial and agricultural enterprises in general and for other independent activities:

[1]. Article IV states "The term "enterprise" includes any kind of enterprise whether it belongs to an individual, a partnership, a company or any other legal entity or de facto body"

A. If an enterprise with its fiscal domicile in one Contracting State has a permanent establishment in the other Contracting State, there shall be attributed to each permanent establishment the net business income which it might be expected to derive, if it were an independent enterprise engaged in the same or similar activities, under the same or similar conditions. Such net income will in principle be determined on the basis of the seperate accounts pertaining to such establishments. According to the provisions of the Convention such income shall be taxed in accordance with the legislation and agreements of the State in which such establishment is situated.

B. The fiscal authorities of the contracting States shall, where necessary, in execution of the preceding section, rectify the accounts produced, especially to correct errors or ommissions, or to re-establish the prices or remuneration entered in books at the value which would prevail between independent persons dealing at arm's length. If the accounts of the permanent establishment in one Contracting State are rectified asa result of such verification, a corresponding rectification shall be made in the accounts of the establishment in the other Contracting State with which the dealings in question have been effected.

C. If an establishment does not produce an accounting showing its own operations, or if the accounting produced does not correspond to the normal usages of the trade in the country where the establishment is situated, or if the rectification provided for in the preceeding section cannot be effected, or if the taxpayer agrees, the fiscal authorities may determine, in a presumptive manner, the business income by applying a percentage to the gross receipts of that establishment. This percentage is fixed in accordance with the nature of the transaction in which the establishment is engaged and by comparison with the results obtained by similar enterprises operating in the country. Where the activities of the permanent establishment are in the nature of those of a genuinely independent commission agent or broker, that incomemay be determined on the basis of the customary commission received for such services.

D. If the method of determination described in the preceeding sections are found to be inapplicable, the net business income of the permanent establishment may be determined by a computation based on the total income derived by the enterprise from the enterprise in which such establishment has participated.

This determination is made by applying to the total income coefficients based on a comparison of gross receipts, assets, number of hours worked or other appropriate factors, provided such factors are so selected as to ensure results approaching as closely as possible those which would be reflected by a seperate accounting.

2. In determining the net income on the basis of the seperate accounting of a permanent establishment, a properly apportioned part of the general expenses of the head office of the enterprise may be deducted.

RXBA BARKER, S.C. The conception of permanent establishment of business profit in international tax treaties

3. In respect of banking and financial enterprises, the allocation of the income shall be affected in conformity with the principles laid down in paragraph 1 of the present article, provided that where a permanent establishment of the enterprise is in the position of a creditor or debtor in relation to another permanent establishment of the enterprise, the following provisions shall apply.

A. If a permanent establishment in one State (Creditor State) supplies funds, whether in the form of an advance loan, overdraft, deposit or otherwise, to a permanent establishment in the second state (Debtor State), interest shall be deemed to accrue as income to the Creditor establishment and as a deduction from gross income to the debtor establishment for tax purposes, and it shall be computed as the inter-bank rate for similar transactions in the currency used;

B. The interest corresponding to the principle capital allotted to the establishment, whether in the form of an advance, loan, overdraft, deposit or otherwise shall be, however, excluded from the interest accruing as income to the creditor establishment and deductible from gross income by the debtor establishment.

4. The net income of insurance enterprises shall be determined in conformity with the principles laid down in paragraph 1 of the present article. If however, these principles are not applicable in a given case, the net taxable income of a permanent establishment belonging to an insurance enterprise may be assessed, either by applying to the gross premiums received as a result of the activity of the permanent establishment coefficients computed on the basis of the total income of a representative national enterprise of the particular category of insurance concerned, or by apportioning the income according to the ratio existing between the gross premiums relating to the permanent establishments and the total gross premium received by the enterprise.

5. In cases where the foregoing rules donot result in a fair allocation of income, the computent authorities may consult to agree upon a method that will prevent double taxation".

The basic rule of the model tax conventions is that where an enterprise has its fiscal domicile in one Contracting State and a permanent establishment in the other State, there shall be attributed to each permanent establishment the net business income which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions. Such net income shall, in principle, be determined on the basis on the separate accounts pertaining

to each establishment, and it shall be taxed in accordance with the legislation and agreements of the State in which the establishment is situated.

The fiscal authorities of the Contracting States shall, where necessary, rectify the accounts produced especially to correct errors or omissions, or to re-establish prices or remunerations entered in the books at the values which would prevail between independent persons dealing at arm's length. If the accounts of a permanent establishment in one country are adjusted, corresponding adjustments shall be made to the accounts of the establishment in the other country with which the transactions in question were effected.

If an establishment does not produce an accounting covering its operations, or the accounting produced does not correspond to the normal usages of the trade in the country where the establishment is situated, or if the required corrections cannot be effected, the fiscal authorities are permitted to determine, in a presumptive manner, the business income of the establishment by applying a percentage to its gross receipts. This percentage is to be fixed in accordance with the nature of the transactions in which the establishment is engaged, and by comparison with the results obtained by similar enterprises operating in the country. Where the activities of the permanent establishment are similar to those of an independent commission agent or broker, taxable income may be determined on the basis of the customary commission for the services in question.

Only in the event that the allocation methods described above are found to be inapplicable may the profits of a permanent establishment be determined by a computation based on the total income derived by the enterprise from

the activities in which the establishment had participated. It will be noted that the London and Mexico Model conventions not only treat the method of fractional apportionment as subsidiary to all tohers, but further limit its application to the part of the profits of the enterprise derived from transactions in which the establishment (whose share in the total profits is to be determined) had participated. This determination is to be made by applying to the total amount of income, coefficients based on a comparison of appropriate factors such as gross receipts, assets or number of hours worked. The Governments are enjoined to select factors that will ensure results closely approaching those that would be reflected by a separate accounting.

The Model Conventions further provide that where the profits of an establishment are determined on the basis of a separate accounting, a properly apportioned part of the general expenses of the head office may be deducted in arriving at these profits. They further include special allocation provisions for banking and financial enterprises, permitting establishments of such enterprises to charge each other interest for funds supplied, and for establishments of insurance enterprises whose profits may be determined by applying coefficients to the amounts of gross premiums received, or by apportioning income in the ratio of premiums attributable to theestablishment to those collected by the enterprise as a whole.

As pointed out in the commentary of the League of Nations Fiscal Committee to the London and Mexico Model Conventions,[6] the main allocation principle is that the profits on which a branch or permanent establishment of a foreign enterprise may be taxed in the country where it is situated shall not exceed the earnings that are the

[6]Ibid.,p. 18.

direct result of the activities of the establishment, or the yield of the assets assigned to it. The authors of these drafts, as those of the multilateral convention of 1933, considered that the method of separate accounting is the one best suited to allocate to each country the share of the total profits of an enterprise which the establishment in that country had produced, provided that the records of the establishment conform to usual standards of accuracy and completeness, and that they are made available to the fiscal authorities. In view of the Fiscal Committee, the use of the method of separate accounting serves the following purposes: (a) to give the taxation of branch establishments a strictly territorial scope; (b) to place branches of foreign enterprises in a position of tax equality with similar establishments of domestic enterprises; (c) to conform to the usual practice of international business organizations of keeping separate accounts for each establishment; and (d) to protedt the fiscal interests of the countries concerned by counteracting the concealment or diversion of profits. The last-named purpose is also served by the correction of accounts provided for in the draft article.

E. OECD Draft Convention

Paragraph 2 of article 7 of the Draft Convention of 1963 prescribes the use of the "direct" method of profit allocation in language which is practically identical to that of the League of Nations Draft Convention of 1933 and the protocol to the London and Mexico Model Conventions.

Article 7 - Business Profits

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.

If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as to attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.

4. Insofar as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall however, be such that the result shall be in accordance with the principles laid down embodied in this Article.

5. No profits shall be attributed to a permanent establishment by reason of the merepurchase by that permanent establishment of goods or merchandise for the enterprise.

6. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

7. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

As pointed out in the Report of the Fiscal Committee,[8] the trading accounts of a permanent establishment - which are commonly available if only because a well-run business organization will normally wish to be informed about the profitability of its various branches - are in the great majority of cases used by the tax authorities to ascertain

[7]The taxation of "Business Profits" Agreements of N.Z. are reprinted as appendix I,J,K,L,M,N,O, and P.

[8]Supra at p.82.

the profit properly attributable to the establishment. Even though such accounts exist, however, it may still be necessary for the fiscal authorities to adjust them, for example because goods were invoiced by the head office to the establishment at other than arm's length prices and profits were diverted from the permanent establishment to the head office, or vice versa. In such cases, it will usually be appropriate to substitute ordinary market prices for the same of similar goods for the prices used.[9]

As an exception to the general rule of paragraph 2, article 7 of the OECD Draft Convention, paragraph 4 of the same article permits the use of the fractional apportionment method of determining the profits of apermanent establishment if the use of that method has been customary in the taxing State; the method selected shall, however, be such that the results obtained thereby are in accordance with the principles laid down in article 7. The commentary of the Fiscal Committee interprets the latter clause as requiring an allocation that approximates as closely as possible the results that would be obtained on the basis of a separate accounting, and makes it incumbent upon the tax authorities to select the method which appears most likely to produce that result.[10] The commentary leaves no doubt that the Fiscal Committee does not consider the method of fractional apportionment as generally suitable to determine the operating results of a permanent establishment, and that it prefers to restrict the application of that method to the exceptional cases where it was traditionally applied in the country concerned and is accepted as satisfactory to both by the tax authorities and by the taxpayers in that country.

[9]Ibid

[10]Ibid., p.87.

Paragraph 3, article 7 of the OECD Draft Convention provides that in determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the establishment, including executive and general administrative expenses, regardless of where such expenses are incurred. The commentary of the Fiscal Committee recognizes that it will be neccessary in some cases to estimate, or calculate by conventional means, the amount of expenses that is to be taken into account. Thus general administrative expenses incurred at the head office of the enterprise may be apportioned on the basis of the turnover of the establishment, or perhaps the gross profit realized by it, in relation to the turnover or gross profit of the enterprise as a whole.[11]

The commentary holds, in accordance with the prevalent governmental practice, that interest, royalties and similar payments made by a permanent establishment to its head office in return for money loaned or licences granted, should not be allowed as deductions in computing the profits of the establishment. It is recognized that special considerations apply to interest payments on loans (as distinguished from capital contributions) made between establishments of banks or other financial institutions, and to interest paid by an enterprise to an outside creditor where the underlying loan is related to the activities of the permanent establishment.[12]

F. Treaties between industrialized counties

The great majority of treaties between industrialized countries prescribe the use of the method of separate accounting for determining the profits of a permanent

[11] Ibid., p.83

[12] Ibid., p.84

establishment. Most of the treaties reviewed simply incorporate the text of paragraph 2 of the model article,[13] while others specify that the income derived from the activities of the permanent establishment shall as a rule be determined from its balance sheet.[14] Most of these treaties also incorporate the rule of paragraph 3 of the model article in regard to the deduction of expenses incurred for purpose of the permanent establishment. Some treaties include exclusionary language that is directed specifically at "artificial transfers of profits, and in particular, remuneration agreed upon in the form of so-called interest or royalties between permanent establishments of the same enterprise."[15]

The use of the method of fractional apportionment is permitted under some treaties "in special cases",[16] or in so far as this method had been customarily used in a contracting country. Some treaties including the latter criterion follow the text of the model article and prescribe that the method of apportionment adopted shall be such that the results obtained thereby will be in accordance with the principles laid down in the article,[17] while others omit this rule.[18]

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[13] Belgium-Canada (1958); Candada-Finland (1959); Canada-Norway (1960); Denmark-Japan (195); France-Federal Republic of Germany (1959); Federal Republic of Germany-Ireland (1962); Federal Republic of Germany-Netherlands (1958); Federal Republic of Germany-United Kingdom (1964); Greece-Sweden (1961); Italy-United Kingdom (1960); Japan-Norway (1959); Japan-United Kingdom (1962); Luxembourg-United States (1962); Sweden-United Kingdom (1960).

[14] Austria-Norway (1960); Austria-Sweden (1959); Denmark-Federal Republic of Germany (1962); Federal Republic of Cermany-Norway (1958); Federal Republic of Germany-Sweden (1959).

[15] Denmark-Federal Republic of Germany (1962); Federal Republic of Germany-Norway (1958); Federal Republic of Germany-Sweden (1959).

[16] Denmark-Federal Republic of Germany (1962).

[17] Denmark-Ireland (1964); Finland-United Arab Republic(1965); Philippines-Sweden (1966).

[18] France-Spain (1963); Norway-Spain (1963).

The New Zealand/Japan Agreement (1963) is the only treaty the writer was able to find that includes more elaborate rules for determining the profits of a permanent establishment in the absence of adequate factual information by permitting the tax authorities to use their discretion or to make an estimate of the profits, provided that the determinations made are, to the extent possible, in accordance with the principles of the model article reproduced in that convention.

The treaty between Belgium and the Federal Republic of Germany (1967) provides that where the profits attributable to the permanent establishment cannot be precisely determined because of the absence of adequate books of account and other records, the country in which the establishment is situated can determine the tax of the establishment according to its own rules of law and by comparison with the profits realized by enterprises carrying on the same or similar activities under the same or similar conditions in its territoty. The treaty between Belgium and the United Kingdom (1967) includes a similar although somewhat less elaborate provision.

Certain treaties concluded by Switzerland, following a rule that was developed in Swiss inter-cantonal taxation, provide for a "privileged allocation" (praecipuum) of a fraction - often, 10 per cent - of the total profits of the enterprise of the head office,[20] leaving the balance

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[20] Treaties of Switzerland with Ireland (1966) and Sweden (1965). The final protocol of 15 March 1931 to the Federal Republic Switzerland Convention of 1931 (which remains valid under the republished treaty of 1959) states in general terms that in apportioning the profits of an enterprise, special consideration shall be given to the seat of the enterprise if it carries on substantial management functions. For the purpose of applying this provision, the Government have agreed to a privileged allocation of 10 per cent to the main office, in Switzerland, of an insurance company with establishments in Germany. See Locher, II Doppelbesteuerung Schweiz-Deutschland

of the profits to be allocated to the various parts of the enterprise in accordance with the treaty article dealing with business profits. The France-Switzerland treaty (1966) permits the Contracting States to apportion the total profits of an enterprise to its various parts in accordance with the custom of the States; the treaty thus appears to permit a "privileged allocation" to the head office although it does not expressly state this rule. The Switzerland-United States convention (1951) permits the competent authorities of the two countries tolay down rules by agreement for the apportionment of industrial and commercial profits; however, such rules have not been formulated to date. The conventions of Switzerland with Sweden (1965) and Ireland (1966) permit a previous allocation of not more than 10 per cent of the total profits to the seat (Sweden-Switzerland) or head office (Ireland-Switzerland) of the enterprise.

Under the treaties of Switzerland with Ireland (1966) and Sweden (1965), the profits attributable to a permanent establishment maintained in one of the treaty countries by an insurance enterprise of the other treaty country shall be determined by apportioning the total profits of the enterprise in the ratio of gross premium receipts of the establishments to total gross premium receipts of the enterprise. Special provisions in reference to life insurance companies not having their head office in Ireland or the United Kingdom are included in the treaties of Canada with Ireland (1966) and the United Kingdom (1966).

G. Treaties between industrialized and developing countries

Practically all recent treaties between industrialized and developing countries incorporate the rule of paragraph 2, article 7, of the OECD Draft Convention providing for

taxation of a permanent establishment as if it were a separate and distinct enterprise. A relatively large number of these treaties state this principle without qualification and include no alternative rule permitting taxation of the profits of the establishment on an estimated basis or by apportioning the total profits of the enterprise.[21] Other treaties, however, make provision for one or both of these alternative bases of taxation where the use of the separate accounting method is not feasible in an individual case.

Some of the latter treaties, reproducing the text of the London and Mexico Model Conventions, state that the tax authorities of the countries concerned may rectify the accounts submitted by the taxpayers, especially to correct errors or omissions or to re-establish prices or remunerations entered in the books at such values as would prevail between independent parties dealing at arm's length with each other.[22]

Other treaties are more elaborate and prescribe that the amount of profits attributable to a permanent establishment shall be estimated on a reasonable basis where a correct determination is either impossible or wouldpresent exceptional difficulties. This particular clause is found in certain treaties between Indiea and industrialized countries.[23]

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[21] Austria-United Arab Republic (1962); Ceylon-Federal Republic of Germany (1962); Denmark-Pakistan (1961) Denmark-Thailand (1965); Federal Republic of Germany Pakistan (1958); Jamaica-United Kingdom (1965); Israel-Sweden (1959); Israel-United Kingdom (1962); Israel-United States (1965), not ratified); Japan-Federation of Malaya (1963); Japan-Pakistan (1959) Japan-Singapore (1961); Japan-Thailand (1963); Pakistan-Sweden (1958); Pakistan-Switzerland (1959); Pakistan-United Kingdom (1961).

[22] United Arab Republic-United States (1960). This is the wording used in article V1.1.B of the Mexico and London Model Tax Conventions.

[23] Treaties of India with Austria (1963); Denmark (1959); Federal Republic of Germany (1959); Finland (1961); Japan (1960); Norway (1959); United States (1959),not ratified).

Under these treaties, determination of the profits of an establishment by estimate is the only alternative to a precise computation on the basis of separate accounts, and no provision is made for apportioning the total profits of the enterprise. The same is true for those treaties which permit the tax authorities to exercise their discretion or to make an estimate of the profits where a correct determination of income on the basis of separate accounts is precluded by inadequate information, provided that the exercise of discretion or the estimate made is in accordance with the general tenor of the treaty article.[24]

Comparatively few treaties include rules in reference to an apportionment of the total profits of the enterprise. Some of these treaties follow the wording of paragraph 4 of article 7 of the OECD Draft Convention,[25] while others provide in the alternative for an apportionment or for applying a reasonable percentage to the receipts of the enterprise, depending on which method is customarily applied in the taxing country. Under any one of these alternatives, however, the results arrived at shall be in accordance with the principles laid down in the treaty article.

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[24] Argentina-Sweden (1962); Brazil-Sweden (1965); Federal Republic of Germany-United Arab Republic (1959); India-Sweden (1958); Sweden-United Arab Republic (1958).

[25] Federal Republic of Germany-Israel (1962); France-Israel (1963); Norway-United Arab Republic (1964).

H. Evaluation and special problems:
evaluation of methods

Both the method of separate accounting and the apportionment method are apt to result in practical difficulties, and either method can lead to inequitable results in certain situations.

One of the main advantages of the method of separate accounting as already pointed out in the report of the Fiscal Committee of the League of Nations, is that it permits a determination of the profits of a permanent establishment without considering the operating results of the enterprise in other countries. Another advantage of this method is that the profits determined with its help are precise and can be compared to those of domestic enterprises or subsidiaries of foreign corporations in the country concerned.

One major disadvantage of the method of separate accounting is that it does not permit compensating the profits and losses of the establishment of a business enterprise in different countries. As far as this method is applied, each establishment stands on its own. The result may be excessive taxation, as in the case where an establishment in a treaty country operates at a profit while other establishments of the same enterprise, or the foreign enterprise as a whole, sustains an operating loss. The carry-over of operating losses, if permitted at the domicile of the foreign enterprise, is not in every case sufficient to preclude this inequity. Treating each establishment of a business enterprise as an autonomous unit may also result in premature - or, in some cases, entirely fictitious - realization of profits, as in the case where the manufacturing establishment of an enterprise in one country is required to credit itself with a profit on the shipment of goods to the selling branch of the same

enterprise in another country, and the latter does not dispose of the goods in the same taxable year, or for some reason (such as theft, spoilage or obsolescence) never disposes of them.

The apportionment method avoids the shortcomings of themethod of separate accounting because taxable income in both countries is based on the total profit of the enterprise. The apportionment thus avoids taxing the profit of an establishment notwithstanding the existence of an over-all loss, and it also avoids the premature taxationof profits which, from the view-point of the enterprise as a whole, are not as yet realized.

On the other hand, the apportionment method has serious disadvantages. It is at best difficult, and in most cases impossible, for the tax authorities of any country to determine the profits of a foreign enterprise as a whole. Apart form the fact that the fiscal authoritiescannot examine the books of the enterprise at its foreign domicile, there is the problem that the rules on the determination of taxable income vary from one country to the other and that the use of a tax base computed according to the tax law of another country can lead to incongruous results and gross inequalities in the taxation of an establishment as compared to similar domestic enterprises. Even if the determination of the tax base in the other two countries is similar, the selection of the proper allocation factors may present almost insoluble problems, because elements such as receipts, payroll or capital may have very different weight and importance not only in different lines of business but in different countries as well. Finally, the allocation of profits to various establishments according to the formula

can be quite misleading if the establishments have dissimilar functions.

I. Transfer of merchandise between establishments

Where goods that are purchased or produced by an enterprise are sold by its establishment in another country, or goods purchased or produced by the establishment are shipped by the latter to the head office for sale abroad, the transfer prices forming the basis for taxation must be determined as if the establishment and the enterprise of which it is a part were separate and unrelated entities. The fact that this treatment may create taxable income for the establishment before the enterprise as a whole has realized a profit through the sale of the goods to outside parties must be accepted as an unavoidable consequence of treating the establishment as an independent enterprise.[26]

The proper transfer price (arm's length price) can be determined from comparable sales made by the enterprise to unrelated parties, giving due consideration to differences in markets, competitive conditions, quantities, terms of delivery or payment, and other factors that may be relevant in the individual case.[27]

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[26] According to the United States Treasury regulations, under section 482 of the Internal Revenue Code (para. 1.482-1 (d) (4), the Government can adjust the income of related taxpayers to reflect their true taxable income, notwithstanding the fact that the ultimate income anticipated from a series of transactions may not be realized, or is realized during a later period.

[27] For the three methods descrived in the United States Treasury regulations, (comparable uncontrolled price method, resale price method, and cost-plus method), see Treasury regulations sec. 1.482-2 (e).

Where the enterprise ships goods to its foreign establishment for resale, and a wholesale price can be established for the goods at the domicile of the establishment, this price should be acceptable as a fair transfer price, assuming that the sales conditions are comparable or that the corrections provided for in the OECD Draft Convention can be made. In appropriate cases, consideration must be given to the fact than an enterprise is in a position to undersell its competitors, or that it deliverately charges inadequate sales prices for a limited time in order to penetrate a local market.

J. Deduction of interest, royalties and similar charges by a permanent establishment.

All model conventions, as well as a number of bilateral tax treaties, deny a deduction for interest, royalties and other charges made by an enterprise to its permanent establishment in another country. This disallowance is usually justified on the ground that the head office and the permanent establishment are integral parts of the same enterprise and as such incapable of standing in a debtor-creditor, or licensor-licensee relationship to each other. Another reason for the prohibition may be that charges of this kind were frequently used in the past to conceal distributions of profits in violation of local rules of taxation or foreign exchange control.

As mentioned above, the commentary of the OECD Fiscal Committee[28] provides for a limited exception to this rule in favour of interest which establishments of financial enterprises charge to each other because the making and receiving of loans and advances is closely relatied to the ordinary business of these enterprises.

[28] Organisation of Economic Co-operation and Development, Report of the Fiscal Committee, pp. 83, 84.

The report of the Fiscal Committee also contemplates that where an enterprise pays interest to a third party and the payment is related to the activities of the permanent establishment, a proportionate part thereof should be taken into account in computing the profits of the establishment as an expense incurred for its purposes.[29] It may be noted that the highest tax court of the Federal Republic of Germany has sanctioned this rule and permitted the deduction, by the establishment, of interest on a loan taken up by the foreign enterprise if an effective connesion between that loan, and the loan made by the head office to the establishment, can be shown to exist.[30] In order to demonstate this connexion, it is not sufficient to show that amounts equivalent to the borrowings of the foreign enterprise were transferred to the establishment, because the transfer might have been made from funds of the enterprise; it also must be shown that the funds were made available to the establishment as a loan, as distinguished from a contribution to capital.

According to the prevailing view, the establishment is not allowed to deduct patent royalties, service fees, and similar items charged to it by the head office because such charges would be incompatible with the unitary nature of the enterprise. On the other hand, it would seem that the head office should be entitled to charge a reasonable amount to the establishment for costs and expenses incurred on its behalf, such as

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[29] Ibid., p. 84.

[30] Decision of the German Federal Fiscal Court (Bundesfinanzhof) of 27 July 1965, BStBl, part III, 1966, p.24.

royalties paid to third parties or the cost of services rendered by it to the establishment, and that the latter could claim a deduction for such charges.[31] A deduction would probably not be permitted for any profit element included in the charge. In this respect, the rule may be different from that applying to services rendered by a parent company to its subsidiary domiciled in another country.

In the present era of greatly increased international business and the advent of large multinational corporations operating over wide geographical areas problems of allocation and apportionment of profits have become of crucial importance. As long as no uniform concepts regarding the source and allocation of international income are developed, each country is likely to be guided by its own interest and it insiston standards that will give it the greatest claim on international income. The arm's length clause in article 7, (4) of the OECD Draft Convention of 1963, and in the treaties adopting this rule, is by itself not sufficient to resolve the detailed and intricate allocation problems arising in actual practice.

While all countries will, in one form or another, resort to some method of reallocation where there are distortions of income of enterprises under common control, only the United States and Germany have so far formalized such rules.

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[31] See Organisation for Economic Co-operation and Development, Report of the Fiscal Committee, p.84.

[32] Internal Revenue Code on 1954, section 482, and the administrative regulations under this provision. The very extensive regulations were first published in "proposed" form in 1966 and made final in 1968. The proposed regulations were submitted by the United States Government to the Fiscal Committee of the OECD. The subject matter was discussed, in the framework of recognition of services and licences of incorporeal rights between parent companies and their foreign subsidiaries, at the twenty-third Congress of the International Fiscal Association held at Rotterdam (1969).

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Appendix A.

The Double Taxation Relief (Canada) Order 1948

Article II (1) (i)

The term "permanent establishment", when used with respect to an enterprise of one of the territories, means a branch or other fixed place of business, but does not include an agency unless the agent has and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf.

An enterprise of one of the territories shall not be deemed to have a permanent establishment in the other territory merely because it carries on business dealings in that other territory through a bona fide broker or general commission agent acting in the ordinary course of his business as such.

The fact that an enterprise of one of the territories maintains in the other territory a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute that fixed place of business a permanent establishment of the enterprise.

Thefact that a company which is a resident of one of the other territory or which is engaged in trade or business in that other territory (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary company a permanent establishment of its parent company.

Appendix B.

The Double Taxation Relief (United States of America) Order 1952

Article II (1) (o)

The term "permanent establishment" when used with respect to an enterprise of one of the Contracting Governments means a branch, management, factory, mine, farm, or other fixed placeof business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or regularly fills orders on its behalffrom a stock of goods or merchandise.

An enterprise of one of the Contracting Governments shall not be deemed to have a permanent establishment in the territory of the other Contracting Government merely because it carries on businessdealings in that territory through a bona fide broker or general commission agent acting in the ordinary course of his business as such.

The fact that an enterpriseof one of the Contracting Governments maintains a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute that fixed place of business a permanent establishment of the enterprise.

The fact that a corporation of one Contracting Government has a subsidiary corporation which is a corporation of the other Contracting Government or which is engaged in trade or business in the territory of such other Contracting Government (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary

corporation a permanent establishment of its parent corporation. The maintenance within the territory of one of the Contracting Governments by an enterprise of the other Contracting Government of a warehouse for convenience of delivery and not for purposes of display shall not of itself constitute a permanent establishment within that territory even though offers of purchase have been obtained by an agent of the enterprise in that territory and transmitted by him to the enterprise for acceptance.

Appendix C.

The Double Taxation Relief (Sweden) Order 1956

Article II (1)(j)

The term "permanent establishment", when used with respect to an enterprise of one of the territories, means a branch or other place of business and includes a management, factory, office, mine, quarry or other place of natural resources subject to exploitation as well as agricultural, pastoral or forestry property. It also includes a place where building construction is carried on or machinery or equipment is installed or used when such construction, installation or use is carried on or extends for a period of at least one year, but does not include an agency in the other territory unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of the enterprise or has a stock of goods or merchandise in that other territory from which he regularly fills orders on its behalf. In this connection -

(i) An enterprise of one of the territories shall not be deemed to have a permanent establishmentin the other territory merely because it carries on business dealings in that other territory through a bona fide broker or general commission agent acting in the ordinary course of his business as such;

(ii) The fact that an enterprise of one of the territories maintains in the other territory a fixed placeof business exclusively for the purchase of goods or merchandise shall not of itself constitute that fixed placeof business a permanent establishment of the enterprise;

(iii) The fact that a companywhich is a resident of one of theterritories has a subsidiary company which is a resident of the other territory or which carries on a trade orbusiness in that other territory (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary company a permanent establishment of its parent company;

Appendix D.

The Double Taxation Relief (Japan) Order 1963

Article II (1) (m)

The term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on;

(ii) A permanent establishment shall include especially:
(aa) a place of management;
(bb) a branch;
(cc) an office;
(dd) a factory;
(ee) a workshop;
(ff) a warehouse;
(gg) a mine, quarry or other place ofnatural resources subject to exploitation;
(hh) an agricultural, pastoral or forestry property;
(jj) a building site or construction or assembly project which exists for more than twelve months;;

(iii) Where the business of an enterprise of one of the Contracting States is of a mobile nature the place where such business is being carried on in the other Contracting State shall be deemed to be a fixed place of business;

(iv) A person acting in one of the Contracting States for or on behalf of an enterprise of the other Contracting State shall be deemed to be a permanent establishment in the former Contracting State if -
(aa) therperson has and habitually exercies in the former contracting state a general authority to negotiate and conclude contracts on behalf of such enterprise, unless the activities of such person are limited to the purchase of goods or merchandise on behalf of such enterprise; or
(bb)the person habitually maintains in the former Contracting State a stock of goods or merchandise belonging to such enterprise from which such a person regularly fills orders on behalf of such enterprise; or
(cc)the person habitually secures orders in the former Contracting State, exclusively or almost exclusively for the enterprise itself or for such enterprise and other enterprises which are controlled by it or have a controlling interest in it;

6v) (aa)An enterprise of one of the Contracting States shall not be deemed to have a permanent establishment in the other contracting state merely because it carries on business dealings in that other Contracting state through a bona fide broker or general commission agent or other agent of inde pendent status acting in the ordinary course of his business as such;
(bb)The fact that an enterprise of one of the Contracting States maintains in the other Contracting State a fixed place of business solely for the purpose of purchase, storage or delivery of goods ormerchandise, or for collecting information shall not of itself constitute that fixed place of business apermanent establishment of the enterprise.

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(cc) The fact that a corporation of one of the Contracting States has a subsidiary corporation which is a corporation of the other Contracting State or which carries on a trade or business in that other Contracting State (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation;

(vi) Where an enterpriseof one of the Contracting States sells to a resident of the other Contracting State goods manufactured, assembled, processed, packed or distributed in the other Contracting State by an industrial or commercial enterprise orundertaking for, or at or to the order of, that first mentioned enterprise and that first mentioned enterprise participates in the management, control or capital of that other enterprise or undertaking, then, for the purpose of the present Convention, that first mentioned enterprise shall be deemed to have a permanent establishment in the other Contracting State and to be engaged in trade or business in the other Contracting State through that permanent establishment;

(n) The term "competent authorities" means, in the case of New Zealand, the Commissioner of Inland Revenue or his authorised representative; and, in the case of Japan the Minister of Finance or his authorised representative;

(o) Words in the singular include the plural and words in the plural include the singular.

Appendix E.

<u>The Double Taxation Relief (United Kingdom) Order 1966</u>

Article II (1)(p)(q)

(p) (i) the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on;

(ii) a permanent establishment shall include especially;
(aa) a place of management;
(bb) a branch;
(cc) an office;
(dd) a factory;
(ee) a workshop;
(ff) a mine, quarry, oilwell or other place of extraction of natural resources;
(gg) a building site or construction or assembly project which exists for more than twelve months;

(iii) the term "permanent establishment" shall not be deemed to include -
(aa) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
(bb) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

(cc) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise.

(dd) the maintenance of a fixed place of business solely for thepurpose of purchasing goods or merchandise, or for collecting information, for the enterprise;

(ee) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise;

(iv) an enterprise ofone of the territories shall be deemed to have a permanent establishment in the other territory if -

(aa) it carries on supervisory activities in that other territoryfor more than twelve months in connection with a construction installation or assembly project which is being undertaken in that other territory;

(bb)it carries on the activity of providing the services within that other territory of public entertainers or athletes referred to in Article XIV;

(v) a person acting in one of the territories on behalf of an enterprise of the other territory - other than anagent of an independent status to whom sub-paragraph (vi) applies - shall be deemed to be a permanent establishment in the former territory if he has, and habitually exercises in that former territory, an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise on behalf of the enterprise;

(vi) an enterpriseof one of the territories shall not be deemed to have a permanent establishment in the other territory merely because it carries on business in that other territory through a broker, general commission agent or any other agent of an independent status where any such person is acting in the ordinary course ofhis business;

(vii)the fact that a company which is a resident of one of the territories controls or is controlled by a company which is a resident of the other territory, or which carries on business in that other territory (whether through a permanent establishment or otherwise) shall not of itself consititute either company a permanent establishment of the other;

(viii)where an enterprise of one of the territories sells in the other territory goods manufactured, assembled, processed, packed or distributed in the other territory by an industrial or commercial enterprise for, or at, or to the order of, that first-mentioned enterprise and -

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(aa) either enterprise participates directly or indirectly in the management, control or capital of the other enterprise; or

(bb) the same persons participate directly or indirectly in the management, control or capital of both enterprises then for the purposes of this agreement that first-mentioned enterprise shall be deemed to have a permanent establishment in the other territory and to be engaged in trade or business in the other territory through that permanent establishment;

(g) the term "international traffic" includes traffic between places in one country in the courseof a voyage which extends over more than one country.

Appendix F.

The Double Taxation Relief (Australia) Order 1972

Article 4.

(1) For the purposes of this Agreement the term "permanent establishment" in relation to an enterprise means a fixed place of trade orbusiness in which the trade or business of the enterprise is wholly or partly carried on.
(2) The term "permanent establishment" includes -
(a) a place of management;
(b) a branch;
(c) an office;
(d) a factory;
(e) a workshop;
(f) a mine, quarry or otherplace of extraction of natural resources;
(g) an agricultural,pastoral or forestry property; and
(h) a building site or construction, installation or assembly project which exists for more than six months.
(3) The term "permanent establishment" shall not be deemed toinclude -
(a) the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise;
(b) the maintenance of a stockof goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
(c) the maintenance of a fixed place of trade or business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise; or
(d) the maintenance of a fixed place of trade orbusiness solely for the purpose of activities which have a preparatory or auxiliary character for the enterprise, such as advertising or scientificresearch.
(4) An enterprise of a Contracting State shall be deemed to have a permanent establishment in the other Contracting State and to carry on trade or business through that permanent establishment if -
(a) it carries on supervisory activities in that other Contracting State for more than six months in connection with a building site, or a construction, installation or assembly project which is being undertaken in that other Contracting State; or
(b) substantial equipment is inthat other Contracting State being used or installed by, for or under contract with the enterprise.
(5) A person acting in a Contracting State on behalf of an enterprise of the other Contracting State (other than an agent of independent status to whom paragraph (7) of this Article applies) shall be deemed to be a permanent establishment of that enterprise in the first-mentioned Con racting State if he has, and habitually exercises in that first-mentioned Contracting State, an authority to conclude contracts on behalf of the enterprise, unless his activities arelimited to the purchase of goods or merchandise for the enterprise.
(6) An enterprise of a Contracting State shall be deemed to have a permanent establishment in the other Contracting State and to carry on trade or business through that permanent establishment if -

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(a) on behalf of, or for, or at or to the order of, that enterprise, another enterprise -

(i) manufactures, assembles, processes, packs or distributes in that other Contracting State any goods or merchandise;

(ii) performs, in that other Contracting State, any mining or quarrying operations or any operations carried on in association with mining or quarrying operations, or performs any operations for the extraction, removal or other exploutation of standing timber or of any natural resource; or

(iii) breeds, manages, agists or raises in that other Contracting State any livestock; and

(b) either enterprise participates directly or indirectly in the management, control or capital of the other enterprise, or the same persons participate directly or indirectly in the management, control or capital of both enterprises.

(7) An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on trade or business in that other Contracting State through a broker, a general commission agent or any other agent of independent status, where such a person is acting in the ordinary course of his business as a broker, a general commission agent or other agent of independent status.

(8) The fact that a company which is a resident of a Contracting Sate controls or is controlled by a company which is a resident of the other contracting State, or which carries on trade or business in that other State (whether through a permanent establishment or otherwise), shall not of itself make a place of business of either company a permanent establishment of the other.

Appendix G.

The Double Taxation Relief (Singapore) Order 1973

Article 4.

(1) For the purpose of this Agreement the term "permanent establishment", in relation to an enterprise, means a fixed place of trade or business in which the trade or business of theenterprise is wholly or partly carried on.

(2)The term "permanent establishment" includes -

(a) a place of management;
(b) a branch;
(c) an office;
(d) a factory;
(e) a workshop;
(f) a mine, quarry or otherplace of extraction of natural resources;
(g) a farm or plantation, or an agricultural, pastoral or forestry property; and
(h) a building site or a construction, installation or assembly project which exists for more than six months.

(3) The term "permanent establishment" shall not be deemed to include -

(a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
(c) the maintenance of a fixed place of trade or business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise or
(d) the maintenance of a fixed place of trade or business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character for the eneterprise.

(4) An enterprise of a Contracting State shall be deemed to have a permanent establishment in the other Contracting State and to carryon trade or business through that permanent establishment if -
(a) it carries on supervisory activities in that other Contracting State for more than six months in connection with a building site, or a construction, installation or assembly project which is being undertaken, in that other Contracting State; or
(b) substantial equipment is that other Contracting State being used or installed by, for or under contract with the enterprise,

(5) A person acting in a Contracting State on behalf of an enterprise of the other Contracting State (other than an agent of independent status to whom paragraph (6) of this Article applies) shall be deemed to be a permanent establishment of that enterprise in the first-mentioned Contracting State if -
(a) he has, and habitually exercises in that first-mentioned Contrading State, any authority to conclude contracts on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise;
(b) there is maintained in that first-mentioned Contracting State a stock of goods or merchandise belonging to the enterprise from which he havitually fills orders on behalf of the enterprise; or
(c) in so acting he carries out in that first-mentioned ContractingState activities of any of the kinds referred to in subparagraph
(a) (i) or subparagraph (a) (ii) or subparagraph (a) (ii) of paragraph (8) of this Article.

(6) An enterprise of a Contracting State shall not be deemed tohave a permanent establishment in the other Contracting State merely because it carries on trade or business in that other Contracting State through a broker, a general commission agent or any other agent of independent status, where such a person is acting in the ordinary course of his business as a broker, a general commission agent or other agent of independent status.

(7) The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on trade or business in that other state (whether through a permanent establishment or otherwise), shall not of itself constitute a place of business of either company a permanent establishment of theother.

(8) In any case where paragraph (5) of this Article does not apply, an enterprise of a Contracting State shall be deemed to have a permanent establishment in the

other Contracting State and to carry on trade or business through that permanent establishment if -

(a) for, or at or to the order of, that enterprise, another enterprise -
  (i) manufactures, assembles, processes, packs or distributes in that other Contracting State any goods or merchandise; or
  (ii) performs, in that other Contracting State, any mining or quarrying operations or any operations carried on in association with mining or quarrying operations, or performs, in that other Contracting State, any operations for the extraction, removal or other exploitation of standing timber or of any natural resource; or
  (iii) breeds, manages, agists or raises in that other Contracting State any livestock; and

(b) either enterprise participates directly or indirectly in the management, control orcapital of the other enterprise, or the same persons participate directly or indirectly in the management, control or capital of both enterprises.

appendix H.

<u>The Double Taxation Relief (Malaysia Order 1976</u>

Article 4.

(1) For the purposes of this Agreement the term "permanent establishment", in relation to an enterprise, means a fixed place of business in which the business of the enterprise is wholly or partly carried on.

(2) The term "permanent establishment" includes especially -
  (a) a place of management;
  (b) a branch;
  (c) an office;
  (d) a factory;
  (e) a workshop;
  (f) a mine, quarry, oil well, gas well or other place of extraction of natural resources;
  (g) a farm or plantation, or an agricultural, pastoral or forestry property; and
  (h) a building site or a construction, installation or assembly project which exists formore than six months.

(3) the term "permanent establishment" shall not be deemed to include -
  (a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
  (b) the maintenance of a stock of goods ormerchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
  (c) the maintenance of a fixed place ofbusiness solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise; or
  (d) the maintenance of a fixed place of business solely for thepurpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise.

(4) An enterprise of a Contracting State shall be deemed to have a permanent establishment in the other Contracting State and to carry on business through that permanent establishment if -

(a) it carries on supervisory activities in that other Contracting State for more than six months in connection with a building site,or a construction, installation or assembly project which is being undertaken, in that other Contracting State; or
(b) substantial equipment is in that other Contracting State being used or installed by, for or under contract with theenterprise.

(5) A person acting in a Contracting State on behalf of an enterprise of the other Contracting State (other than an agentof independent status to whom paragraph (6) of this Article applies) shall be deemed to be a permanent establishment of that enterprise in the first-mentioned Contracting State if -
(a) he has, and habitually exercies in that first-mentioned Contracting State, any authority to conclude contracts on behalf of the enterprise, unless hisactivities are limited to thepurchase of goods or merchandise for the enterprise;
(b) there is maintained in that first-mentioned Contracting State a stock of goods ormerchandise belonging to the enterprise from which he habitually fills orders on behalf of the enterprise; or
(c) in so acting he carries out in that first-mentioned Contracting State activities of any of the kinds referred to in subparagraph (a) (i) or subparagraph (a) (ii) orsubparagraph (a) (iii) of paragraph (8) of this Article.

(6) An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State through a broker, a general commission agent or any other agent of independent status, where such a person is acting in the ordinary course of his business as a broker, a general commission agent or other agent of independent status.

(7) The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through apermanent establishment or otherwise), shall not of itself constitute a place of businessof either company a permanent establishment of the other.

(8) In any case where paragraph (5) of this Article does not apply, an enterprise of a Contracting State shall be deemed to have a permanent establishment in the other Contracting State and to carry on business through that permanent establishment if -
(a) for, or at or to the orderof, that enterprise, another enterprise -
(i) manufactures, assembles, processes, packs or distributes in that other Contracting State any goods or merchandise; or
(ii) performs, in that other Contracting State, any mining or quarrying operations or any operations carried on in association withmining or quarrying operations, or performs, in that other Contracting State, any operations for the extraction, removal or other exploitation of standing timber or of any natural resource; or
(iii) breeds, manages, agists or raises in that other Contracting State any livestock; and
(b) either, enterprise participates directly or indirectly in themanagement control or capital of the other enterprise,

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or the same persons participate directly or indirectly in the management, control or capital of both enterprises.

Appendix I.

The Double Taxation Relief (Canada) Order 1948

Article III

(1) The industrial or commercial profits of a New Zealand enterprise shall not be subject to Canadian tax unless the enterprise is engaged in trade or business in Canada through a permanent establishment situated therein. If it is so engaged, tax may be imposed on thoseprofits by Canada, but only on so much of them as is attributable to that permanent establishment:

Provided that nothing in this paragraph shall affect any provisions of the law of Canada regarding the taxation of income from the business of insurance.

(2) The industrial or commercial profits of a Canadian enterprise shall not be subject to New Zealand tax unless the enterprise is engaged in trade or business in New Zealand through a permanent establishment therein. If it is so engaged, tax may be imposed on those profits by New Zealand, but only on so much of them as is attributable to that permanent establishment:

Provided that nothing in this paragraph shall affect any provisions of thelaw of New Zealand regarding the taxation of income from the business of insurance.

(3) Where an enterprise of one of the territories is engaged in trade or business in the other territory through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities and dealing at arm's length with the enterprise of which it is a permanent establishment, and the profits so attributed shall be deemed to be income derived from sources in that other territory.

If the information available to the taxation authority concerned is inadequate to determine the profits to be attributed to the permanent establishment, nothing in this paragraph shall affect the application ofthe law of either territory in relation to the liability of the permanent establishment to pay tax on an amount determined by the exercise of a discretion or the making of an estimate by the taxation authority of that territory:

Provided that such discretion shall be exercised or such estimate shall be made, so far as the information available to the taxation authority permits, in accordance with the principle stated in this paragraph.

(4) Profits derived by an enterprise of one of theterritories from sales, under contracts concluded in that territory, of goods ormerchandise stocked in a warehouse in that territory for convenience of delivery and not for the purposes of display shall not be attributed to a permanent establishment of the enterprise in that other territory notwithstanding that the offers of purchase have been obtained by an agent of the enterprise in that other territory and transmitted by him to the enterprise for acceptance.

(5) No portion of any profits arising from the sale of goods or merchandise by an enterprise of one of the territories shall be deemed to arise in the other territory by reason of the mere purchase of the goods or merchandise within that other territory.
(6) Where a company which is a resident of one of the territories derived profits or income from sources within the other territory, the Government of that other territory shall not impose any form of taxation on dividends paid by the company to persons not resident in that other territory, or any tax in the nature of an undistributed profits tax on undistributed profits of the company, by reason of the fact that those dividends or undistributed profits represent, in whole or in part, profits or income so derived.

Appendix J.

The Double Taxation Relief (United States of America) Order (1952)

Article III

(1) The industrial or commercial profits of a United States enterprise shall not be subject to New Zealand tax unless the enterprise is engaged in trade or business in New Zealand through a permanent establishment situated therein. If it is so engaged, New Zealand tax may be imposed on the entire income of such enterprise from sources within New Zealand. Nothing in this paragraph shall affect any provisions of the law of New Zealand regarding thetaxation of income from the business of insurance.
(2) The industrial or commercial profits of a New Zealand enterprise shallnot be subject to United States tax unless the enterprise is engaged in trade or business in the United States through a permanent establishment situated therein. If it is so engaged, United States tax may be imposed on the entire income of such enterprise from within the United States.
(3) Where an enterprise of one of the Contracting Governments is engaged in trade or business in the territory of the other Contracting Government through a permanent establishment situated therein, there shall be attributed to that permanent establishment the industrieal or commercial profits which itmight be expected to drive if it were an independent enterprise engaged in the same or similar activities and dealing at arm's length with the enterprise of which it is a permanent establishment, and the profits so attributed shall be deemed to be income derived from sources within the territory of such other Contracting Government.
(4) In determining the industrial or commercial profits from sources within the territory of one of the Contracting Governments of an enterprise of the other Contracting Government no profits shall be deemed to arise from the mere purchase of goods or merchandise within the territory of the former Contracting Government by such enterprise.
(5) In the determination of the industrial or commercial profits of the permanent establishment there shall be allowed as deductions all expenses of a type allowed as a deduction by the Contracting Government in whose territory the perman-

ent establishment is situated and which are reasonably applicable to the permanent establishment including executive and general administrative expenses so applicable.

(6) If the information available to thetaxation authority concerned is inadequate to determine the profits to be attributed to the permanent establishment, nothing in this paragraph shall affect the application of the law of either territory in relation to the liability of the permanent establishment to pay tax on an amount determined by the exercise of a discretion or the making of an estimate by the taxation authority of that territory: Provided that such discretion shall be exercised or such estimated shall be made, so far as theinformation available to the taxation authority permits, in accordance with the principle stated in this paragraph.

Appendix K.

The Double Taxation Relief (Sweden) Order 1956.

Article III.

(1) The industrial or commercial profits of a New Zealand enterprise shall not be subject to Swedish tax unless the enterprise carries on a trade orbusiness in Sweden through apermanent establishment situated therein. If it carries on a trade or business as aforesaid, tax may be imposed on those profits by Sweden, but only on so much of them as is attributable to that permanent establishment:

Provided that nothing in thisparagraph shall affect any provisions of the law of Sweden regarding the taxation of income from the business of renting motion picture films or of insurance.

(2) The industrial or commercial profits of a Swedish enterprise shall not be subject to New Zealand tax unless the enterprise carries on a trade orbusiness in New Zealand through a permanent establishment situated therein. If it carries on a trade or business as aforesaid, tax may be imposed on thoseprofits by New Zealand, but only on so much of them as isattributable to that permanent establishment:

Provided that nothing in this paragraph shall affect any provisions of the law of New Zealand regarding the taxation of income from the business of renting motion picture films or of insurance.

(3) Where an enterprise of one of the territories carries on a trade or business in the other territory through a permanent establishment situated therein, there shall be attributed to that permanent establishment the industrial or commercial profits which it might be expected to derive in that other territory if it were an independent enterprise engaged in the same or similar activities and its dealing with the enterprise of which it is a permanent establishment were dealings at arm's length with that enterprise; and the profits so attributed shall be deemed to be income derived from sources in that other territory. If the information available to the taxation authority concerned is inadequate to determine the

profits to be attributed to the permanent establishment, nothing in this paragraph shall affect the application of the law of either territory in relation to the liability of the permanent establishment to pay tax on an amount determined by the exercise of a discretion or the making of an estimate by the taxation authorityof that territory:

Provided that such discretion shall be exercised or such estimate shall be made, so far as the information available to the taxation authority permits, in accordance with the principle stated in this paragraph.

(4) Where an enterprise of one of the tattitories derives profits, under contracts concluded in that territory, from sales of goods or merchandise stocked in a warehouse in the other territory for convenience of delivery and not for purpose of display, those profits shall not be attributed to a permanent establishment of the enterprise in that other territory, notwithstanding that the offers of purchase have been obtained by an agent of the enterprise in that other territory and transmitted by him to the enterprise for acceptance.

(5) No portion of any profits derived by an enterprise of one of the territories shall be attributed to a permanent establishment situated in the other territory by reason of themere purchase of goods or merchandise within that other territory by the enterprise.

appendix L.

<u>The Double Taxation Relief (Japan) Order 1963</u>.

Article III

(1)(a) The industrial or commercial profits (excluding profits derived from the operation of ships or aircraft) of a New Zealand enterprise shall not be subject to Japanese tax unless the enterprise carries on a trade or business in Japan through a permanent establishment situated therein. If it carries on a trade or business as aforesaid, tax may be imposed on those profits by Japan, but only on so much of them as is attributable to that permanent establishment.

(b) The industrial or commercial profits (excluding profits derived from the operation of ships or aircraft) of a Japanese enterprise shall not be subject to New Zealand tax unless the enterprise carries on a tradeor business in New Zealand through a permanent establishment situated therein. If it carries on a trade or business as aforesaid, tax may be imposed on those profits by New Zealand, but only on so much of them as is attributable to that permanent establishment.

(c) Nothing in subparagraphs (a) and (b) of this paragraph shall affect any provisionsof the law of either Contracting State regarding the taxation of income from the business of renting motion picture films or of insurance.

(2)(a) Where an enterprise of one of the Contracting States carrieson a trade or business in the other Contracting State through a permanent establishment situated therein, there shall be attributed to that permanent establishment the industrial or commercial profits which it might be expected to derive in that other Contracting Stateif it were

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an independent enterprise engaged in the same or similar activities and its dealing with the enterprise of which it is a permanent establishment were dealings at atm's length with that enterprise.

(b) If the information available to the taxation authority concerned is inadequate to determine the profits to be attributed to thepermanent establishment, nothing in subparagraph (a) of this paragraph shall affect the application of the law of either Contracting State in relation to the liability of the permanent establishment to pay tax on an amount determined by theexercise of a discretion or the making of an estimate by the taxation authority of that Contracting State:

Provided that such discretion shall be exercised or such estimate shallbe made, so far as the information available to the taxation authority permits, in accordance with the principle stated in thesaid subparagraph.

(3) In determining the industrial or commercial profits of a permanent establishment, there shall be allowed as deductions all expenses which would be deductible if the permanent establishment werean independent enterprise in so far as they are reasonably allocable to the permanent establishment, including executive and general administrative expenses so deductible, whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere:

Provided that only such deductions shall be allowed as are of a substantially similar nature to deductions allowable under thelaw of the contracting State in which the permanent establishment is situated.

Where an enterprise of one of the Contracting States derives profits under contracts concluded in that Contracting State, from sales of goods or merchandise stockedin a warehouse in the other Contracting State for convenience of delivery and not forpurpose of display, those profits shall not be attributed to a permanent establishment of the enterprise in that other Contracting State notwithstanding that the offers of purchase have been obtained by an agent of the enterprise in that other Contracting State and transmitted by him to the enterprise for acceptance.

(5) No portion of any profits derived by an enterprise of one of the Contracting States shall be attributed to a permanent establishment situated in the other Contracting State by reason of the mere purchase of goods or merchandise within that other Contracting State by the enterprise.

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Appendix M.

The Double Taxation Relief (United Kingdom) Order 1966

Article III

(1) Industrial or commercial profits of a United Kingdom enterprise shall be exempt from New Zealand tax unless the enterprise is engaged in trade or business in New Zealand througha permanent establishment situated therein. If such enterprise is so engaged, tax may beimposed by New Zealand on the industrialor commercial profits of the enterprise but only on so much of them as is directly or indirectly attributable to that permanent establishment.

(2) Industrial or commercial profits of a New Zealand enterprise shall be exempt from United Kingdom tax unless the enterprise is engaged in trade or business in the United Kingdom through a permanent establishment situated therein. If such enterprise is so engaged, tax may be imposed by the United Kingdom on theindustrial or commercial profits of the enterprise but only on so much of them as is directly or indirectly attributable to that permanent establishment.

(3) Nothing in paragraphs (1) and (2) of this Article shall affect any provisions of thelaw of either territory regarding the taxation of any person who carries on a business of any form of insurance or of renting motion picture films (other than films for exhibition on television); provided that if the law in force in either territory at the date of signature of this Agreement relating to thetaxation of such persons is varied (otherwise than in minor respects so as not to affect its general character), the Contracting Governments shall consult each other with a view to agreeing to such amendment of this paragraph as may be necessary.

(4) Where an enterprise of one of the territories is engaged in trade or business in the other territory through a permanent establishment situated therein there shall be attributed to such permanent establishment the industrial or commerdial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment. If the informationabailable to thetaxation authorities concerned is inadequate to determine the profits to be attributed to the permanent establishment, nothing in this paragraph shall affect the application of the law of either territory in relation to the liability of the permanent establishment to pay tax on an amount determined by the exercise of a discretion of the making of an estimate by the taxation authorities of that territory; provided that such discretion shall be exercised or such estimate shall be made, so far as the information available to the taxation authorities permits, in accordance with the principle stated in this paragraph.

(5) In determining the industrial or commercial profits of an enterprise of one of the territories which are taxable in the other territory in accordance with the previous paragraphs of this Article, there shall be allowed as deductions all expenses (including executive and generaladministrative expenses) which would be deductible if the permanent establishment were an independent enterprise and which are reasonably connected with the profits so taxable, whether incurred in the territory in which the permanent establishment is situated or elsewhere.

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appendix M.

(6) No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

appendix N.

The Double Taxation Relief (Australia) Order 1972.

Article 5.

(1) Industrial or commercial profits of an enterprise of a Contracting State shall be subject to tax only in that Contracting State unless the enterprise carries on trade or business in the other Contracting State through a permanent establishment siutated therein. If the enterprise carries on trade or business as aforesaid, tax may be imposed by that other Contracting State on the whole of the industrial or commercial profits of the enterprise from sources within that other Contracting State whether or not those profits are attributable to that permanent establishment

(2) Where an enterprise of a Contracting State carries on trade or business in the other Contracting State through a permanent establishment situated therein, there shall be attributed to that permanent establishment the industrial or commercial profits which it might be expected to make if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment; and the profits so attributed shall be deemed to be income derived from sources in that other Contracting State and shall be taxed accordingly.

(3) In determining the industrial or commercial profits attributable to a permanent establishment in a Contracting State, there shall be allowed as deductions all expenses of the enterprise, including executive and general administrative expenses, which would be deductible if the permanent establishment were an independent enterprise and which are reasonably connected with the permanent establishment, whether incurred in the Contracting State in which the permanent establishment is situated elsewhere.

(4) If the information available to the competent authority of the Contracting State concerned is inadequate to determine the industrial or commercial profits to be attributed to the permanent establishment, nothing in this Article shall affect the application of the law of that Contracting State in relation to the liability of the enterprise to pay tax in respect of the permanent establishment on an amount determined by the exercise of a discretion or the making of an estimate by the competent authority of that Contracting State. Provided that the discretion shall be exercised or the estimate shall be made, so far as the information available to the competent authority permits, in accordance with the principle stated in this Article.

(5) Industrial or commercial profits shall not be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

(6) Nothing in this Article shall apply to either Contracting State to prevent the operation in the Contracting State of any provisions of its law at any time in force

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relating to the taxation of any income from the business of any form of insurance. Provided that if the law in force in either Contracting State at the date of signature of this Agreement relating to the taxation of that income is varied (otherwise than in minor respects so as not to affect its general character), the Contracting Governments shall consult with each other with a view to agreeing to such amendment of this sub-paragraph as may be appropriate.

Appendix O.

The Double Taxation Relief (Singapore) Order 1973.

Article 5.

Industrial or Commercial Profits.

(1) Industrial or commercial profits of an enterprise of a Contracting State shall be subject to tax only in that Contracting Stateunless the enterprise carries on trade or business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on trade or business as aforesaid, tax may be imposed by that other Contracting State on the whole of the industrial or commercial profits of the enterprise from sources within that other Contracting State whether or not those profits are attributable to that permanent establishment

(2) Where an enterprise of a Contracting State carries on trade or business in the other Contracting State through a permanent establishment situated therein, there shall be attributed to that permanent establishment the industrial or commercial profits which it might be expected to make if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment; and the profits so attributed shall be deemed to be income derived from sources in that other Contracting State and shall be taxed accordingly.

(3) In determining the industrial or commercial profits attributable to a permanent establishment in a Contracting State, there shall be allowed as deductions all expenses of the enterprise, including executive and general administrative expenses, which would be deductible if the permanent establishment were an independent enterprise and which are reasonably connected with thepermanent establishment, whether incurred in the Contracting State in which the permanent establishment is situated elsewhere.

(4) If the information available to the competent authority of the Contracting State concerned is inadequate to determine the industrial or commercial profits to be attributed to the permanent establishment, nothing in this article shall affect the application of the law of that Contracting State in relation to theliability of the enterprise to pay tax in respect of the permanent establishment on an amount determined by the exercise of a discretion or the making of an estimate by the competent authority of that Contracting State. Provided that the discretion shall be exercised or the estimate shall be made, so far as the information available to the competent authority permits, in accordance with the principle stated in this Article.

(5) Industrial or commercial profits shall not be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.
(6) Nothing in this Article shall apply to either Contracting State to prevent the operation in the Contracting State of any provisions of its law at any time in force relating to the taxation of any income from the business of any form of insurance.

Appendix P.

The Double Taxation Relief (Malaysia) Order 1976.

Article 5.

Industrial or Commercial Profits.

(1) Industrial or commercial profits of an enterprise of a Contracting State shall be subject to tax only in that Contracting State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, tax may be imposed by that other Contracting State on the whole of the industrial or commercial profits of the enterprise from sources within that other Contracting State whether or not those profits are attributable to permanent establishment.
(2) Where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall be attributed to that permanent establishment the industrial or commercial profits which it might be expected to make if it were an independent enterprise engaged in thesame or similar activities under the same or similar conditions and dealing at arm's length with theenterprise of which it is a permanent establishment; and the profits so attributed shall be deemed to be income derived from sources in that other Contracting State and shall be taxed accordingly.
(3) In determining the industrial or commercial profits attributable to a permanent establishment in a Contracting State, there shall be allowed as deductions all expenses of the enterprise, including executive and general administrative expenses, which would be deductible if the permanent establishment were an independent enterprise and which are reasonably connected with the permanent establishment, whether incurred in the Contracting State in which the permanent establishmentis situated or elsewhere.
(4) If the information available to the competent authority of the Contracting State concerned is inadequate to determine the industrial or commercial profits to be attributed to the permanent establishment, nothing in this Article shall affect the application of the law of that Contracting State in relation to the liability of the enterprise to pay tax in respect of the permanent establishment on an amount determined by the exercise of a discretion or the making of an estimate by the competent authority of that Contracting State. Provided that the discretion shall be exercised or the estimate shall be made, so far as the information available to the competent authority permits, in accordance with the principle stated in this Article.

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(5) Industrial or commercial profits shall not be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.
(6) Nothing in this Article shall apply to either Contracting State to prevent the operation in the Contracting State of any provisions of its law at any time in force relating to the taxation of any income from the business of any form of insurance.

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Due	Borrower's Name
23 JUN 1982	J. van Roy (Accy)
5-7-82	M. Burrows
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