



Columbia Center on Sustainable Investment

A JOINT CENTER OF COLUMBIA LAW SCHOOL
AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY

CCSI Briefing Note

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March 2018

Understanding how the various definitions of Permanent Establishment can limit the taxation ability of resource- rich source countries

Key Points

- 1 Double Taxation Agreements (DTAs) are bilateral tax treaties that are designed to reduce the negative impact of double taxation through the allocation of taxing rights to the State of residence (i.e. where the company has its base) and to the State of source (i.e. where the taxable operations takes place);
- 2 The allocation of the rights to tax business profits of non-resident entities' operations depends on whether these operations can constitute a "Permanent Establishment" (PE) according to the definition included in each DTA. If non-resident entities fulfill the criteria established in this PE definition, taxation is due at the source State. On the contrary, if non-resident entities fall outside of the scope of this definition, the residence State obtains these rights. DTAs can therefore result in source States losing significant tax revenue from operations of non-residents (unless such operations are conducted under a PE);
- 3 Loosely defining the PE without due regard for the risk of loopholes might encourage companies to structure their investments in order to avoid fulfilling the criteria of the PE definition and thus avoid taxation at source;
- 4 For the purpose of extractive industries, these tax avoidance structures normally involve bypassing the time threshold that triggers a PE (by splitting long term contracts into short term contracts), and/or structuring and dividing contracts to enable them to be considered of preparatory or auxiliary nature, thus fitting into then general exclusions of PE that exist in most DTAs (fragmentation of activities and/or misuse/abuse of specific activity exemptions);
- 5 Under the Base Erosion and Profit Shifting (BEPS) project, the OECD has proposed a Multilateral Convention aimed at tackling tax evasion and avoidance schemes. This convention includes measures to prevent the artificial avoidance of a PE through contract splitting and through the fragmentation of business operations. Unfortunately, as States are given much flexibility to renegotiate their DTAs and adopt these measures, it is unlikely that resident States will have an incentive to change the status quo. In other words, many of the problems that DTAs create for source countries will likely remain unchanged;
- 6 In addition, the UN and OECD Model DTAs – normally used as basis for DTAs - are not aimed at covering the specific characteristics of extractive industries. Resource rich States should thus aim to include specific clauses that cover these issues; after explaining the various options to optimize taxing rights related to PE in the context of extractives, **this brief presents a sample PE clause to that effect as well an offshore and withholding tax clause both aimed at protecting source State's position in DTAs (Annexes III-V).**

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² Acknowledgments: The authors are particularly grateful to John Bush, James Reynolds and Joe Guttentag of the International Senior Lawyers Project and to Nicolas Maennling and Tehena Mebratu-Tsegaye of CCSI for their extensive inputs and support.

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I. Introduction

In recent years, the increase in the globalization of trade and investment has had important implications in policy discussions on international taxation and the harmful effects of aggressive tax planning. These discussions have paved the way for a greater debate on double taxation agreements (DTAs); in order to prevent the double taxation of income, DTAs specify which State has the right to tax in a scenario where a company resident in State A (“Residence State”) receives profits from operations in State B (“Source State). However, by establishing these provisions, DTAs have also encouraged companies to create complex tax avoidance schemes. The Organisation for Economic Co-operation and Development (OECD) recently released several recommendations to tackle these practices under the Base Erosion and Profit Shifting (BEPS) project, which allowed for several international public consultations and discussions on tax evasion and avoidance. As an outcome of these discussions, the OECD ultimately released the “Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion Profit Shifting”¹ (Multilateral Convention), a Convention that allowed for States to amend their existing DTAs in order to reduce the possibility of tax evasion/avoidance (due to its relevance, this subject is covered in more detail below). In addition, the OECD reviewed its own model DTA to also align it with the conclusions of the BEPS project.

According to the International Monetary Fund (IMF)², between 1975 and 2013 the number of existing DTAs rose from approximately 250 to nearly 3,000, despite a lack of evidence-based analysis on their economic and revenue impact. In the same study, the IMF warned that DTAs between the Netherlands and developing countries had led to a loss of revenue for the latter of at least €770 million in 2011. Non-OECD States that concluded DTAs with the United States may have lost approximately \$1.6 billion in 2010. These results led the IMF to conclude that “...countries should not enter treaties lightly— all too often this has been done largely as a political gesture—but with close and well-advised attention to the risks that may be created”. Other international organizations and NGOs have also warned of the possible risks of DTAs. For example, in a recent study ActionAid estimated that Bangladesh

¹ Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, 2017, OECD, available at: <http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>

² Spillovers in International Corporate Taxation, 2014, Washington DC: International, Monetary Fund, p.27, available at: <http://www.imf.org/external/np/pp/eng/2014/050914.pdf> . The conclusions of this paper are attributed to IMF staff and not to the IMF or its executive board.

loses \$85 million every year as a result of restrictive DTA provisions on withholding taxes on dividends³. Estimates of DTA's impact on other taxes – such as taxes on profits – are much harder to quantify due to the lack of reliable data on economic transactions⁴.

It is also worth noting that most developed countries already include measures in their domestic legislation to alleviate the effects of double taxation, such as providing companies with a tax credit for taxes paid abroad. In other words, if the negative effects of double taxation can be solved through domestic legislation, where resident States (i.e. where the company has its base) alleviate their own companies of the double taxation burden, one could question the real need for implementing such treaties that have had deleterious impacts on the tax revenues for source States (i.e. where the taxable operations takes place).

European Union vs. tech giants' lack of physical presence:

- ✓ Both Apple and Google have recently agreed to pay over \$600 million in back taxes in Italy. These companies were routing their sales through its international headquarters in Ireland and therefore avoiding triggering a PE;
- ✓ Although very few details were disclosed, these cases have served as a basis for the European Union to consider revising the rules on Permanent Establishment so that “businesses could be taxed in countries even if they have no offices, warehouses or shops there”.

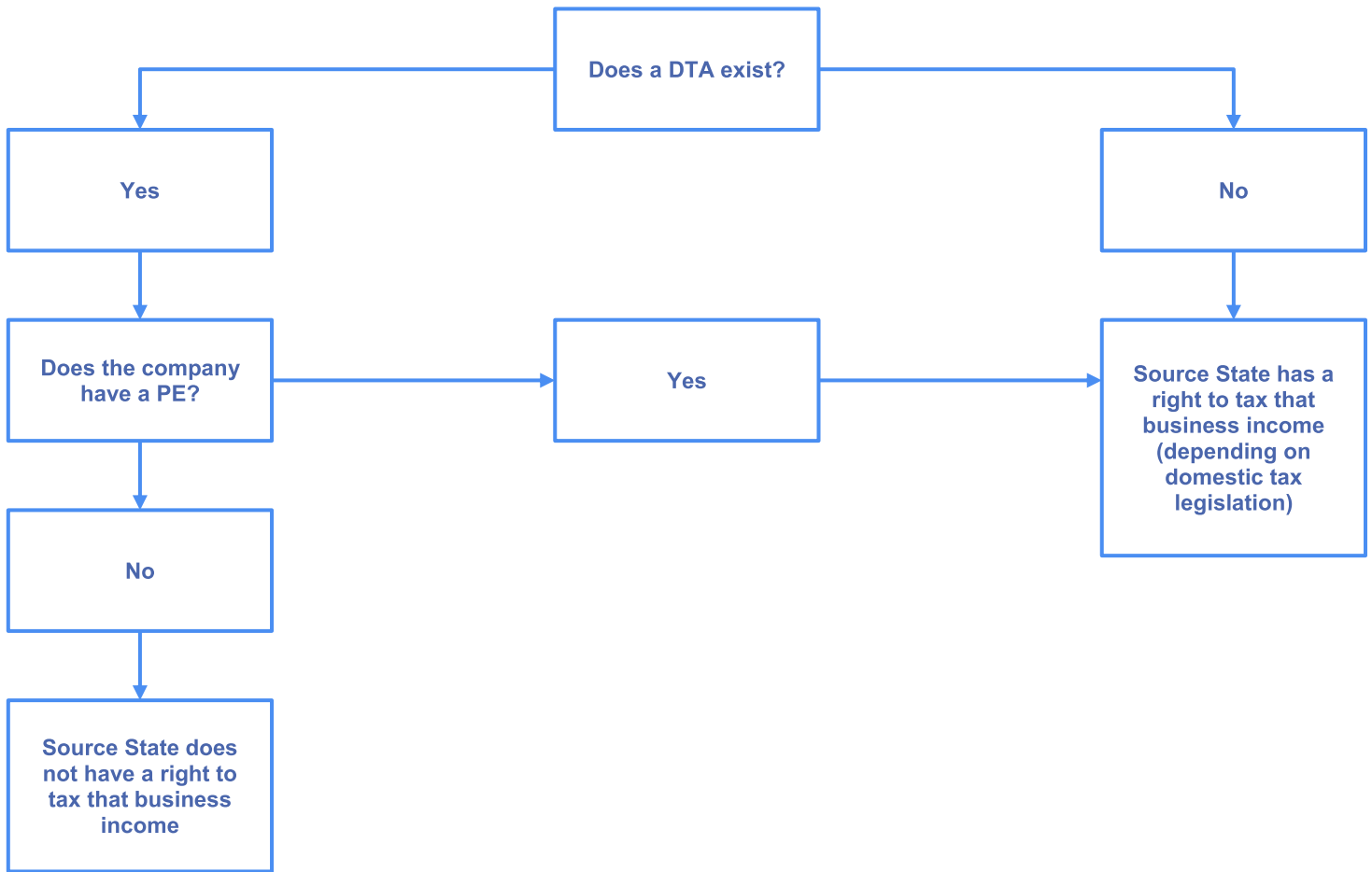
Source: EU to find ways to make Google, Facebook and Amazon pay more tax, 2017, The Guardian, available at: <https://www.theguardian.com/business/2017/sep/21/tech-firms-tax-eu-turnover-google-amazon-apple> “Permanent Establishment” Becomes Tax Authorities' Weapon Of Choice in Attack on Corporates, 2016, Forbes, available at: <https://www.forbes.com/sites/joeharpaz/2016/04/04/permanent-establishment-becomes-tax-authorities-weapon-of-choice-in-attack-on-corporates/#2c8f5d504f5d>, and Google Agrees to Pay Italy \$334 Million in Back Taxes, 2017, The New York Times, available at: <https://www.nytimes.com/2017/05/04/technology/google-italy-tax.html>

Figure 1 below explains the idea of how a PE can have an impact on a State's right to tax:

³ Mistreated - The tax treaties that are depriving the world's poorest countries of vital revenue, 2016, ActionAid, p.3, available at: http://www.actionaid.org/sites/files/actionaid/actionaid_-_mistreated_tax_treaties_report_-_feb_2016.pdf

⁴ Assessing the loss in profit taxes would require calculating the taxable income of non-resident companies that do not conduct their operations through a permanent establishment and thus are generally not obliged to file tax returns.

Figure 1:



As, among other things, DTAs establish that the profits of a foreign company can only be taxed by the source State if the company carries on business in that State through a PE, it is vital to clearly define and understand this concept to guarantee that source States do not lose revenue that they would otherwise collect in the absence of the DTA.

The existence of different definitions of PE within DTAs and the different points of view from the OECD and the United Nations (UN) - arguably the two most important organizations to reflect on this topic – further complicate the understanding of the issue. In addition, it is also important to take into consideration that each State will likely have its own definition of PE in their domestic legislation. While the definition of PE in DTAs decides which State will have the right to tax a given income, the domestic law establishes its own tests to define how such rights to tax are exercised by the source and residence states. Furthermore, PE is merely one aspect among several that States need to consider when entering or negotiating DTAs. Several provisions and taxes need to be read as if they were

linked to each other as this would be the best way to understand the different problems that may exist. For example, for PE purposes it is also essential to correctly understand transfer pricing rules (i.e. the rules that establish that closely related companies should interact with each other in a similar way as they would with any other company). Even the best PE definition would do little to prevent tax avoidance if operations between related entities are not closely monitored to avoid transfer pricing issues. As the concept of PE is, in itself, extremely complex, this briefing report does not address these issues.

The concept of PE in DTAs is of utmost importance for resource rich countries that are dependent on tax revenues from natural resources and where an incorrect interpretation or a narrower definition might lead to an undesirable loss of revenue. If we consider that extractive industry projects often involve a great number of highly specialized operators working with different timelines and locations, and are often regulated by contracts that may or may not cover tax rights (and PE definitions), understanding what triggers a PE can be an extremely challenging task.

Recently the UN 's Committee of Experts on International Cooperation in Tax Matters offered a proposed guidance report that is aimed at addressing some of the PE issues in extractive industries⁵. Given the complexity of the issue at hand, it is nonetheless important to take into consideration the different interpretations and proposed solutions that were introduced by other international organizations and individual States. This briefing note – building upon the UN proposed guidance report - aims to review some of these solutions and provide a practical guidance for source States on some of the issues related to PE in extractive industries. In Section II, the briefing reviews the main definitions of PE and outlines the policy discussions that surround it. Section III discusses the impact of such definitions on extractive industries, while addressing some measures implemented by resource rich States. Section IV highlights some of the relevant recommendations provided by the international community to face aggressive tax planning mechanisms that are used to avoid triggering a PE in extractive industries. Finally, Section V presents policy options for decision makers to consider when negotiating or renegotiating DTAs.

⁵ Proposed Guidance on Permanent Establishment in the Extractive Industries, 2016, Committee of Experts on International Cooperation in Tax Matters Thirteenth Session, United Nations, available at: http://www.un.org/esa/ffd/wp-content/uploads/2016/12/13STM_CRP22_Extractives_PEs.pdf .

II. What is a Permanent Establishment?

General definition: underlying aspects and implications

In many countries the law requires that a resident company's operations be taxed in the jurisdiction in which it is resident even where the operations of the resident company are located in another country. This may result in a company being subject to tax in both its country of residence, and in the country where its operations are located. A typical DTA is designed to avoid the possibility of double taxation by allocating taxing rights between the source country and resident country. The concept of PE in DTAs establishes a threshold for taxing at source, meaning taxing the activity of the non-resident company in the source State. While the thresholds vary depending on the DTA, the basic idea is that the definition of the PE provides the minimum limit where a source State considers that the duration and/or the nature of the activity of the non-resident is enough to justify a need to pay taxes where the operation takes place. For example, most DTAs establish that a building site or construction or installation project is a PE if it lasts more than a certain number of months (normally between 6 and 12 months). However, the problem with this is that if companies are able to avoid the PE threshold established in the DTA, a company may operate without being liable to taxation at source (for that income). As a result, some companies have resorted to the use of tax avoidance strategies – such as splitting-up contracts between closely related companies (see explanation below) - to bypass the existing PE definition and avoid or significantly reduce their tax liability in the State where the operations take place.

The definition of the PE should be grounded in a clear understanding of the implications for the policy choices of the country. A wider definition of PE (i.e. one that includes a broader range of situations where a PE would exist) will likely provide more taxing rights to the source State, and conversely, a narrower definition of PE (i.e. one that has a limited amount of cases where a PE would be created) might reduce the source State's rights to tax. Capital importing countries might agree to a narrower definition of PE when negotiating a DTA for a number of reasons – it might be due to a lack of understanding of the implications, or it might be because the decision makers in capital importing countries believe that by conceding to a narrow definition of PE, they will attract Foreign Direct Investment which will compensate for the initial loss of revenue. On the other hand, capital importing countries might negotiate a wider definition as a part of a conscious effort to preserve taxation rights, and in recognition that taxation should

not deter investment as long as the investor has other incentives (e.g. the right to exploit the State's natural resources on terms that render the operations profitable).

Model conventions

Despite substantial wording differences between them, most DTAs have similar provisions. This is a result of States adopting model conventions such as those proposed by the OECD⁶, the UN⁷ or the United States⁸. These treaties serve as a base for States to either fully adopt (i.e. without making any changes to those proposed in the model), or to make changes when deemed fit. There are also DTAs established at a regional level, such as the Andean tax model (focus in Latin America)⁹ or the East African Community treaty, with the latter not fully implemented as many states in the region fear that it might lead to tax evasion and avoidance schemes¹⁰. For the purpose of extractive industries¹¹, the general structure of the article that defines the requirements for a PE to exist can be best summarized in the following way¹²:

- 1) An initial definition of the elements that constitute a PE (also known as the “place of business test”):
 - a) the existence of a “place of business”; and
 - b) this place of business must be “fixed” (i.e. established at a specific/distinct place with a certain degree of permanence. However, no physical attachment to the soil is necessary); and
 - c) the business operations of the company are conducted through this fixed place of business (i.e. employee(s) not “independent” of the company conduct business in the State in which the fixed place is situated);

⁶ The OECD Model Tax Convention on Income and on Capital (2017), available at: <http://www.oecd.org/tax/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm> .

⁷ United Nations Model Double Taxation Convention between Developed and Developing Countries (2011), available at: <http://www.un.org/esa/ffd/tax-committee/ta-unmodel.html> .

⁸ United States Model Income Tax Convention (2006), available at: <https://www.irs.gov/individuals/international-taxpayers/the-us-model-income-tax-convention-and-model-technical-explanation> .

⁹ English translation of the Andean Community Income and Capital Tax Convention (2004), available at: <http://internationaltaxtreaty.com/download/bolivia/dtc/Andean%20Community-DTC-May-2004.pdf> .

¹⁰ “Double taxation pact put on ice as businesses cry foul”, The East African, last visited on 12/12/2017, available at: <http://www.theeastafrican.co.ke/business/Double-taxation-pact-put-on-ice-as-businesses-cry-foul-/2560-3897322-2yfi5/index.html>

¹¹ Most DTAs include one specific article that defines a PE. The general definition covers other areas that are not included in this briefing (e.g. broker services). The aim of this section is thus to provide a summary of the relevant provisions for the purpose of the definition of PE from extractive industry project's perspective.

¹² It is worth noting that the OECD made significant changes to its model convention in late 2017. Although the general structure remained similar to the one set forth above, the revised model introduced some changes to the PE definition that go in line with the BEPS project (analyzed with greater detail in Section IV of this briefing).

- 2) A second and/or third section provides a list of examples of what might constitute a PE (e.g. a place of management, a branch or a mine, an oil or gas well), as well as the minimum period of time for some activities to trigger the existence of a PE (known as the “duration test”). This section is particularly relevant as the wording might provide stronger or weaker taxing rights to the source State: a shorter time threshold would likely provide a source state with stronger taxing rights, while a longer threshold would likely allow non-residents operating in that State to avoid meeting the threshold required for a PE and thus avoid being taxed at source;
- 3) A following section providing exceptions to the general rule to exclude activities that are considered to have a preparatory or auxiliary nature (e.g. the use of facilities solely for the purpose of storage or display of goods belonging to the company). These exceptions exist as it is assumed that preparatory or auxiliary activities will generate either no or relatively low income. In many cases it is extremely difficult to distinguish between auxiliary activities and a company’s core business and thus analyzing the existence of a PE requires analyzing each case to understand the real nature of the company’s activity. Again, the wording of this section will define if source States will have stronger or weaker taxing rights.

It is important to note that, despite their similarities, the existing model conventions present different policy options with significant impacts on taxing rights. For example, while the current (and recently updated) OECD model¹³ proposes a minimum period of time of more than twelve months for a construction activity to constitute a PE, the UN model reduces that period of time by half. As a result, in a case where a construction activity lasts seven months or more, source States that have adopted the UN model would be entitled to tax all the profits that derive from that activity, while States that have adopted the OECD model would not. In addition, in the event of services being provided by employees or other personnel from a non-resident company for longer than 183 days in any twelve-month period, these activities are specifically covered in the PE definition in the UN model but are not included in the current (and recently updated) OECD model, which many countries find problematic.¹⁴ Another example of disparities in the definition of PE between conventions relates to the definition of activities that are of a “preparatory

¹³ 2017 update to the OECD Model Tax Convention, available at: <http://www.oecd.org/tax/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm> .

¹⁴ In other words, under the OECD model convention the performance of these services does not – by itself – create a PE. According to the UN’s commentaries to their model convention “*Many developing countries believe that management and consultancy services should be covered because the provision of those services in developing countries by enterprises of industrialized countries can generate large profits.*”.

or auxiliary” character¹⁵. In contrast with the OECD model, the UN adopts a stricter approach and excludes the “delivery of goods” from its list of exceptions. As explained throughout this briefing, the trade-off for States between additional revenue and administrative costs as a result of tax collection and auditing should always be considered¹⁶. For the purpose of extractive industries, table 1 below summarizes the most relevant differences between both model conventions.

Table 1:

PE provision description	OECD	UN
Duration test for construction activities	12 months	6 months
Supervisory activities for construction activities	Not covered	Covered
Duration test for the provision of consultancy services	Not covered	183 days in any 12-month period commencing or ending in the fiscal year concerned
Preparatory or auxiliary activities	The “delivery of goods” is considered a preparatory or auxiliary activity	The “delivery of goods” is <u>not</u> considered a preparatory or auxiliary activity
Specific anti-abuse clauses	Yes (anti fragmentation of activities)	No

As negotiations between contracting States involve different contexts, more often than not, a given State will sign multiple DTAs that embrace several different policy options. Table 2 below demonstrates some of the policy options implemented by Uganda and Zambia in their respective DTAs¹⁷:

¹⁵ “It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity” (United Nations Model Double Taxation Convention between Developed and Developing Countries, p.120).

¹⁶ In its commentaries to their model convention, the UN also argues that States should consider the practical aspects of the trade-off between the administrative costs involved in assessing the taxable income attributed to that activity and the revenue obtained (United Nations Model Double Taxation Convention between Developed and Developing Countries, p.124).

¹⁷ Table 2 is an adaption of “figure 8” in Martin Hearson’s critical review of DTAs in Sub-Saharan Africa (Hearson, Martin (2015) Tax treaties in sub-Saharan Africa: a critical review, p.22, Tax Justice Network - Africa, Nairobi, Kenya. ISBN 9789966185440, available at: http://eprints.lse.ac.uk/67903/1/Hearson_Tax_treaties_in_sub-Saharan_Africa.pdf).

Table 2:

PE provision description	Uganda (of 10 treaties in force)	Zambia (of 18 treaties in force)
Duration test for construction activities		
Less than 6 months (better for source countries)	0%	6%
6 months (UN model)	100%	56%
More than 6 months (worse for source countries and similar to the OECD model)	0%	39%
Other covered activities		
Supervisory activities	80%	94%
Service PE	30%	28%
PE exceptions - exclusion of the term "delivery of goods" (in line with the UN model)		
For the use of facilities solely for the purpose of storage or display (or delivery) of goods	60%	6%
For the maintenance of a stock of goods or merchandise solely for the purpose of storage, display (or delivery)	70%	6%

As best detailed in Sections III and IV of this briefing, the duration test is extremely important for the purpose of assessing the existence of a PE in extractive industries. Table 3 below demonstrates how different outcomes will likely take place, even when negotiations occur with the same State (in this case Mauritius¹⁸):

¹⁸ It should be noted that Mauritius is recognized – even by its Prime-Minister - as a jurisdiction that uses taxation to attract foreign direct investment (“Mauritius struggles with tax haven crackdown”, 2017, Financial Times, available at: <https://www.ft.com/content/e37d1df6-8436-11e7-94e2-c5b903247afd>).

Table 3¹⁹:

Contracting States / Year	Rwanda/Mauritius (2001)	Senegal/Mauritius (2002)	Uganda/Mauritius (2003)	Zambia/Mauritius (2011)	Kenya/Mauritius (2012)	Rwanda/Mauritius (2013)
Duration test for construction PE (months)	12	9	6	9	12	6
Duration test for services PE (months)	12	9	4	Not included	6	6

As previously mentioned, recently the OECD approved a new version of its tax convention to align with the BEPS project (addressed in more detail in Section IV). As discussed below, these changes introduce some measures aimed at tackling the artificial avoidance of PE, which in many cases goes beyond what is currently included in the, more “source State friendly”, UN convention²⁰. Although these changes present a positive step toward preventing tax avoidance, unfortunately the revised model convention maintains many of the same provisions that shift taxing rights from source to resident States (e.g. the 12-month duration test for a building or construction site, 6 months longer than the more “source State friendly” UN model).

Finally, in an effort to provide policy makers with some guidance on how best to interpret these conventions, both the UN and the OECD have produced commentaries on their respective model conventions. Despite not having

¹⁹ Table 3 is an adaption of “table 7” in Martin Hearson’s critical review of DTAs in Sub-Saharan Africa (Hearson, Martin (2015) Tax treaties in sub-Saharan Africa: a critical review, p.27, Tax Justice Network - Africa, Nairobi, Kenya. ISBN 9789966185440, available at: http://eprints.lse.ac.uk/67903/1/Hearson_Tax_treaties_in_sub-Saharan_Africa.pdf).

²⁰ An example of this is the inclusion of paragraph 4.1 in article 5 of the OECD convention that may help group commonly controlled activities together in order to create a PE: “Paragraph 4 [exceptions from the general PE definition] shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character, provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.”.

legal force, these commentaries are used as a basis for taxpayers, courts and tax administrations' interpretation of DTAs, and are often updated.

III. Effect on extractive industries

As discussed above, triggering a PE can occur through various ways:

- 1) the company's physical presence in a given State,
- 2) the period of time during which it operates, and
- 3) the type of activity it conducts (e.g. auxiliary or not).

In the case of extractive industries, where multiple - often commonly owned – parties operate, all of these aspects need to be considered for the different operations that occur under the same project and throughout the development stages of an extractive industry investment. The questions to be raised are:

- (i) whether fragmented activities of a common project should be lumped together to create a PE;
- (ii) whether contract duration split on work involving one project should be grouped to create a PE; and
- (iii) what is a sufficient time period for work in a jurisdiction to create a PE.

These issues will be discussed in greater detail throughout the course of this briefing.

To add to the complexity, States and companies that operate in the extractive industries' sector will often enter into investor-State contracts. Investor-state contracts may establish ring-fenced regimes where each contractual area (and the PEs that they create) is treated independently for tax purposes. Furthermore, companies often operate in these areas under a consortium association (e.g. Joint Operating Agreement), thus generating different PEs for all those involved in the consortium. Finally, subcontractors are normally hired to perform highly specialized short-term work that may also trigger several other PEs in the same contractual area.

This complexity requires the tax administration to closely monitor the work performed by various entities in order to correctly assess the number of existing PEs and their respective timeline. This is especially relevant when closely related companies operate in a given area over short periods of time, as this may allow for companies to divide operations into several contracts and thus avoid triggering a PE for some of them. This would also allow for companies to shift profits into companies that would not be deemed to have a PE, thus avoid being taxed at source.

Stages of investment

The typical investment cycle in extractive industries includes:

- i) an initial stage where investors establish a representative office or a branch to collect information and ultimately obtain licenses to perform their operations;
- ii) an exploration stage;
- iii) a development stage (if the exploration proves to be successful);
- iv) a production stage; and finally
- v) an abandonment and decommissioning stage when the work is complete and facilities are dismantled.

Throughout these different stages of investment, a company's operations will likely trigger a PE. States normally require that companies establish a local presence in the region (e.g. a branch) and, even when that is not the case, the duration of time during which the companies will operate in the contractual area will likely fulfil the requirements of the definition of PE in DTAs. Considering that one of the elements of PE is a connection between the business operation of the company and a specific place of business, companies may also trigger more than one PE in the source State. Thus, a PE may exist solely in the area where either the geological surveys or the extraction takes place; a different PE may also be triggered if a company has a coordination office in a different location (e.g. the State's capital); and different PEs may exist if State and company agree to survey or explore different contractual areas (this is especially important where ring-fenced regimes are implemented, where costs from one area cannot offset the profits from another contractual area).

Despite the fact that most PE disputes can be found in the activities leading up to production and/or the supplemental activities involved in maintaining or terminating production, noteworthy PE issues may arise during each of these stages and are highlighted below:



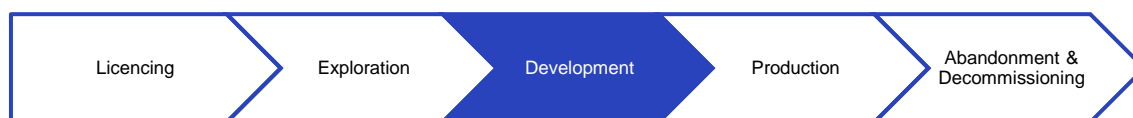
The existence of a PE during the initial licensing stage will largely depend on the company's activities ²¹. It should be noted that, for long term operations where a PE will likely exist, delaying the existence of a PE is not necessarily a problem for source States as it will eliminate the possibility for the companies to offset future profits with the costs incurred during this stage (which a PE in this early stage would have entitled them to, provided that the fiscal regime allows for loss carry forward).



As model conventions do not necessarily consider all the issues related to extractive industries, exploration activities are not included in the list of examples of PEs provided by the OECD and UN's model conventions. To prevent any interpretation problems arising from this omission, some States have adopted specific provisions that are aimed at including activities during this stage, such as the case of the DTA between the Government of the Republic of Ghana and the Government of the Republic of Mauritius signed on March 1st, 2017 where it is stated that: “*The*

²¹ According to the UN, many States consider that if a non-resident company establishes a representative office in the source State, that operation per se does not trigger a PE as long it does not engage in business activities that could potentially generate income (i.e. selling goods or services) (Proposed Guidance on Permanent Establishment in the Extractive Industries, Committee of Experts on International Cooperation in Tax Matters Thirteenth Session, p.18, available at: http://www.un.org/esa/ffd/wp-content/uploads/2016/12/13STM_CRP22_Extractives_PEs.pdf).

term "permanent establishment" shall include: (...) (h) an installation or structure used for the exploration of natural resources". However, including a similar provision in the list of examples will not – per se – trigger a PE. As best described by the UN in its commentaries to their model convention: "While paragraph 2 [that sets out the list of PE examples] notes that offices, factories, etc., are common types of permanent establishments, when one is looking at the operations of a particular enterprise, the requirements of paragraph 1 [that sets out the tests of PE] must also be met. Paragraph 2 therefore simply provides an indication that a permanent establishment may well exist; it does not provide that one necessarily does exist. This is also the stance of the OECD Commentary (...)"²². In this sense, even though the examples do not work on a standalone basis, including a greater level of detail may provide the source State with more arguments to defend a specific position in future disputes.



At the development stage, a PE will likely already exist. However, it is still worth analyzing other sources of income that are attributable to the PE but not directly linked to the exploitation of natural resources, such as the possibility of capital gains arising from the disposition of the business assets (such as the right to the license) used in the PE; such capital gains will be taxable in the source State.²³



²² United Nations Model Double Taxation Convention between Developed and Developing Countries, p.105.

²³ Wei Cui, Taxation of Capital Gains, September 2014, UN, available at: http://www.un.org/esa/ffd/tax/2014TBP2/Paper_TaxationCapitalGains.pdf

At the stage of production, there is little debate that most activities performed by investors will trigger a PE. Considering that investors often hire subcontractors to perform short-term work in the contractual area, from a PE perspective the relevance will likely focus on the duration of time during which the latter perform their operations in order to assess the existence of a PE of these companies. Given the importance of this topic, issues related to subcontractors will be treated in a separate section below.



After the production stage, the company's PE will continue to exist until the operation is completed, and the facilities are decommissioned. Subcontractors are normally hired to perform decommissioning operations; once again the existence of a PE for these companies will depend on the duration of time they require to perform their services. It should also be noted that this stage is still relevant for the purpose of assessing the PE of the company. As long as the obligation to perform lies on the contractor, hiring additional work (i.e. subcontractors) to perform a specific task such as dismantling infrastructure does not exclude a company's responsibility and its PE²⁴. This is especially true with the UN model, where "supervisory activities" are explicitly included in the PE definition²⁵.

Subcontractors

The main issue when it comes to PE in extractive industries mostly lies in the number of short-term highly specialized technical services that take place in the contractual areas. As independent third parties that are hired to perform these services will wish to avoid triggering a PE (and thus avoid being taxed at source), they will likely

²⁴ In its commentaries to their model convention, the UN reproduces the OECD Commentary in this sense: "If an enterprise (general contractor) which has undertaken the performance of a comprehensive project subcontracts parts of such a project to other enterprises (subcontractors), the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor on the building project. The subcontractor himself has a permanent establishment at the site if his activities there last more than [six] months." (United Nations Model Double Taxation Convention between Developed and Developing Countries, p.109).

²⁵ Source States that adopt the OECD model will face greater difficulties justifying this position as this model currently does not specifically mention supervisory activities.

structure their operations in a way that avoids the threshold established by the applicable DTA (e.g. agreeing to perform services within a 5-month period to avoid the 6-month limit). Furthermore, companies that wish to mitigate the inevitable taxation at source through their own PE, might also take advantage of these short-term operations by hiring closely related companies to perform part of the operations, as this would enable them to shift profit that would otherwise be taxed at source. Due to its relevance, section IV of this paper will dedicate a specific section analyzing these and similar harmful practices of tax evasion.

Resident states will have an incentive to negotiate DTAs in order to guarantee longer PE time thresholds, thus guaranteeing more taxing rights for themselves. For example, the DTA between the Government of the People's Republic of China and the Government of Ukraine, signed on December 4th, 1995²⁶, established a duration test of 18 months, 6 months longer than the already "resident-State friendly" OECD model. This presents a significant revenue loss for the Government of Ukraine in foreign direct investment made by Chinese companies. The negative impact of a poorly negotiated DTA can be seen in the case that opposed the Indian tax authorities and J. Ray McDermott Eastern Hemisphere Ltd., a company resident in Mauritius:

²⁶ DTA between the Government of the People's Republic of China and the Government of Ukraine, available at: <http://www.chinatax.gov.cn/eng/n2367756/c2368319/part/2368322.pdf> .

Indian Tax Authorities v. J. Ray McDermott Eastern Hemisphere Ltd.:

- ✓ The DTA between India and Mauritius provides that the profits of a Mauritian company operating in India can only be taxed by India if it has a PE in that State;
- ✓ Article 5 of the DTA defines a PE as a fixed place of business in India through which the business of a Mauritian enterprise is wholly or partly carried on. Article 5(2)(i) provides that a PE includes a building site or construction or assembly project or supervisory activities in connection therewith, when a project or supervisory activity continues for more than 9 months;
- ✓ J. Ray McDermott Eastern Hemisphere Ltd., a company resident in Mauritius and whose core work revolves around the transportation, installation, and construction of offshore platforms for mineral oil exploration, entered into several contracts with an unrelated Indian company to perform works and services in different locations in India. The company also had a related group company operating in India that provided support and coordination to its operations through a liaison office;
- ✓ In its tax returns, the company claimed that it did not have a PE in India – and thus it was not obliged to pay any taxes - as the time spent in each project was less than nine months;
- ✓ During an audit assessment, the Indian tax authorities disagreed with this opinion and deemed that the company did have a PE in India. In their assessment, the tax authorities considered that the periods spent by the company on each project should be aggregated (which totaled more than nine months). The assessment also considered that the liaison office of its group company also served as a PE for the company itself. This was based on the notion that the projects it carried out in India were executed with the assistance of this office;
- ✓ As the matter reached the court for a final decision, the tax authorities' assessment was overturned. The court found that when treaty partners intend time to be aggregated, the DTA will specifically say so. As an example, the court noted that India's treaty with Australia provided that time spent on all projects should be aggregated when determining a PE. By contrast, the wording of the India – Mauritius DTA appeared to call for each project to be considered on an independent basis. In other words, the court found that each of the company's projects should be analyzed on a standalone basis and not aggregated;
- ✓ The court also found that the liaison office belonged to a separate legal entity that only performed preparatory and/or auxiliary activities. Considering that these activities were explicitly excluded from a PE under article 5(3) of the DTA, the liaison office could not constitute a PE;
- ✓ As a result of this decision, and ultimately as a result of a weaker DTA PE provision, India was not allowed to tax the income received by the company's operations in its territory.

Source: Income Tax Appellate Tribunal - Mumbai, J. Ray Mc Dermott Eastern vs Assessee on May 6, 2016 available at:

<https://indiankanoon.org/doc/23113879/>

For source States to guarantee and protect their taxable base, the definition of PE – namely through a strong duration test and anti-abuse clauses - is therefore extremely relevant as it establishes the minimum threshold needed for a company's activity to trigger a PE. Some States opt to only include the duration test for construction activities. For example, the DTA between the Republic of Italy and the Government of Canada, signed on June 3, 2002, determines that *"The term "permanent establishment" shall include especially: (...) g) a building site or construction or installation project only if it lasts for more than 12 months."*²⁷. For States with weaker tax administrations, this option has the downside of allowing further room for interpretation on other activities – such as technical services - which might lead to lengthy disputes with taxpayers. Resource rich States might thus want to consider adopting a provision that establishes a link between extractive industries and specific timelines. For example, in the DTA established between Australia and the Republic of Italy, from the 5th of November, 1985, it is mentioned that a PE will exist if *"substantial equipment is being used in that State for more than twelve months by, for or under contract with the enterprise in exploration for, or the exploitation of, natural resources, or in activities connected with such exploration or exploitation"*²⁸. This can be useful if States wish to establish a clear separation between extractive industries and other construction related activities and avoid potential policy discussions regarding the negative impact that a shorter duration test would have on other non-extractive-industry related investments²⁹. While companies in extractive industries are mostly attracted by the State's natural resources, companies that operate in other sectors will likely have other motives or incentives in their decision to invest (e.g. new consumers of its goods or services; decreasing costs of production by transferring production to locations with low labor costs; and/or tax incentives),³⁰ and a shorter duration test could potentially discourage some investors. By establishing different duration tests between extractive and non-extractive industries, States would be able to safeguard taxing rights for the former without potentially deterring other investments (e.g. a three month - period to trigger a PE for extractive industries and a twelve month- period for the remaining industries). For example, the

²⁷ DTA between the Republic of Italy and the Government of Canada, available at: https://www.fin.gc.ca/treaties-conventions/Italy_-eng.asp .

²⁸ DTA established between the Commonwealth of Australia and the Republic of Italy, available at: <http://www.austlii.edu.au/au/other/dfat/treaties/1985/27.html>

²⁹ In the absence of a separation, the duration test for an Oil & Gas activity would be the same as for building a new road. This means that changes in the general duration test would likely involve several stakeholders (e.g. Ministry responsible for the economy or foreign investment and construction companies). Establishing a separation between extractive and non-extractive industries would have the advantage of reducing the number of stakeholders involved in these discussions.

³⁰ Background Paper for the Eighth Columbia International Investment Conference on Investment Incentives: The good, the bad and the ugly Assessing the costs, benefits and options for policy reform, 2014, Columbia Center on Sustainable Investment, p. 12, available at: http://ccsi.columbia.edu/files/2014/01/VCC_conference_paper_-_Draft_Nov_12.pdf .

DTA between the Government of Republic of India and the Swiss Confederation, from the 21st of April, 1995³¹ distinguished between a building site or construction, installation or assembly project, or supervisory activities (which would require more than 6 months to trigger a PE) and the installation or structure used for the exploration or development of natural resources (more than 90 days to trigger a PE). However, it is also important to consider that this difference may require additional administrative resources from the tax administration, particularly when the same company performs activities in both extractive and non-extractive industries.

Another issue related to subcontractors occurs when a non-resident owner rents special equipment (e.g. a rig) to a company under the basis of a bareboat agreement³². In these cases, the rent paid by the company to the owner of the equipment will likely be treated as a royalty payment and thus will likely be subject to withholding tax. However, if the beneficial owner of those royalties (i.e. the entity that will actually benefit from those payments) is operating in the source State through a PE and the rent is linked to the business operation under which such PE exists, the rent will be included in the taxable income of the said PE (which might be beneficial to the source state when corporate income tax rates, applicable to the PE's income, are higher than the withholding tax that would be due otherwise)³³. Due to its complexity, a case-by-case analysis will be required in order to assess if the beneficial owner has a PE in the source State, and that a link exists between both activities.

Furthermore, the duration test should assess the actual duration of the activity as opposed to the intended duration. In other words, for tax purposes what is relevant is the actual presence and activity of the subcontractor and not the timeline agreed by both parties.

³¹ DTA between the Government of Republic of India and the Swiss Confederation, available at: <https://www.incometaxindia.gov.in/Pages/international-taxation/dtaa.aspx>.

³² A bareboat agreement refers to an arrangement whereby one party hires a boat or ship without the owner of that ship or boat providing any crew or technical assistance. The party that hires is therefore responsible for appointing the crew, operating expenses, insurance among other arrangements.

³³ The UN states that if the rent paid is classified as a royalty payment under the relevant DTA, "*royalty provisions apply unless the rent is beneficially owned by a resident of the other contracting state that carries on business in the source state through a PE in that state and the rent is effectively connected to that PE*". Some DTAs include payments for the rental of equipment in their definition of royalty (Proposed Guidance on Permanent Establishment in the Extractive Industries, 2016, Committee of Experts on International Cooperation in Tax Matters Thirteenth Session, United Nations, p.28).

Finally, it is also important to note that these thresholds of 6, 12 or 18 months were first established considering the technology and working methods of a specific period³⁴. In today's world, where construction can occur within shorter periods of time, source States may wish to question if the established timelines still make sense.

Withholding tax on technical services as an alternative to PE for States with weaker tax administrations

While in States where a strong tax administration exists, interpreting a PE clause that addresses extractive industries might not present an issue, policy makers in States where tax administrations do not have the resources to effectively fight tax evasion and/or avoidance might wish to consider a different approach. Several States have adopted withholding taxes on technical services, which although they are not specifically focused on extractive industries, would cover much of the operations performed by subcontractors. Recently, the UN's Subcommittee on Tax Treatment of Services has also proposed³⁵ to adjust the UN's model convention in order to include a new article that allows imposition of a withholding tax on payments for technical and other services made to non-residents at a rate to be negotiated by the contracting States. For the purpose of extractive industries, this can serve as an alternative for States that foresee interpretation problems with the definition of PE. The introduction of this clause would mean a country could impose a minimum level of taxation for companies that provide specific services (e.g. technical services to companies) even where they are not considered to have a PE.

One disadvantage of this approach is that withholding taxes are levied on the gross amount paid (i.e. they do not take into consideration the costs that companies incur) and therefore companies with smaller profit margins will have fewer incentives to operate where these taxes exist as they will further reduce the company's profit margin. In addition, withholding tax rates are normally lower than the domestic corporate income tax rates that would apply to domestic companies or non-residents that operate through a PE. This means that the implementation of a withholding tax on these services will likely result in the source States taxing a greater number of service providers (as it would be more difficult for them to avoid taxation), but at a lower tax rate. The ability to levy a withholding tax

³⁴ It is assumed that this threshold is the limit upon which it is reasonable to consider that there is a strong connection between the company's activity and the source State (i.e. the difference between trading with another State or trade within another State).

³⁵ Taxation of Services Report of the Coordinator (Ms. Liselott Kana), 2016, Subcommittee on Tax Treatment of Services, Committee of Experts on International Cooperation in Tax Matters Seventh session, United Nations, annex 1, available at: http://www.un.org/esa/ffd/wp-content/uploads/2016/10/12STM_CRP1_Services.pdf.

is also dependent on having the payer located in the country, which will not always be the case.

On a final note, this option could be adopted together with a broader definition of PE as long as a provision is included that makes it clear that the withholding tax shall only apply in the absence of a PE. If a PE is proven to exist, the non-resident should be taxed at the general domestic corporate income tax rate.

Example (withholding tax on fees for technical services provided by non-resident companies):

- Company A – resident of State A - is hired by company B to perform technical services in State B;
- **Prior to the withholding tax (WHT) on technical services:** State B (source State) was only able to tax the income derived by this operation if company A was deemed to have a PE. If a PE existed, the income would be taxable under the domestic corporate income tax rate. In the absence of a PE, State A (resident State) would have exclusive right to tax this income;
- **After the WHT on technical services:** adding this clause would result in company A being taxed in State B (source State), regardless of the existence of a PE. This tax would be collected in each payment made by company B to company A, thus resulting in less administrative costs for State B. Typically WHT differs from corporate income tax as it i) applies on the revenue received and thus does not allow for deductions of business expenses and others; ii) has a lower tax rate than corporate income tax.

The offshore clause

In an effort to preserve taxing rights, some source States with offshore petroleum resources have included “offshore clauses” in their DTAs. Under these clauses, companies that receive income from ‘offshore activities’ over a certain period of time will be deemed to have a PE in the source State, regardless of the general requirements for a PE. In other words, contrary to the general definition of PE, this clause enables source States to collect revenue from the majority of operations performed by non-residents as long as these companies are operating offshore. An example of this is Article 27(3) of the DTA established between the United States of America and the Kingdom of the Netherlands, in effect since January 1st, 1994³⁶, which states that: “*An enterprise of one of the States which carries*

³⁶ DTA between the United States of America and the Kingdom of the Netherlands Available at: <https://www.irs.gov/pub/irs-trty/nether.pdf> .

on offshore activities³⁷ in the other State shall, subject to paragraph 4 [which refers to auxiliary and preparatory activities], be deemed to be carrying on, in respect of those activities, business in that other State through a permanent establishment situated therein, unless the offshore activities in question are carried on in the other State for a period or periods not exceeding in the aggregate 30 days in a calendar year.”.

On a final note, when offshore activities take place, States should also consider the importance of correctly determining the geographical area covered by their DTAs³⁸. In the above example of the DTA between the Netherlands and the United States of America, “*the term "the Netherlands" comprises the part of the Kingdom of the Netherlands that is situated in Europe and the part of the sea bed and its sub-soil under the North Sea, over which the Kingdom of the Netherlands has sovereign rights in accordance with international law for the purpose of exploration for and exploitation of the natural resources of such areas, but only to the extent that the person, property, or activity to which this Convention is being applied is connected with such exploration or exploitation”.*

Example (offshore clause with a 30-day threshold):

- Company A, resident of State A, operates in the continental shelf of the state B for a 10-month period;
- The DTA between the both States has a general PE duration test threshold of 12-months for a building site or construction or installation project;
- **Prior to the offshore clause:** under the general rule, no PE would exist and thus State B (source State) would not be able to collect any revenue;
- **After the offshore clause:** adding the offshore clause would result in company A having a PE (as it would surpass the 30-day limit), and thus it would be obliged to pay income tax in the state B on the profits it obtained from that operation.

³⁷ Article 27 (2) of the same DTA establishes that “offshore activities” refers to “*activities which are carried on offshore in connection with the exploration or exploitation of the seabed and its sub-soil and their natural resources, situated in one of the States.*”.

³⁸ Further information on this topic is available in Maja Stubbe Gelineck’s article “Permanent Establishments and the Offshore Oil and Gas Industry – Part 1”, 2016, IBFD - Bulletin for international taxation, available at: https://www.ibfd.org/sites/ibfd.org/files/content/pdf/bit_2016_04_int_3.pdf .

IV. Base Erosion Profit Shifting

As previously mentioned, in recent years the international community has paid much attention to the harmful effects of tax evasion and aggressive tax planning. The best example of this is the OECD's BEPS project³⁹, which is aimed at assisting governments to find solutions to close existing loopholes that allow companies to shift profits to lower tax jurisdictions. Despite BEPS taking a general approach – and thus not focused on a specific industry – some recommendations presented by the OECD are still relevant for natural resource rich States.

Artificial avoidance of PE status through contract splitting and the specific activity exemptions

As previously discussed in the subsection on subcontractors, many companies have searched for ways to circumvent the PE criteria. This is especially true in activities leading up to the production stage and/or the supplemental activities involved in maintaining or terminating production. In some cases, companies opt to divide or “split” long-term contracts into short-term contracts purposely created to avoid the threshold established by the duration test (commonly known as contract splitting). In other cases, companies divide or “fragment” their operations with the objective of separating activities that may be deemed to have a preparatory or auxiliary nature (known as artificial avoidance of PE status through the specific activity exemptions, hereinafter referred to as fragmentation of activities and/or misuse/abuse of specific activity exemptions⁴⁰). As these preparatory or auxiliary activities are explicitly excluded from most PE definitions, companies are able to avoid being taxed at source on the income they receive from providing these services/works. Finally, the decision to split a contract can also lead to the decision of fragmentation of activities, in which case the two practices would overlap.

Although it is often clear that abusive tactics are the motivation behind specific companies' structures, proving those situations may turn out to be a complex task for the tax administration. Contract splitting, for example, can have dire consequences for source States, especially in cases where DTAs do not allow for the aggregation of time spent in similar projects. That being said, the OECD released a set of recommendations under Action 7 of the BEPS

³⁹ Further information on this topic is available at: <http://www.oecd.org/tax/beps/>.

⁴⁰ This method of artificial avoidance of PE aims to take advantage of the list of PE exceptions that exist in most DTAs (as per our comments on the general description of PE clauses in DTAs, described in Section II of this briefing).

report on the topic of “Preventing the Artificial Avoidance of Permanent Establishment Status”⁴¹, including by contract splitting and the fragmentation of activities and/or misuse/abuse of specific activity exemptions. According to one of OECD’s suggestions under Action 7, States that are concerned with the harmful effects of contract splitting and do not wish to rely solely on the general anti-abuse clause in their domestic law⁴², might wish to adopt a specific clause aimed at tackling this issue by establishing a link between short-term contracts performed by the same company (or a closely related entity) in the same area within a specific period of time. If such link exists, the several short-term operations shall be treated as one for the purpose of assessing the existence of a PE. Action 7 also helped re-shape the OECD’s model convention by addressing other common strategies used by companies to avoid having a taxable presence in a country under a DTA. For example, in the list of activities that are excluded from the definition of PE for being considered of preparatory or auxiliary nature, the OECD model convention now includes an anti-abuse provision that is aimed at tackling the fragmentation of a business operation into several “auxiliary” projects. In an effort to avoid interpretation problems, this revised convention also defines the meaning of closely related companies and clarifies that this can include independent companies that are subject to the “control”/supervision of the main contractor (i.e. this does not necessarily involve share ownership but rather decision making power over the company’s operation), as well as group companies (i.e. involving share ownership)⁴³. If the related/group companies and independent contractors can be legally tied to the producing company, in most cases all of them will be seen as having PEs under the specific anti-fragmentation rules.⁴⁴ However, as most DTAs are already in force, adopting the recommendations that were provided under Action 7’s

41 Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report, OECD, 2015, available at: <http://www.oecd.org/ctp/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report-9789264241220-en.htm> .

42 Despite the fact that DTAs have a stronger legal value than domestic law, the latter can still be used in the absence of a treaty provision that covers the same topic. This means that if a State considers that a company is abusing the rights provided by a DTA, a domestic anti-abuse clause can be invoked as a way to protect the State’s rights. These provisions are normally very broad as they are aimed at providing tax administrations some flexibility to tackle abuse mechanisms that lead to tax avoidance. Contrary to specific anti-abuse clauses, general anti-abuse clauses are not normally included in DTAs. As the UN points out in their commentaries to their model tax convention: “(...) *Many countries, however, will consider that including such a provision in their treaties could be interpreted as an implicit recognition that, absent such a provision, they cannot use other approaches to deal with improper uses of tax treaties. This would be particularly problematic for countries that have already concluded a large number of treaties that do not include such a provision*” (United Nations Model Double Taxation Convention between Developed and Developing Countries, p. 49).

43 For the purpose of this new provision, a new paragraph 8 in article 5 [on PE] defines closely related enterprises as a situation where “based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company’s shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company’s shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises”.

44 For further clarification also see: Additional Guidance on the Attribution of Profits to Permanent Establishments, BEPS Action 7, OECD, 2018, available at: www.oecd.org/tax/beps/additional-guidance-attribution-of-profits-to-a-permanent-establishment-under-bepsaction7.htm .

effort to tackle tax avoidance would require intense – and somewhat unrealistic - bilateral negotiations between several States with unpredictable outcomes which could ultimately defeat the purpose of the recommendations provided by the BEPS project⁴⁵. As a result, the OECD's Multilateral Convention, explained in greater detail below, was developed.

It is nonetheless interesting to note that some DTAs were already in line with the final output of the recommendations of Action 7. For example, a similar anti abuse mechanism to prevent associated companies from dividing contracts to avoid a PE was also adopted in the above mentioned DTA between United States and the Kingdom of the Netherlands⁴⁶. The relevant clause provides that if a company (company A) operating offshore is associated with another company (company B) that is also carrying out operations offshore in the same project, the period of time that both companies spend in their respective activities shall be aggregated to assess if the 30-day duration test has been met. Provided that this period of time has passed, both companies will be treated as having a PE and will be taxed accordingly.

It is important to clarify that the fact that a subcontractor performs several different operations does not necessarily mean that it does so to avoid triggering a PE. Subcontractors might perform several different tasks for different clients and in different contractual areas and thus – like in any other case where anti-abuse clauses are being considered – a case by case analysis will be required.

Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

As previously mentioned, the OECD introduced the Multilateral Convention to bypass bilateral negotiations of existing DTAs and as a way to promote the implementation of the BEPS recommendations in a more efficient way.

⁴⁵ As previously mentioned, DTAs serve as a way to attribute taxing rights between States. While source States – in the absence of fair DTA provisions– tend to lose with this attribution, resident States tend to benefit. This means that in some cases while the former have an incentive to amend their DTA provisions, the later have the incentive to continue to benefit from these provisions.

⁴⁶ Article 27 (3) "(...)For the purposes of this paragraph: a) where an enterprise carrying on offshore activities in the other State is associated with another enterprise and that other enterprise continues, as part of the same project, the same offshore activities that are or were being carried on by the first-mentioned enterprise, and the afore-mentioned activities carried on by both enterprises - when added together - exceed a period of 30 days, then each enterprise shall be deemed to be carrying on its activities for a period exceeding 30 days in a calendar year; b) an enterprise shall be regarded as associated with another enterprise if one holds directly or indirectly at least one third of the capital of the other enterprise or if a person holds directly or indirectly at least one third of the capital of both enterprises".

Through the Multilateral Convention, States are able to update their tax treaties through a single instrument that establishes both a number of minimum standards that States are obliged to comply, as well as additional measures that States may or may not opt to include in their DTAs – which is to be negotiated on a bilateral basis.

For the purpose of PE, the Multilateral Convention allows States to adopt specific clauses to prevent the avoidance of a PE status through the fragmentation of activities and/or misuse/abuse of specific activity exemptions (article 13 of the Multilateral Convention – annex I to this briefing report), and contract splitting (article 14 of the Multilateral Convention – annex II to this report) – both explained in greater detail and with practical examples below. In addition, the Multilateral Convention also proposed some much-needed general anti-avoidance rules, such as the Principle Purpose Test (PPT) or the Simplified Limitation on Benefits (S-LOB). If implemented, these rules provide States with more flexibility to tackle tax evasion and avoidance including the possibility of denying a tax treaty benefit if it is clear that obtaining this benefit was one of the principal purposes of an arrangement or transaction⁴⁷.

Ideally, the use of the PPT or S-LOB clauses should be used in coordination – and not in replacement off – the specific anti PE abuse clauses mentioned above. This would deter companies from seeking loopholes to shift their profits abroad and it would also give more powers to source States by providing additional clarity on the intentions behind the PE clause. For the purpose of extractive industries these recommendations are well received as they provide source States with mechanisms to fight the artificial avoidance of PE through different highly specialized services – such as those performed by subcontractors. The main points of these recommendations can be summarized below:

Anti-fragmentation rules:

- ✓ specific activity exemptions (i.e. preparatory or auxiliary nature) do not apply when either (1) a non-resident company or a closely related company carries on its business activities through a PE in the source country and it also performs other activities that – although auxiliary in nature – are part of a cohesive business

⁴⁷ Article 7 (1) on the Prevention of Treaty Abuse, of the Multilateral Convention states that “*Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.*”.

operation; or (2) the combination of activities carried on by a non-resident company and a different, but closely related company, result in a cohesive business operation that cannot be considered to be of merely “preparatory or auxiliary nature”.

Example (fragmentation of activities and/or misuse/abuse of specific activity exemptions):

- Company A was hired by company B to assist in the construction of offshore platforms for oil exploration (which is not an auxiliary activity in itself). To perform these works, both companies entered into several contracts that were deemed to be considered auxiliary on an individual level (e.g. stockpile of products);
- **Prior to adopting anti-fragmentation rules:** company A could argue that each activity is merely auxiliary and therefore excluded from the general definition of PE. The real consequences of this example are perhaps best demonstrated in the above-mentioned court decision in the case that opposed the Indian Tax Authorities and J. Ray McDermott Eastern Hemisphere Ltd;
- **After adopting anti-fragmentation rules:** the tax administration can argue that the company’s operation should be viewed as a whole and not merely on an individual project level. In other words, the exclusion for auxiliary/preparatory activities should only apply when considering the overall activity of company A and not on an activity by activity basis.

Anti contract-splitting rules:

- ✓ Aggregation of time spent performing activities at a place that constitutes a building site, construction project, installation project or other specific project identified in the relevant DTA, as long as these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days;
- ✓ Aggregation of time performing connected activities in a place that constitutes a building site, construction project, installation project or other specific project identified in the relevant DTA, if these activities are carried out during different periods of time, each exceeding 30 days, by one or more closely related companies.

Example (contract-splitting):

- Company B, resident of State B, is hired by company A to perform technical services in a mining operation in State A for a period of 7 months. In order to avoid an increase in the overall cost of the operation as a result of taxation, company A and company B divide the said operation into three different contracts (e.g. first contract of two months, a second contract of two months and an additional contract of three months). These contracts are all different in nature, but their overall objective is identical;
- **Prior to adopting anti contract-splitting rules:** State A (source State) would have to depend on domestic anti-abuse legislation and waste resources arguing that the division of contract existed purely for tax avoidance reasons;
- **After adopting anti contract-splitting rules:** State A would automatically aggregate the duration spent in each contract as long as the operations occurred in the same area and project.

As noted above, unfortunately the OECD decided to provide some flexibility that allows States to divert from the general idea of the Multilateral Convention and the BEPS project. On one hand, it grants States the possibility to decide which DTA it wishes to be covered by the Multilateral Convention. This, in itself, favours States that benefit from the current DTAs and ignores the problems created by DTAs in developing countries. In addition, not all provisions of the Multilateral Convention are mandatory. As noted in paragraphs 6 and 3 of articles 13 and 14 respectively (see Annexes I and II), the OECD opted to provide contracting States with some flexibility on the issue of PE, especially when it comes to provisions relating to the exploration for or exploitation of natural resources. This in turn has resulted in many States opting out of these new standards, thus jeopardizing the efforts of the project itself⁴⁸⁴⁹. For obvious reasons, this presents an issue that needs to be addressed either by bilateral negotiations or by enforcing domestic anti-abuse legislation. By enabling States to opt out of these clauses, the OECD allows for

⁴⁸ According to KPMG, a few jurisdictions "(...) opted out of the anti-fragmentation rule, including Germany, Luxembourg and Singapore. In addition, some jurisdictions opted out of the specific activity exemption rule changes altogether, including Canada, China, Hong Kong, Korea and Switzerland. (...) Many jurisdictions opted out of the rule relating to splitting up contracts, but some elected to adopt the rule (although some only with respect to activities other than natural resource exploration and exploitation), including Argentina, Australia, France, India, Indonesia, Ireland, the Netherlands and New Zealand". Available at: <https://home.kpmg.com/xx/en/home/insights/2017/06/tnf-kpmg-analysis-mli-implementing-treaty-related-beps.html> (last visited 14/11/2017).

⁴⁹ In an article for Tax Notes, Lewis raised concerns about the fact that only 15% of signatory States have signed these optional standards and that many of the States that raised reserves against these provisions "are OECD countries or countries that are commonly used for outbound foreign direct investment" (Lewis, A., "The Year in Review: The MLI: Advancing International Tax Policy, One Ratification at a Time", 12/27/17, Tax Notes).

the continuation of the same harmful tactics it originally set out to fight against. Another point worth mentioning is the fact that the main two BEPS outputs (i.e. the Multilateral Convention and the revised OECD model convention) should have been aligned in their objective to tackle tax evasion and avoidance mechanisms. However, if we analyze the different provisions that exist in the two instruments, the reality is that the provisions adopted in the 2017 revised OECD model convention tend to protect source States far more than the provisions established under the Multilateral Convention. This is especially problematic if we consider that most States have already adopted DTAs, and therefore the Multilateral Convention was clearly the legal instrument that could have had more impact in tackling these harmful practices. As an example, while the revised 2017 OECD model convention specifically clarifies that any exemption from PE must be of preparatory or auxiliary nature, the Multilateral Convention still leaves this door open for interpretation of whether the activities provided in the list of exceptions need to have a preparatory or auxiliary nature (see Annex I - option A no2.a) of article 13 of the Multilateral Convention). As a result, DTAs that are not aligned with the latest OECD convention may maintain a loophole that allows an interpretation of this exception clause that is disadvantageous for the source State. This can be the result of several factors, but one might question the important role that OECD member countries and multinational companies played in the decision-making process of the BEPS project as compared to the capital importing countries that are usually non –OECD members⁵⁰. Overall, the idea of the BEPS project can be viewed as a positive change as it intends to provide source States with the necessary tools to fight aggressive tax planning mechanisms that are practiced by many multinational companies⁵¹. However, by providing options for States to implement specific clauses, the BEPS project can also be seen as missed opportunity to champion real change.

⁵⁰ According to Action Aid, 87 per cent of responses to the BEPS consultation on country-by country reporting were sent by companies. The same organization also states that non-members of the OECD or G20 played a very limited role in the overall discussions (ActionAid, *Levelling Up: Ensuring a fairer share of corporate tax for developing countries*, 2015, p. 18, available at https://www.actionaid.org.uk/sites/default/files/publications/levelling_up_final.pdf).

⁵¹ Despite its problems, the Multilateral Convention still introduces some important changes, such as topics such as the clarification that DTA's main intention is to eliminate double taxation without creating opportunities for non-taxation, or the introduction of a mandatory principal purpose test or a limitation of benefits, both aimed at tackling treaty shopping.

V. A way forward

Considering all the issues that revolve around the concept of PE from an extractive industries perspective, policy makers from natural resource rich States might thus wish to scrutinize the literature for potential dangers in negotiating and signing DTAs. As previously mentioned, in the presence of a strong domestic legislation claiming taxing rights on source country income, a country may wish to carefully evaluate the wisdom of entering into a DTA, particularly where there is only limited evidence that a DTA will serve as a way to attract foreign direct investment⁵². Resource rich countries like Angola⁵³ or Timor-Leste⁵⁴ have been able to attract major multinational companies without signing any DTAs.

If the decision is made to opt for a DTA, it is advisable that governments seek to diverge from the model tax conventions – including the revised OECD model convention and the UN model convention - and include specific provisions that best protect their interests. As we have seen in the examples of the DTAs between the Netherlands and the US or between Australia and Italy, several resource rich States have already taken measures to mitigate the possible negative effects of DTAs. Our recommendations should also be taken into consideration when evaluating domestic legislation and the wording of concessions agreements related to extractive industries. This means that DTAs, domestic legislation and concession agreements, all need to be aligned in order to guarantee that taxing rights acquired through one mechanism (e.g. domestic tax law) are not given away by another (e.g. weak DTA). Ideally, in order to avoid confusion and possible disputes, concession agreements should not include tax provisions, stabilization clauses etc. These provisions can be an issue in the event of future amendments to the

⁵² Hearson, Martin, Measuring tax treaty negotiation outcomes: the Action Aid tax treaties dataset, 2016, Institute of Development Studies, International Centre for Tax and Development, p.10, available at: <http://www.ictd.ac/publication/2-working-papers/99-measuring-tax-treaty-negotiation-outcomes-the-actionaid-tax-treaties-dataset>

⁵³ It should be noted however that there have been some reports that Angola is negotiating DTAs with a few countries, namely Portugal and more recently the United Arab Emirates (as per the Angolan press release of the “Agência Angola Press” of December 2017, available at http://www.angop.ao/angola/en_us/noticias/politica/2017/11/49/Angola-and-negotiate-double-taxation-agreement.3b1c0c5a-d437-43a1-8e33-270b5e091a31.html).

In the case of Timor-Leste, a DTA was negotiated with the Portuguese Government. The final agreement was approved and published by the Portuguese authorities in 2012, but it still lacks proper approval on the Timorese side. As a result, to this day the DTA is still not valid for both contracting States (information available at: http://info.portaldasfinancas.gov.pt/pt/informacao_fiscal/convencoes_evitar_dupla_tributacao/convencoes_tabelas_doclib/Documents/Tabela_CDTs_2017.pdf (p.7 and 8)).

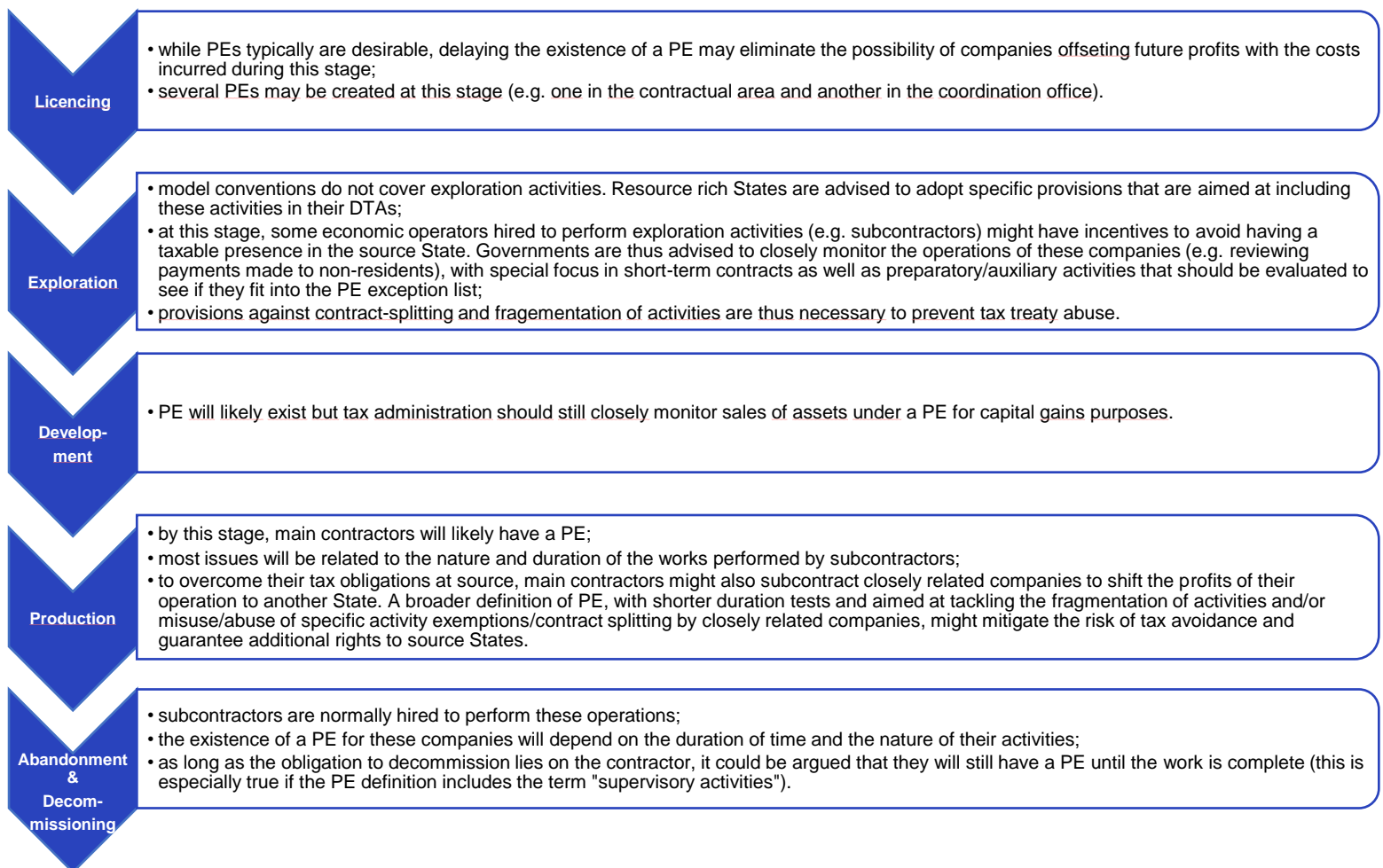
⁵⁴ In the case of Timor-Leste, the domestic legislation (under the Private Investment Law no. 15/2011) already allows for generous tax incentives, including tax breaks of up to 10 years. The country was also able to attract major foreign direct investors such as the Heineken Group (for further information see: <http://timor-leste.gov.tl/?p=11061&lang=en>) and Bolloré (for further information see: <http://timor-leste.gov.tl/?p=15648&lang=en>); although whether this is the result of tax incentives or other factors is also questionable.

domestic legislation and/or the applicable DTA, where legal interpretation problems may occur. Further, having relevant tax rules spread out over a number of instruments, for example the tax law, DTAs and concession agreements, also has the downside of complicating the work of tax authorities and – to a point – increasing compliance costs for private investors as both parties will have to assess which activities are covered by the different legal instruments.

Key recommendations

Adopt a broader and contextualized definition of PE

An initial measure to consider is adopting a broad definition of a PE in DTAs that can guarantee that each investment stage is covered:



As previously discussed, the objective of DTAs is to reduce the negative impact of double taxation through the allocation of taxing rights to the State of residence and to the State of source. While this objective can appear mutually beneficial for both types of States in the context of extractive industries, it is often not the case. In other words, if country A has natural resources but no resident extractive industry, there is relatively no point in abdicating its right to tax non-resident companies on their operations at source as it will not benefit from this skewed taxing right (i.e. since country A does not have such an industry that would operate abroad). In these situations, it is advisable that resource rich States adopt a PE provision that increases their rights to tax at source exclusive of an equivalent provision for the other treaty State. An example of the wording that might be adopted is included in Annex III to this briefing report.

This PE sample clause in Annex III assumes an approach based on the UN model convention and the BEPS project (including the new provisions introduced by the revised 2017 OECD model tax convention), while at the same taking into consideration some elements that are relevant for resource rich States. Specifically, it tackles contract splitting and the fragmentation of activities and/or misuse/abuse of specific activity exemptions (e.g. allowing for the aggregation of time spent on similar projects). Special attention should be given in deciding the duration test for these activities to trigger a PE (*i.e.*, the shorter this threshold is, the more tax rights source States will have) and anti-fragmentation rules. Policy makers may also consider enacting separate provisions for extractive and non-extractive industries. Finally, the PE clause should be adjusted for each context and to take into consideration the capacity of the tax administration as well as the different investment projects that exist – or will likely exist – in the State. Annex III provides different options for policy makers to adjust to their specific context.

Introducing an offshore clause

In addition to broadening the definition of PE, resource rich States might also want to consider including an offshore clause in their DTAs (when applicable). Following the example above provided of the DTA between the Netherlands

and the US, annex IV offers a similar sample offshore clause⁵⁵ for policy makers to consider. Once again, this clause merely serves as an example and should be adjusted in accordance with the State's context.

Specific measures for States with weaker tax administrations

As some of these proposals – especially the offshore clause – will likely contribute to a significant increase in taxing rights, it is important to realize that they will also likely result in an increase in the source States administrative costs. In developing countries, where tax administrations will typically lack the necessary resources to deal with lengthy and complex tax disputes, this might become a challenge. In addition, even if States reduce the timeline of the duration test, it is important to note that service providers will still have an incentive to structure investments in order to avoid that threshold. Thus, introducing a withholding tax for specific technical services has the advantage of avoiding behavior changes from service providers (as this would not result in less taxation) as well as reduced compliance and administrative costs for both taxpayers and the tax administration. As previously mentioned, this option could exist in combination with the remaining options. Annex V provides a similar wording to that adopted by the DTA established between the Government of the Republic of India and the Royal Government of Bhutan⁵⁶ and can be used as a basis for policy discussions⁵⁷.

⁵⁵ The wording of this clause is identical to the one in the said DTA, with the exception of the last paragraph which states that: "*Where documentary evidence is produced that tax has been paid in the United States on the items of income that may be taxed in the United States according to Article 7 (Business Profits) or Article 15 (Independent Personal Services) in connection with respectively paragraph 3 or paragraph 5 of this Article, and according to paragraph 6 of this Article, the Netherlands shall allow a reduction of its tax, which shall be computed in conformity with the rules laid down in paragraph 2 of Article 25 (Methods of Elimination of Double Taxation)*".

⁵⁶ Available at: <https://www.incometaxindia.gov.in/Pages/international-taxation/dtaa.aspx> .

⁵⁷ Some States opted to include this withholding tax within the article for royalties. This has the advantage of creating a less extensive DTA (as opposed to creating two different articles that would operate in a similar way), but policy makers might wish to consider establishing different tax rates for both types of income.

Annex I – Multilateral Convention article 13 – Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions

1. A Party may choose to apply paragraph 2 (Option A) or paragraph 3 (Option B) or to apply neither Option.

Option A

2. Notwithstanding the provisions of a Covered Tax Agreement that define the term “permanent establishment”, the term “permanent establishment” shall be deemed not to include:

a) the activities specifically listed in the Covered Tax Agreement (prior to modification by this Convention) as activities deemed not to constitute a permanent establishment, whether or not that exception from permanent establishment status is contingent on the activity being of a preparatory or auxiliary character;

b) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in subparagraph a);

c) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b), provided that such activity or, in the case of subparagraph c), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.

Option B

3. Notwithstanding the provisions of a Covered Tax Agreement that define the term “permanent establishment”, shall be deemed not to include:

a) the activities specifically listed in the Covered Tax Agreement (prior to modification by this Convention) as activities deemed not to constitute a permanent establishment, whether or not that exception from permanent establishment status is contingent on the activity being of a preparatory or auxiliary character, except to the extent that the relevant provision of the Covered Tax Agreement provides explicitly that a specific activity shall be deemed not to constitute a permanent establishment provided that the activity is of a preparatory or auxiliary character;

b) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in subparagraph a), provided that this activity is of a preparatory or auxiliary character;

c) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

4. A provision of a Covered Tax Agreement (as it may be modified by paragraph 2 or 3) that lists specific activities deemed not to constitute a permanent establishment shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting Jurisdiction and:

a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of a Covered Tax Agreement defining a permanent establishment; or

b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character, provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

5. a) Paragraph 2 or 3 shall apply in place of the relevant parts of provisions of a Covered Tax Agreement that list specific activities that are deemed not to constitute a permanent establishment even if the activity is carried on through a fixed place of business (or provisions of a Covered Tax Agreement that operate in a comparable manner).

b) Paragraph 4 shall apply to provisions of a Covered Tax Agreement (as they may be modified by paragraph 2 or 3) that list specific activities that are deemed not to constitute a permanent establishment even if the activity is carried on through a fixed place of business (or provisions of a Covered Tax Agreement that operate in a comparable manner).

6. A Party may reserve the right:

a) for the entirety of this Article not to apply to its Covered Tax Agreements;

b) for paragraph 2 not to apply to its Covered Tax Agreements that explicitly state that a list of specific activities shall be deemed not to constitute a permanent establishment only if each of the activities is of a preparatory or auxiliary character;

c) for paragraph 4 not to apply to its Covered Tax Agreements.

7. Each Party that chooses to apply an Option under paragraph 1 shall notify the Depository of its choice of Option. Such notification shall also include the list of its Covered Tax Agreements which contain a provision described in subparagraph a) of paragraph 5, as well as the article and paragraph number of each such provision. An Option shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have chosen to apply the same Option and have made such a notification with respect to that provision.

8. Each Party that has not made a reservation described in subparagraph a) or c) of paragraph 6 and does not choose to apply an Option under paragraph 1 shall notify the Depository of whether each of its Covered Tax Agreements contains a provision described in subparagraph b) of paragraph 5, as well as the article and paragraph number of each such provision. Paragraph 4 shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have made a notification with respect to that provision under this paragraph or paragraph 7.

Annex II – Multilateral Convention article 14 – Splitting-up of Contracts

1. For the sole purpose of determining whether the period (or periods) referred to in a provision of a Covered Tax Agreement that stipulates a period (or periods) of time after which specific projects or activities shall constitute a permanent establishment has been exceeded:

a) where an enterprise of a Contracting Jurisdiction carries on activities in the other Contracting Jurisdiction at a place that constitutes a building site, construction project, installation project or other specific project identified in the relevant provision of the Covered Tax Agreement, or carries on supervisory or consultancy activities in connection with such a place, in the case of a provision of a Covered Tax Agreement that refers to such activities, and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding the period or periods referred to in the relevant provision of the Covered Tax Agreement; and

b) where connected activities are carried on in that other Contracting Jurisdiction at (or, where the relevant provision of the Covered Tax Agreement applies to supervisory or consultancy activities, in connection with) the same building site, construction or installation project, or other place identified in the relevant provision of the Covered Tax Agreement during different periods of time, each exceeding 30 days, by one or more enterprises closely related to the first-mentioned enterprise, these different periods of time shall be added to the aggregate period of time during which the first mentioned enterprise has carried on activities at that building site, construction or installation project, or other place identified in the relevant provision of the Covered Tax Agreement.

2. Paragraph 1 shall apply in place of or in the absence of provisions of a Covered Tax Agreement to the extent that such provisions address the division of contracts into multiple parts to avoid the application of a time period or periods in relation to the existence of a permanent establishment for specific projects or activities described in paragraph 1.

3. A Party may reserve the right:

a) for the entirety of this Article not to apply to its Covered Tax Agreements;

b) for the entirety of this Article not to apply with respect to provisions of its Covered Tax Agreements relating to the exploration for or exploitation of natural resources.

4. Each Party that has not made a reservation described in subparagraph a) of paragraph 3 shall notify the Depository of whether each of its Covered Tax Agreements contains a provision described in paragraph 2 that is not subject to a reservation under subparagraph b) of paragraph 3, and if so, the article and paragraph number of each such provision. Where all Contracting Jurisdictions have made such a notification with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by the provisions of paragraph 1 to the extent provided in paragraph 2. In other cases, paragraph 1 shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with paragraph 1.”.

Annex III – Proposed PE clause from an extractive industries’ perspective

(1) For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

(2) The term "permanent establishment" shall include:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;

(f) a warehouse, in relation to a person providing storage facilities for others;

(g) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources; and

(h) an installation or structure used for the exploration of natural resources.

(3) The term “permanent establishment” also encompasses:

(a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities (whether separately or together with other sites, projects or activities) last more than [**comment: ideally not more than six months**];

(b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than [**comment: ideally, not more than six months**] in any 12-month period commencing or ending in the fiscal year concerned; [**comment: if policy makers wish to separate between extractive and non-extractive industries, we suggest including an additional paragraph c)**]

(c) Activities mentioned in subparagraphs (a) and (b) above, as well as the use of substantial equipment, for more than [comment: the minimum duration possible in order to guarantee tax revenue (e.g. between 30 days and three months)] by, for or under contract with an enterprise in exploration for, or the exploitation of, natural resources, or in activities connected with such exploration or exploitation.

(3.1) For the sole purpose of determining whether the period (or periods) referred to in paragraph (3) has been exceeded:

- a) where an enterprise of a Contracting State carries on activities in the other Contracting State at a place that constitutes a building site, construction project, installation project or carries on supervisory or consultancy activities in connection with such a place, and these activities are carried on during one or more periods of time that, in the aggregate, exceed 30 days without exceeding the period or periods referred to in paragraph (3); and
- b) where connected activities to those performed by that same enterprise are carried on in that other Contracting State during different periods of time, each exceeding 30 days, by one or more enterprises closely related to the first-mentioned enterprise, these different periods of time shall be added to the aggregate period of time during which the first mentioned enterprise has carried on the activities identified in paragraph (3).

(4) Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include:

- (a) The use of facilities solely for the purpose of storage or display 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 or display;
- (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 of collecting information, for the enterprise;
- (e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity;
- (f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e);

provided that such activity or, in the case of subparagraph f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.

(4.1) Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and:

a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or

b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

(5) Notwithstanding the provisions of paragraphs 1 and 2, where a person—other than an agent of an independent status to whom paragraph 7 applies—is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:

(a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or

(b) 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.

(6) Notwithstanding the preceding provisions of this Article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.

(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 business in that other State through a broker, general commission

agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status within the meaning of this paragraph.

(8) 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.

(9) For the purposes of this Article, a person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises.

Annex IV– Proposed offshore clause

1. The provisions of this Article shall apply notwithstanding any other provision of this Convention. However, this Article shall not apply where offshore activities of a person constitute for that person a permanent establishment under the provisions of Article [Permanent Establishment] or a fixed base under the provisions of Article [Independent Personal Services].
2. In this Article the term "offshore activities" means activities which are carried on offshore in connection with the exploration or exploitation of the seabed and its sub-soil and their natural resources, situated in one of the States.
3. An enterprise of one of the States which carries on offshore activities in the other State shall, subject to paragraph 4, be deemed to be carrying on, in respect of those activities, business in that other State through a permanent establishment situated therein, unless the offshore activities in question are carried on in the other State for a period or periods not exceeding in the aggregate 30 days in a calendar year. For the purposes of this paragraph:
 - a) where an enterprise carrying on offshore activities in the other State is associated with another enterprise and that other enterprise continues, as part of the same project, the same offshore activities that are or were being carried on by the first-mentioned enterprise, and the afore-mentioned activities carried on by both enterprises - when added together - exceed a period of 30 days, then each enterprise shall be deemed to be carrying on its activities for a period exceeding 30 days in a calendar year;
 - b) an enterprise shall be regarded as associated with another enterprise if one holds directly or indirectly at least one third of the capital of the other enterprise or if a person holds directly or indirectly at least one third of the capital of both enterprises.
4. However, for the purposes of paragraph 3, the term "offshore activities" shall be deemed not to include:
 - a) one or any combination of the activities mentioned in paragraph [...] of Article [paragraph regarding the exclusion of auxiliary or preparatory activities from the definition of Permanent Establishment];
 - b) towing or anchor handling by ships primarily designed for that purpose and any other activities performed by such ships; or
 - c) the transport of supplies or personnel by ships or aircraft in international traffic.

5. A resident of one of the States who carries on offshore activities in the other State, which consist of professional services or other activities of an independent character, shall be deemed to be performing those activities from a fixed base in the other State if the offshore activities in question last for a continuous period of 30 days or more.
6. Salaries, wages and other similar remuneration derived by a resident of one of the States in respect of an employment connected with offshore activities carried on through a permanent establishment in the other State may, to the extent that the employment is exercised offshore in that other State, be taxed in that other State.

Annex V – Withholding tax on technical services

Royalties and fees for technical or professional services

1. Royalties or fees for technical or professional services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. However, such royalties or fees for technical or professional services may also be taxed in the Contracting State in which they arise, and according to the laws of that State, but if the beneficial owner of the royalties or fees for technical or professional services is a resident of the other Contracting State the tax so charged shall not exceed [withholding tax rate applicable for these activities] per cent of the gross amount of the royalties or fees for technical or professional services.
3. (a) The term "royalties" as used in this ARTICLE means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films or films or tapes used for television or radio broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.

(b) The term "fees for technical or professional services" as used in this ARTICLE means payments of any kind, other than those mentioned in Articles [Article related to dependent personal services such as salaries and wages] of this Agreement as consideration for—
 - (i) managerial or technical or consultancy services, including the provision of services of technical or other personnel; or
 - (ii) professional services including independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, surgeons, dentists and accountants.
4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for technical or professional services being a resident of a Contracting State, carries on business in the other Contracting

State in which the royalties or fees for technical or professional services arise, through a permanent establishment situated therein and the right or property in respect of which the royalties or fees for technical or professional services are paid is effectively connected with such permanent establishment. In such case the provisions of ARTICLE [article related to the definition of business profits] read with ARTICLE [article related to the definition of PE] of the Agreement shall apply.

5. (a) Royalties and fees for technical or professional services shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority, or a resident of that State. Where, however, the person paying the royalties or fees for technical or professional services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the liability to pay the royalties or fees for technical or professional services was incurred, and such royalties or fees for technical or professional services are borne by such permanent establishment, then such royalties or fees for technical or professional services shall be deemed to arise in the Contracting State in which the permanent establishment is situated.

(b) Where under sub-paragraph (a) royalties or fees for technical or professional services do not arise in one of the Contracting States, and the royalties relate to the use of, or the right to use, the right or property, or the fees for technical or professional services relate to services performed, in one of the Contracting States, the royalties or fees for technical or professional services shall be deemed to arise in that Contracting State.

6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for technical or professional services, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this ARTICLE shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Agreement.

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