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by

Adolfo Martín Jiménez*

1. Introduction

In appearance, the one-sentence wording of article 5(3) of the OECD Model seems very simple: "A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months."

It is, however, a rather complex clause if account is taken that (i) it very much reflects all the problems connected with the permanent establishment (PE) concept and its evolution along the years, (i) due to the "mobility" of construction works, article 5(3) of the OECD Model was the precursor of very relevant changes to the PE concept and the Commentary on Article 5 of the OECD Model in its different versions from 1977, (iii) the same clause in the UN Model seems to have a different nature, (iv) construction PEs have been affected by the OECD base erosion and profit shifting (BEPS) works in a very relevant form, (v) despite clarifications to the OECD Commentary on Article 5(3) in 2017 very relevant interpretative doubts remain unresolved, and, last but not least, (vi) construction projects and contracts can be intricate and affect a number of different types of taxpayers and activities.

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Complexity makes interpretation difficult and may lead countries to hold divergent positions on the application of article 5(3) of the OECD Model. Therefore, this chapter will explore the problems of interpretation of such an article. For that purpose, it will start in section 2 with a historical study in order to explain the nature of the construction PE, the contradictions in this concept that are evident in the evolution of the construction PE and the geographical and commercial coherence tests that were born in the context of article 5(3) of the 2017 OECD Model to explain and, if possible, avoid some of those contradictions. As will be shown, the commercial and geographical coherence tests, if interpreted differently by the source and residence states, which is not difficult, may cause asymmetries and different views on whether or not there is a PE with outcomes that can be detrimental either for states or for the taxpayers, depending on the situation.

Second, the UN version of the construction PE (article 5(3)(a) of the UN Model) represents a different PE test for building activities. This version can be explained in part as a reaction to how the same test has evolved in the OECD context, but it could not completely get rid of its links with the OECD version, which makes this provision even more difficult to interpret than article 5(3) of the OECD Model. The different nature of article 5(3)(a) of the UN Model (in comparison with article 5(3) of the OECD Model), its contradictions as well as its limited relevance and effect in the current UN Model (2017) will be explained in section 3.

The BEPS-derived modifications to the construction PE will be the object of section 4, where the new anti-splitting up of contracts clause and its problems will be studied, as well as the alternative anti-abuse approach to fight against the artificial splitting up of contracts. In the context of article 5(3) of the OECD Model, the limited success and problems of the anti-fragmentation clause/anti-abuse approach proposed by BEPS Action 7, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) and the 2017 OECD Model will be explained in that section.

Contrary to what it may seem, not all the problems of interpretation of the objective

and subjective scope of article 5(3) of the OECD Model have been resolved in 2017, even if the 2017 version of the OECD Model has added some relevant new paragraphs in the Commentary on Article 5 and clarified previous interpretative doubts. Therefore, section 5 will concentrate on the issues still open on the objective scope of article 5(3) of the OECD Model (the meaning of "building, construction or installation" and the problems with on-site planning and supervision). Section 6 will deal with the subjective scope of article 5(3) of the OECD Model and how the article applies to contractors and subcontractors, partnerships or joint ventures. In turn, section 7 will concentrate on the issues connected with the computation of the time threshold of the construction PE (12 months in the OECD Model, 6 months in the UN Model, with different options also in other tax treaties).

Finally, section 8 will briefly deal with attribution of profit issues linked with construction PEs only to note that this is a highly controversial area and that very different approaches can be adopted by source and residence states, in part as a consequences of the different models on attribution of profits that can be found internationally and domestically in different states (due in part to the failure and scarce widespread acceptance of the OECD authorizes approach to attribution of profits to PEs).

2. Some historical data of relevance to interpret article 5(3) OECD Model: Exception vs deeming rule and the importance of the geographical and commercial coherence tests for construction PEs

2.1. The PE concept applies per fixed place and to a stream of income and not per taxpayer

It is well known that the PE concept was historically linked to the type of economy that was prevalent in the early 20th century. This economy was based on immobile

(or relatively low-mobile) industries and production factors, which basically meant that most international business and sectors required some sort of "permanent establishment" to do business in a country. At that time, the concepts of "fixed place of business" or "dependent agency" with capacity to bind a foreign taxpayer were probably the factors that represented international mobility and integration in a foreign economy and also the ones that permitted to capture most of the relevant income derived by foreign taxpayers in the source country ("[a]t that time therefore, the requirement of permanence at a certain location was not inconsistent with extensive source-state taxation", *see* section 10, Skaar, p. 559). The emphasis on those factors also meant an option in terms of source rules: rather than focusing on the business or trade of a taxpayer in a country, the establishment with a degree of permanence of an enterprise was stressed and adopted as a source rule or criterion of economic allegiance (*see* Skaar, id. and p. 111 et seq.).

As a consequence of the "source rules option" (linked to immobile factors), the PE concept applied not per taxpayer, but to streams of income connected with the different fixed places or presences a taxpayer could have in a country (and not with the business done as a whole by the taxpayer within the country). This is important to keep in mind since it is one of the problems or difficulties of the PE concept, especially in the context of article 5(3) of the OECD Model. The idea that the PE concept is linked with a stream of income (and not directly with a taxpayer) was pointed out in the works conducted to the Draft OECD Model of 1963. In this regard, the Report on the Allocation of Profits to Permanent Establishments (WP 7 OEEC, 04.09.1958, FC/WP7 (58) Appendix 1, para. 5) very clearly explained that: "the fiscal authorities [of the source state] should look at the separate items of profit that the enterprise derives from their country and should apply to each item of profit the PE test."

The connection between the PE concept and a stream of income found its way into paragraph 4 of the 1963 Draft Commentary on Article 7, and is still present in paragraph 12 of the Commentary on Article 7 OECD Model (2017).
In order to correctly understand article 5(3) of the OECD Model, it is therefore not

only important to remember that the general PE connect as well as the construction PE is linked with "immobile factors", but also with "streams of income" in turn associated with those immobile factors. Both features will be highly relevant to understand some of the problems of article 5(3) of the OECD Model from its inception until present times since, in the end, article 5(3) applies not only to a taxpayer as such, but to separate presences (construction works in the case of article 5(3) of the OECD Model) of the same taxpayer within the source state.

2.2. When the PE concept reduced its fixity but not the connection with a stream of income: The PE for construction works

Arguably, the most important innovation in the Mexico/London Models (1943 and 1946) was the PE construction clause, which had a similar wording to the one it has today and was also highly influenced by German domestic legislation. This is probably the point in time when the PE principle started to be eroded since it was the explicit recognition that, in some cases (construction works), the PE was not "permanent" (it lasted as long as the construction work would last and no less than 12 months) and was not an "establishment" (since, per definition, construction work does not entail continuity and is often not linked with a specific place as such, but with an area where the construction work is carried on).[1] Despite this innovation, the construction PE did not lose its connection with the general PE concept, and, in the preparatory works of the 1963 Draft OECD Model, it did not appear as an independent clause as such, but as an example in article 5(2) of fixed place of business, which stressed the link between the construction work clause and the general PE concept of article 5(1) of the OECD Model.

It can therefore be said that the construction PE was caught between the fixed place theory inherent in the PE concept and the need to recognize the fact that

[1] *See* Chapter 1 in G. Maisto (ed.), *New Trends in the Definition of Permanent Establishment*, Amsterdam: IBFD, 2019.

construction work goes beyond a fixed place because of the specific nature of the work, that can move within the boundaries of the construction area (e.g. the road, railway, large construction project, etc.). Construction work, by its very nature, is not permanent either, and although this aspect was very relevant to recognize construction PEs in a separate paragraph, the dilution of the fixity requirement is also important for the purposes of this chapter. These ideas were present very clearly in the preparatory works of the 1977 OECD Model. In this regard, the Preliminary Report of Working Party 1 (Germany and the United Kingdom) on the Questions in Connection with the Definition in Article 5 of the Term "Permanent Establishment" (FC/WP1 (70) 1, 17.08.1970, hereinafter cited as the 1970 Report), explained the following:

– Paragraph 32: The time threshold of the construction work clause is linked with "each individual building site" and there will be no accumulation of sites: "The duration of several works is, in no case, to be calculated cumulatively if the building sites are at different locations and in no factual connection. This principle is applied even if the works are performed for the same principal." These statements confirm the application of the PE principle per "stream of income" and not per taxpayer.

– Paragraph 36: The general principles of article 5(1) also apply to building sites ("that only such places of business are PEs which are permanently established at a distinct place apply to building sites, even if, by the nature of the work, the site has to reallocate as work progresses").

– Paragraph 37: Construction works that have to reallocate as work progresses are a "single project that requires reallocation of a building site and has geographical continuity" ("in such cases, a geographical or chronological relation exists between the individual construction phases' that form a single construction project").

In fact, the reflections in the report reveal several ideas: (i) the tension between the need to connect the PE concept to a fixed place, that did not completely fit with the

nature of construction work; (ii) the fact that the construction PE was a type of the general PE clause and was interpreted as such except for the "permanence" requirement; (iii) the need, in view of the nature of the activity, to interpret "fixed place"/situs with a certain degree of flexibility; and (iv) the fact that there was a connection between the "place" (even if interpreted with flexibility), the activity ("construction") and the income that should be allocated to the activity that was carried on at a place.

When in 1977 the construction PE became an independent clause in article 5(3) of the OECD Model, the drafting of the clause picked up those ideas very clearly and, therefore, it cannot be said that it was a deeming provision that created a presumption somehow different to article 5(1) of the OECD Model. Rather, article 5(3) of the OECD Model (1977) was born as a clause intrinsically connected to article 5(1) and with its principles of interpretation and application, even if, due to the nature of the activity, some adaptation was needed. Article 5(3) of the OECD Model (1977) was therefore more an exception (to the permanence requirement) than a fiction if attention is paid to its origins. The fact that some mobile activities not linked intrinsically with a fixed place were captured by the construction PE clause could be saved with the geographical and commercial coherences tests, which produced the outcome of turning into "fixed" activities that are not really fixed in a strict sense. A perfect continuity or bond with article 5(1) of the OECD Model could therefore be maintained with the exception (for the temporal requirement) and the fiction (that some relatively mobile activities are also fixed).

It is a commonplace to stress that the drafting of the article at that time emphasized the exception theory with the reference to "only if" in its wording, but probably the Commentary on Article 5(3) and the 1970 Report prove the nature of article 5(3) even more clearly: the commercial and geographical coherence tests found their way into paragraph 17 of the 1977 Commentary to link the construction work PE with article 5(1) and the fixed place theory it represented, as well as to introduce the flexibility needed in view of the nature of the activity to which the paragraph was addressed, that is to say, in order to interpret the concept of "fixed place" since

"construction work" usually reallocates within the boundaries of the place where a project is executed. The fact that the geographical and commercial coherence tests were also transferred in 2003 into the Commentary on Article 5(1) of the OECD Model reinforces the idea that both paragraphs represent the same underlying principles and concepts and do not have different effects, apart from those that naturally flow from their different wording and the exception effects of article 5(3) for the temporal requirement (the 12-month rule in article 5(3) that does not exist in article 5(1) of the OECD Model). In such a context, article 5(3), as an exception and not a self-standing rule, cannot create a PE where none would exist according to article 5(1) of the OECD Model. As an exception to article 5(1), the construction PE is also linked to a stream of income (the one connected with the specific "fixed place" where construction is carried on) and not to a taxpayer.

2.3. Vagueness and asymmetries in the interpretation of article 5(3) OECD Model: A historical perspective

A rule of interpretation might emerge from the exception effect of article 5(3) of the OECD Model that is clearly shown in its historical evolution before and after 1977 until today briefly explained in the two previous sections: terms such as "building site" or "construction or installation project" cannot be interpreted broadly. Those terms are always connected with a "fixed place" as well as article 5(1) of the OECD Model (and the stream of income derived from that place), not only with the temporal element, as such, that article 5(3) of the OECD Model includes and the construction activity considered in an objective manner (i.e. the interpretation of building site, construction or project is always linked with "the fixed place element", not with construction as an activity in itself). The term "project" is notably broader than "site" and could be interpreted expansively to capture any construction work that could be viewed as a project in the source state. History, however, shows that it should not be attributed a broader meaning than "site", but, if the historical evolution is not taken into account, it is a vague term that could be (literally) interpreted in an expansive form.

However, the connection of article 5(3) with a "fixed place" encapsulates a certain degree of contradiction because of the tension that exists between certain construction, installation or building projects, due to their mobile features, and the concept of fixed place of business. Historically, the function of the geographical and commercial tests was to solve that tension and contradiction. But it is precisely that tension factor that creates one of the major or most relevant interpretation issues in article 5(3) of the OECD Model: unless the geographical and commercial coherence tests are interpreted in a uniform manner by both contracting states in a tax treaty, there is a risk of asymmetries (e.g. some states may interpret "project" with a broad meaning that goes beyond the boundaries of geographical and commercial coherence, some states may interpret "geographical" and/or "commercial coherence" in a very different manner). And these asymmetries are important in economic sectors and industries that are most affected by article 5(3) of the OECD Model, such as building or companies active in the field of natural resources. That is to say, a different perception by the two contracting states about how to interpret "geographical and commercial coherence" or "project or site" can show a different picture of the same taxpayer in two different states and create residual double taxation or no taxation at all. The blurred contours of the geographical and commercial coherence tests (that in the end, tried to accommodate the tension between a fixed place and the relatively mobile nature of construction activities) permits the two contracting states to have a different position on whether the same taxpayer has one or more constructions PEs in the source or residence country.

The latter will happen, for instance, if the source state sees two PEs (PE1 and PE2), one with profits (PE 1: 100) another one with losses (PE2: –100), and the residence country, with a different interpretation of commercial and geographical coherence, only sees one PE in the source country and forces the taxpayer to compensate the source country profits of PE1 with the source country losses of PE2, without giving any credit for the taxes paid in the source country by PE1 if it is a credit state and not permitting the taxpayer to integrate the losses of the source country located in PE2 (if the residence country is an exemption state, the effect would be that the

losses of the PE2 might not be integrated in the residence state tax base if the residence state permits the integration of foreign losses, probably with recapture clauses). In this situation, the outcome may be that the taxpayer is taxed in the source and the residence state and none of them would permit the compensation of the losses of PE2.

The contrary effect may also occur. If the source country permits compensation of losses of PE2 with profits of PE1 there will be no source taxation, but if the residence country sees two separate PEs, losses of PE2 might also be imported into the residence country with a double compensation in the source and residence country. This can happen in credit states and also in states that permit compensation of foreign losses even if they apply the exemption method.

As a consequence, diverging interpretations of the geographical and commercial coherence tests (also of the terms project or site), which are not uncommon due to their vague formulation, may produce asymmetric applications of article 5(3) of the OECD Model and different numbers of PEs for the taxpayer can be seen in the source or the residence country. This effect may also be aggravated and arise if the source country voluntarily permits the joint filing of tax returns by different PEs of the same taxpayer, or when the residence state permits consolidation of profits and losses of different companies of the same group all of them having PEs in the source country, since both states may not see the same number of PEs in all cases either. As mentioned, these issues may be common for companies that often fall within the scope of article 5(3) of the OECD Model (some projects have losses and some others profits; in the initial phases of a project there can be losses) and the divergent interpretation and application of that article may be used in tax planning strategies or create problems and conflicts to taxpayers for the compensation of profits and losses.

2.4. Article 5 (3) OECD Model: A first conclusion

The tensions and contractions that are present in the evolution of article 5(3) of the OECD Model (its connection with the fixed place of business concept despite recognizing that construction work cannot be "fixed" and may be mobile, the attempts to link a stream of income with a relatively mobile place) are at the roots of the problems of interpretation and application of this article, where it is likely that residence and source states may not attribute the same meaning to the geographical and commercial coherence tests or the concepts of site or project. If these inherent problems are combined with the ease to fragment activities to avoid a taxable presence or PE in the source country (or to reduce its tax base) and the different approaches to fight against it (an issue that is explored below in section 4 and is connected with the PE concept as such), it is common to find the application of article 5(3) of the OECD Model in the international arena is not as easy and homogeneous as it may seem at first sight.

3. A different model: The UN version of the construction PE and its diminished importance after 2017

It is common to hold that the construction PE clause has a different nature in article 5(3)(a) of the UN Model if compared to article 5(3) of the OECD Model: unlike the latter, it is a deeming rule and not an exception to the general PE rule. The different nature derives not only from the drafting of article 5(3)(a) of the UN Model (the term "permanent establishment also encompasses") but also from its context and the fact that article 5(3)(b) (the service PE provision) is clearly a deeming provision that follows a source rule – physical presence – that is very different to the fixed place of business inherent in the concept of PE in article 5(1) of the UN or OECD Model.

One would therefore expect that the effect of the deeming rule in article 5(3)(a) of the UN Model would be linked with the type of activity within the source country ("building site, a construction, assembly or installation project or supervisory activities") and the temporal dimension ("six months"), and not so much with the inherent elements of the PE concept in article 5(1) of the UN Model ("fixed place of

business"). If that were the case, the effect of article 5(3)(a) of the UN Model would be much broader than article 5(3) of the OECD Model: carrying on in the source state the activity covered by that article for more than 6 months (the time threshold in the UN Model) will have as a consequence that the taxpayer would have a construction PE in that state.

Surprisingly, not only does paragraph 7 of the Commentary on Article 5(3)(a) of the UN Model (2017) attempt to reduce the impact of the differences between the construction PE in the UN and OECD Models (and the deeming and exception theories), but, moreover, it seems to implicitly accept the commercial and geographical coherence tests closely linked with the fixed place of business and the exception theory of article 5(1) and (3) of the OECD Model. This is probably the effect of recognizing in the Commentary on Article 5(3)(a) of the UN Model (2017) that paragraph 20 of the Commentary on Article 5(3) of the OECD Model (2014) (current paragraph 57 in the 2017 OECD Model) also applies in the UN Model context: it is difficult to understand the impact of that paragraph without recognizing at the same time that the application of the geographical and commercial coherence tests also has effects for article 5(3)(a) of the UN Model (the same also applies for the recognition that paragraphs 51-53 of the Commentary on Article 5(3) of the OECD Model (2017), derived from BEPS Action 7, also apply in the context of article 5(3)(a) of the UN Model, *see* paragraph 11 of the Commentary on Article 5(3) of the 2017 UN Model).

Therefore, the interpretative problems of article 5(3) of the OECD Model are aggravated in the context of article 5(3)(a) of the UN Model: if, in the former, the diffused contours of the geographical and commercial coherence tests could lead to different interpretations and asymmetries, these problems are even more acute in the UN context where the controversy on the nature of article 5(3)(a) of the UN Model (deeming or exception provision) is added to the problems that article 5(3) of the OECD Model already has. As a consequence, the risks of different interpretations by source and residence countries of article 5(3)(a) of the UN Model are more intense.

The only relief is that article 5(3)(a) of the UN Model may be largely irrelevant in the context of the UN Model, especially after the 2017 changes. First, most of the activities captured by article 5(3)(a) of the UN Model will fall within the scope of the new technical services article (article 12A) so that, in terms of taxing jurisdiction of the source country, article 5(3)(a) does not add much. Its function has, as a consequence, changed and it is now more an escape route from the rigours of gross withholding taxation under article 12A (technical services) than an extension of jurisdiction for the source country. Second, most (or at least a good number) of the activities covered by article 5(3)(a) of the UN Model will also be covered by article 5(3)(b) of the UN Model ("service PE") with the difference that the elimination in 2017 of the "same or connected project" requirement render the latter a more powerful tool to affirm source country jurisdiction (with a physical presence tests) than article 5(3)(a) of the UN Model (especially in tax treaties where brand new article 12A of the UN Model might not be included and taking into account that article 5(3)(b) also covers subcontractors).

Basically, this means that even if interpretative problems of the construction PE are more intense in the UN context than in article 5(3) of the OECD Model, this clause has less relevance when it is complemented by article 5(3)(b) and/or article 12A of the UN Model (2017).

4. The BEPS effect and its aftermath: The splitting up of contracts to avoid the time threshold of article 5(3) OECD Model

One of the problems of article 5(3) of the OECD Model is that it is easy to avoid the more than 12-month (6 months in the UN Model) time period by splitting up a single contract into different ones of less duration between related parties. In this regard, the connection of the PE with a stream of income as well as the commercial and geographical coherence tests largely facilitate the splitting up of activities or

contracts. BEPS Action 7 on Preventing the Artificial Avoidance of PEs proposed in 2015 two options to fight against the splitting up of contracts:

(a) add an example in the Commentary on the principal purpose rule derived from BEPS Action 6, so that it captures only tax-driven splitting up of contracts (the example given is two related companies that divide a 22-month contract into two parts, each lasting for 11 months, in order to avoid the application of article 5(3) of the OECD Model), or,

(b) include a clause that accumulates the activities in the same place of closely related companies for the purposes of computation of the 12-month period (a list of factors that can be taken into account to determine whether the activities of the companies are connected was also proposed).

Article 14 of the MLI gave the signing parties the option to (i) reserve all of the clause on splitting-up of contracts or (ii) exclude from it "exploration and exploitation of natural resources".

And, finally, the new Commentary on Article 5(3) of the OECD Model (2017) added both possibilities, as advanced by BEPS Action 7:

– An accumulation or aggregation clause is given as a reference in paragraph 52. For the purposes of the definition of connected activities, paragraph 53 follows a similar approach to the concept of connected project in paragraph 162 of the Commentary on Article 5 of the OECD Model (the service PE provision).

– The anti-abuse (principal purpose test) approach is recognized in paragraph 52 of the Commentary on Article 5 and Example J paragraph 182 of the Commentary on Article 29(9) of the OECD Model.

Both approaches, however, have relevant limits. In the end, the commercial and geographical coherence tests that apply in the context of article 5(3) of the OECD

Model may permit to carry on substantial construction activities in a source state (on the same or different sites) without falling within the anti-splitting up clause or the anti-abuse example. These tests will operate as a defence for a taxpayer against expansive interpretation of the article by source countries. Different interpretations of the commercial and geographical coherence tests will also have an impact on the scope of the anti-splitting up of contracts clause or the application of anti-avoidance rules since an expansive interpretation of both tests may make the new measures less effective, whereas restrictive interpretations may be used by source countries to promote a more aggressive application of the new anti-fragmentation clause or anti-avoidance measures against the splitting up of contracts. Be that as it may, splitting up of construction contracts will also continue with different places of business, without being limited by the (in turn) limited changes in article 5(4) of the 2017 OECD Model (which are also a consequence of BEPS Action 7). This means that substantial construction work can still be conducted in a source country without falling within the scope of the anti-splitting up options, but also that conflicts on how to apply the accumulation approaches will be common depending on how the commercial and geographical coherence tests are interpreted for a single and for different places of business.

The accumulation or anti-fragmentation clause also presents some problems of its own that can be summarized as follows:

(1) It is not completely clear whether it is an objective clause or a specific anti-avoidance rule (SAAR). When trying to define “connected activities”, the reference in paragraph 53 of the Commentary on article 5(3) of the OECD Model (2017) to “whether the activities would have been covered by a single contract absent tax planning considerations” leaves margin for doubt on the nature of the clause and whether the proof of economic soundness for the division of the contracts would exclude the application of the accumulation clause. In this is so, that means that the aggregation clause and the anti-abuse approach may have very similar effects and it does not make much sense to differentiate between both.

(2) The definition of "connected activities" is not fully elaborated since paragraph 53 only refers to factors that may be relevant for that purpose, which again leaves open the possibility of different interpretations in the source and residence states and to invoke the effects of the commercial and geographical coherence test against that clause.

(3) The Commentary on Article 5(3) of the OECD Model (2017) itself may erode the scope of the accumulation clause when it limits its application in some cases. For instance, the training example in paragraph 55 permits to differentiate the construction and the training phases and split up contracts to recognize what paragraph 55 proposes. As will be explained below, training after installation or construction work is an ancillary activity that should not be excluded in most cases from the scope of the "construction or installation project", however, paragraph 55 excludes the training period from the computation of the 12-month threshold, therefore, facilitating the splitting up of contracts.

(4) The accumulation clause may not avoid the erosion of the tax base of the PE with services, royalties, interest, etc.

In addition, not that many countries have accepted the accumulation or aggregation clause. Out of the countries covered in the country reports in this book, only Australia, Norway, the Netherlands (all reserving its extension to offshore natural resource activities) and India have accepted it in the context of the MLI. Other countries reserve the application of article 14 of the MLI (Belgium, China (People's Rep.), France, Germany, Italy, Luxembourg, Spain, South Africa, Sweden, Switzerland and the United Kingdom). Behind this reservation there may hide the will to have a calculated asymmetry in the application of tax treaties. It is clear that some of the more powerful construction companies (or companies affected by the aggregation clause) have their siege in some of the countries that will not apply the accumulation clause so the reservation may have the effect that it does not affect the tax base of those countries, since they have efficient GAARs or SAARs that can be used to attack the artificial splitting up of contracts, but that does not mean the

same will occur in the other states where these companies operate. If the other state is a developing country, it may not have a GAAR or SAAR or it may find it very difficult to apply it, and, therefore, not having the accumulation clause may hamper the possibilities of the source state (developing country) to attack the splitting up of contracts.

The anti-abuse or avoidance approach also deserves another specific comment. Within the European Union, how it is applied will be conditioned by EU law and, particularly after 1 January 2019, by the anti-avoidance clause (article 6) in Directive 1164/2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market. That means that the case law of the European Court of Justice (ECJ) will affect its interpretation and when the clause can apply (it is well known that the formulation of the principal purpose test in the OECD materials, i.e. article 29(9) of the OECD Model (2017), is not fully equivalent to the meaning that the prohibition of abuse has in EU law). Therefore, potential conflicts may arise between EU Member States and non-EU states on how to interpret and apply anti-abuse rules to construction activities in the context of tax treaties.

5. The objective scope of article 5(3) OECD Model

5.1. Introduction

Although the objective scope of article 5(3) of the OECD Model may seem clear, there are very relevant doubts when determining the type of activities that fall within this clause. The two main issues that will be explored in this section refer to the meaning of "building, construction or installation" on the one hand, and "supervision and on-site planning", on the other.

5.2. What is "building, construction or installation"?

Paragraph 50 of the Commentary on Article 5(3) of the OECD Model gives some guidance on the activities covered by the construction PE clause:

– "Construction of buildings, roads, bridges or canals, renovation (more than maintenance or redecoration) of buildings, roads and bridges or canals, laying of pipe-lines, excavating and dredging."

– "Installation" includes "installation related to a construction project" but also "installation of new equipment, such as a complex machine, in an existing building or outdoors".

– Paragraph 50 does not mention but it can be assumed that other activities are included within the scope of article 5(3) of the OECD Model such as drilling, exploration of natural resources, dismantling, cleaning of a site, etc.

Article 5(3)(a) of the UN Model mentions almost the same activities, but also includes "assembly and supervisory activities", although the latter can be assumed to be covered also by article 5(3) of the OECD Model. The difference, therefore, is not on the type of activities covered, but on their link with a fixed place at the disposal of the foreign service provider: whereas in the OECD Model the requirement of a fixed place at the disposal of the enterprise is needed to have a construction PE, in article 5(3)(a) of the UN Model, if interpreted as a deeming provision, it is not. As a consequence, the latter may capture more activities than the former.

In general, the terms "building, construction and installation" will be interpreted pursuant to domestic law (article 3(2) of the OECD Model) or their usual meaning (*see GIL Mauritius Holding Ltd* cited in n. 81 of the India report in this volume). The main problems of interpretation in this respect are, in this author's view, the following:

– *Distinction between "renovation" and "'construction", on the one hand, or "redecoration, maintenance and repair" on the other:* Whereas the former terms are

covered by article 5(3) of the OECD Model, the latter are not. But the line that differentiates both groups of activities is very subtle as many redecoration works may imply renovation and maintenance may also involve construction. From the painter's example in paragraphs 17 and 24 of the Commentary on Article 5.1 it is clear that such an activity is excluded from article 5(3) of the OECD Model. But it would not be that difficult for the painter to turn into someone that carries on activities covered by article 5(3) of the OECD Model and has access to the 12-month period of that article instead of the usually shorter period applicable for the purposes of article 5(1) of the OECD Model: will it be enough that the painter pulls down a wall or performs minor renovation to avoid article 5(1) and be covered by article 5(3)? The distinction is so fine that it is easy for some service providers covered by article 5(1) to have access to extended time thresholds of article 5(3) of the OECD Model and, therefore, tax planning is facilitated (anti-abuse or avoidance rules can obviously be applied in these cases).

– *Installation of equipment:* Paragraph 50 of the Commentary on Article 5(3) of the OECD Model refers to "installation of new equipment, such as a complex machine" as an activity covered by such a paragraph. This abstract reference leaves margin for several doubts:

– Does it refer to mobile or immobile equipment that is fixed to the ground? Paragraph 50 only refers to equipment installed in a building or outdoors, and nothing is specified on the nature of the equipment, apart from the reference to "complex machine". It can therefore be assumed that it can be machinery that remains fixed and attached to the soil (or to a building) or not since it seems that the relevant test is the complexity of the installation that requires more than 12 months.

– The meaning of "equipment" is not clarified either. Does it have a broad meaning such as in article 12(3) of the UN Model? It can probably be assumed that it has an even broader meaning in that article since the nature of the equipment is not specified. In article 12(3) of the UN Model the equipment has to be "industrial, scientific or commercial". Most of the types of equipment can probably be fitted in

those categories but, to the extent that paragraph 50 does not link any adjective to equipment, there is no need to restrict the application to those categories in the context of article 5(3) of the UN Model. Once again, it suffices that the installation is complex enough so as to last for more than 12 months.

– A relevant issue, however, is that before 2003, there was no reference to installation of equipment in the Commentary on Article 5(3) of the OECD Model and, therefore, it is unclear whether paragraph 50 can apply to tax treaties signed before 2003. The generic reference to "installation project" in article 5(3) of the OECD Model can, however, encompass and fully cover the 2003 developments in the Commentary, even if this may not be peacefully accepted by all countries.

– But, probably, the most relevant issue is that the exception theory (the most likely explanation of article 5(3) of the OECD Model) requires to meet the disposal test of article 5(1) of the OECD Model and it will be rare that businesses performing installation work will have the disposal of the place of business unless the concept is interpreted broadly (this problem would not exists in article 5(3)(a) of the UN Model if interpreted as a deeming provision). Since the work has to last for more than 12 months, it seems that the Commentary assumes that in such cases there can be a reasonable presumption of disposal of the place, but this has to be proved.

– Sales plus installation of machinery can present specific problems in terms of determining where installation has enough relevance so as to be regarded as a separate transaction, or, alternatively, an ancillary one to the sale. Paragraph 8 of the Commentary on Article 5 of the UN Model (2017) has a clause for countries that wish to have a specific rule in this context: there will be a construction PE if the installation work lasts less than 6 months and the charges payable for the project exceed 10 per 100 of the sale price. In fact, this clause regards that there will be a PE where the conditions of article 5(3)(a) of the UN Model are not met (i.e. the installation project does not last more than 6 months). In the OECD Model, the problem of sale plus installation has to be approached with the strict application of

article 5(3), which may give rise to uncertainties when the contracting states do not apply the same rules to disaggregate transactions (sale plus installation) and do not view the transaction in the same form (one as a sale with an ancillary installation, another one as a sale plus installation). In most cases, if the installation work lasts for more than 12 months it can hardly be said it is ancillary and seems a relevant element in itself to disaggregate the installation and the sale. Even a more than 6 months installation, that is to say, within the time threshold of article 5(3)(a) of the UN Model, may be relevant enough to be separated and treated independently from the sale.

5.3. On-site planning and supervision

On-site planning and supervision "of the erection of a building" are included within the scope of article 5(3) of the OECD Model (paragraph 50 of the Commentary on Article 5(3) of the 2017 OECD Model). This sentence, however, raises a number of interpretative doubts.

First, on-site planning and supervision (as activities and not only for the computation of the time threshold of the contractor) are connected with a building, which poses the doubt whether on-site planning and supervision of other projects not directly linked with buildings are covered (road, railway, installation of machinery, engineering project, drilling activities? etc.). In this regard, article 5(3)(a) of the UN Model is clearer since "supervisory activities" are associated with "a building site, a construction, assembly or installation project". In this author's view, there is no reason why on-site planning and supervision of "constructions or installation projects" is not also included within the scope of article 5(3) of the OECD Model.

Second, the controversy regarding on-site planning and supervision seems to refer more to the person that conducts the activities than to the nature of the specific business covered (although there are also some doubts in this regard too). Before

2003, the wording of the Commentary was very different to the current paragraph 50 of the Commentary. Paragraph 17 of the Commentary on Article 5(3) of the OECD Model (2000) explained the following: Planning and supervision of the erection of a building are covered by this term, if carried out by the building contractor. However, planning and supervision is not included if carried out by another enterprise whose activities in connection with the construction concerned are restricted to planning and supervising the work. If that other enterprise has an office which it uses only for planning or supervision activities relating to a site or project which does not constitute a permanent establishment, such office does not constitute a fixed place of business within the meaning of paragraph 1, because its existence has not a certain degree of permanence.

This reflects the works of the 1970 Report that was preparatory of the 1977 OECD Model. That Report, paragraph 30, explained that planning and supervision are certainly part of the building site if carried out by the construction contractor. But planning and supervision of the work does not give rise to a construction PE if carried out by another enterprise.

Under new paragraph 50 of the Commentary on Article 5(3) of the OECD Model (2017) (although the wording comes from the 2003 modifications), however, on-site planning and supervision by enterprises independent from the contractor is also covered by article 5(3) of the OECD Model (not only for the computation of the 12-month threshold of the contractor but also as activities that can create a PE for the company that carries it on). Not all states will be willing to recognize that the 2003-2017 Commentary can have retroactive effect with regard to tax treaties concluded before 2003 (e.g. Australia still limits the application of article 5(3) of the OECD Model to supervision by the contractor, France has case law excluding these activities from the scope of article 5(3) of the OECD Model). It must be recognized, however, that some statements in the pre-2003 version of the Commentary were not justified either: why will not the independent enterprise have a PE if it has an office for planning and supervision for a certain period (usually 6 months under article 5(1) if it was not included in article 5(3) of the OECD Model)? It was therefore

natural that some clarifications were added in 2003, although, as will be explained below, some uncertainties still remain.

As commented, the main innovation of the 2003-2017 Commentary was to include on-site planning and supervision within article 5(3) of the OECD Model even if the activity was conducted by an independent party and not only by the contractor (as before 2003). After 2003, it is not fully clear from paragraph 50, however, if the contractor or independent enterprise that conducts the planning/supervisory activity needs to have a fixed place of business at their disposal. This should be the case if the exception theory is defended. And, in this author's opinion, the office that was mentioned before 2003 has the degree of permanence that is required for that purpose (even if no office may be needed to meet the disposal requirement). In this regard, Germany has an observation in paragraph 172 of the Commentary on Article 5(3) of the OECD Model (2017) to make clear that on-site planning and supervision over a construction project will only be covered if the requirements of article 5(1) are met. This observation can probably also apply to other countries as long as they also consider the construction PE clause as an exception to article 5(1) and not as a deeming provision (in article 5(3)(a) of the UN Model supervision is included without the need to also fulfil the requirements of article 5(1) of the UN Model). From a contextual perspective, it would not make sense to consider that on-site planning/supervision are covered by article 5(3) simply without meeting the "place of business requirement" since this will be equivalent to importing into article 5(3) of the OECD Model a threshold (physical presence, reception or use of the service) that is not inherent or recognized in this article.

Additionally, the meaning of the term "supervision" is not fully clear, since it is not defined in the Commentary. Certainly, supervision can cover different activities such as technical, quality or managerial supervision and it can refer to all the construction project or part or phases of it only. Paragraph 50 seems to connect supervision with the erection of a building only, but, as expressed before, all supervision connected with the activities covered by article 5(3) and that is ancillary to the execution of the project should probably be covered (e.g. it would not make sense to include

supervision of the erection of the building but not of the engineering connected with it or to integrate the building in an area where it sits, supervision that refers to electrical work in the building, structural calculations, final decoration, etc.).

Lastly, from paragraph 54 of the Commentary on Article 5(3) of the OECD Model (2017), it appears that on-site planning is always included in the computation of the 12-month threshold. However, paragraph 54 also links on-site planning with "an office" of the contractor. It is therefore unclear what happens if on-site planning is conducted by an independent enterprise from the contractor. The 2003 changes to the Commentary point in the direction that on-site planning, regardless of who is in charge of it, will be included in the computation of the 12 months. That is certainly the case if the contractor has the disposal of the construction site. However, it is unclear what happens with the independent enterprise that conducts on-site planning. In this author's view, if the independent enterprise also has a "place of business" for the time threshold of article 5(3) of the OECD Model, it will also have a PE that is also independent from the PE of the contractor. In most of the cases, if the on-site planning is conducted by an independent enterprise, from the very beginning, the contractor will have the disposal of the site, and, therefore, time spent there by the former will be attributed to the latter. But it may also be the case that the on-site planning activity is conducted without the contractor having the disposal of the place of business (e.g. when the planning activity and its outcome is a condition to conduct further work or is attributed to the owner of the place where the work will be conducted). In that case, it will be difficult to attribute to the contractor the time spent there by the independent planning company, even if the latter can have a PE by itself if there is a fixed place of business. However, a joint interpretation of paragraphs 50 and 54 of the Commentary may produce the outcome that, from the very first moment the preparatory planning work starts, the computation of the 12-month threshold is triggered. Notwithstanding the latter, there should be a correlation between the place of business disposal and the computation of the 12-month threshold for the contractor *and* for the independent company, even if the separation of the two can have the effect of extending the 12 months threshold (subject to the effects of accumulation clauses or anti-abuse

provisions). Some further clarifications of the Commentary in this regard would be welcome.

6. The subjective scope of article 5(3) OECD Model

6.1. Introduction

Article 5(3) of the OECD Model does not define the persons to which it applies by singling out a specific category of them. Rather, its subjective scope is determined by reference to the activity covered in its wording. Businesses or undertakings responsible for the building, construction or installation projects are the ones usually falling within the scope of article 5(3). The contractor of the works would therefore be the person most directly affected by this provision. However, there is some need to add some comments on the specific relationship between the contractor and subcontractors, as well as on partnerships, joint ventures, engineering, procurement and construction (EPC) contracts or joint operating agreements (JOAs) that are common in some sectors. The problems of "supervision" and "on-site planning" activities have been studied in the preceding section.

6.2. Contractors and subcontractors

One of the innovations of the 2017 Commentary on Article 5(3) of the OECD Model refers to the explicit recognition that even if all parts of a complex contract are subcontracted, the contractor will have a PE. Before 2017, subcontracting all parts of a project did not give rise to a PE of the contractor in the Commentary on Article 5(3) of the OECD Model, which may probably have the consequence that this clarification will not be accepted with regard to tax treaties concluded before 2017. It may be thought that this is a major innovation, since a contractor that does not have any presence in the source state and subcontracts all the parts of a contract

will now be included within the scope of article 5(3) of the OECD Model.

However, the innovation is probably less relevant than it appears at first sight since the site or place where the work is executed must be at the disposal of the contractor to trigger the effects of article 5(3) of the OECD Model. As paragraph 54 of the Commentary on Article 5(3) OECD Model (2017) clarifies, time spent by a subcontractor will be attributed to the contractor only if the contractor has the site at its disposal during the time the subcontractor executes its work in terms of legal possession of the site, control of access to an use of the site and has overall responsibility for what happens at that location during that period (*see also* paragraph 40 of the Commentary on Article 5(1), which also explains when the place where the subcontractors work is at the disposal of the contractor for the purposes of the general concept of PE). The origins of this clarification can be traced back to the OECD's draft on Interpretation and Application of Article 5 (Permanent Establishment) OECD Model (2011), where it was explained (paragraph 49) that it would be unlikely that the contractor does not have employees on the construction site in those cases of subcontracting and that it would be strange to have a different outcome if the main contractor's employees spent only 1 day on the site. Basically, therefore, the clarification seeks neutrality between contractors that subcontract relevant parts of the work and others that subcontract all the work and try to reduce their presence in the source state to a minimum, but still control the project in the source state. The new Commentary leaves the contractor less margin to avoid having a construction work PE by manipulating the parts that are subcontracted. It can even be said that in the previous Commentary before 2017, the same outcome could be achieved if, in the end, despite subcontracting all parts, it could be concluded that the site was at the disposal of the contractor.

The fact that time spent at a site by a subcontractor is attributed to the contractor does not exclude the potential PE that the former may also have in addition to the PE of the latter. That is to say, article 5(3) of the OECD Model also applies independently to subcontractors. Also, in this case, the subcontractor needs to have the disposal of the place of business, which will also require a factual and legal

analysis of the situation and relationship of the contractor and subcontractor. The case where supervision is the subcontracted activity may present some peculiarities, although they have already been mentioned above in section 5.3: disposal of the place of business is also a requirement for the supervising company to have a PE.

In case of subcontractors, article 5(3) of the OECD Model will only be applied to the site, project, etc. linked with the contractor. If the subcontractor has any other activity in the source state, it will not be covered by the fact that there is an article 5(3) of the OECD Model and the geographical and commercial coherence tests will be a limit in these cases to attribute to the construction PE the subcontractor may have any other activity of the subcontractor in the source state. There is case law in India in this regard that explains that the rule only applies to a situation where there is conjoint effort of both the contractor and subcontractor at the building site, but not to places where the subcontractor carries out the work of fabrication and assembly if this place is under the subcontractor control and away from the installation site and under no control of contractor (*see Pintsch Bamag Antriebs-Und Verkehrstechnick GMBH* cited in n. 89 of the India report in this volume).

6.3. Partnerships and joint ventures

The 2011 Draft OECD Report on Interpretation and Application of Article 5 (Permanent Establishment), paragraph 52 et seq., also considered how to apply article 5(3) to partnerships and joint ventures. This was the basis for the changes in the 2017 Commentary on Article 5(1) and (3) of the OECD Model on this issue. Therefore, the references to partnerships in paragraph 56 of the Commentary on Article 5(3) of the OECD Model (2017) must be interpreted in conjunction with paragraphs 42-43 of the Commentary on Article 5(1) of the OECD Model, since all of them have the same origins and should be interpreted in parallel.

In fact, paragraph 56 only clarifies two issues regarding the computation of the 12-

month threshold. First, it explains that the 12-month test is applied at the level of the partnership, even if each partner will be assessed the tax for its part of the profits. Second, it considers the case of partners that are resident of different states that have tax treaties with the source country with different time periods in article 5(3) (e.g. one 12 months and the other one 6 months). In that case, it is pointed out in paragraph 56, 'the time threshold of each treaty would be applied at the level of the partnership but only with respect to each partner's share of the profits covered by that treaty". This is regarded as the natural consequence of applying article 5(3) at the level of the same enterprise (i.e. the partnership).

The problem is that paragraph 56 seems to be considering only one specific case (a partnership that has some kind of legal recognition) and it may not apply in other cases. In the construction world or the natural resources sectors, "contractual joint ventures" like large EPC contracts, turnkey projects or JOAs are common and frequently do not have recognition as persons or even partnerships as recognized vehicles (either legally or for tax purposes) to conduct business activities. Paragraph 56 does not clarify what happens in these cases where no partnership with legal recognition is formed by the different parties that participate in the same project and they are only bound by a contract but in fact function as partnership. From what paragraph 42 of the Commentary on Article 5(1) of the OECD explains, the decisive factor would be whether there is a single enterprise and if the different parties jointly carry on business. If such a joint enterprise exists (i.e. there is a sharing in the profits and joint liability), there will be a PE of the "enterprise" (not of the parties) regardless of whether or not it has legal personality or recognition. These conclusions in the context of article 5(1) (which are also derived from the 2011 OECD Report on Interpretation and Application of Article 5 (Permanent Establishment) paragraph 52 et seq.) should also apply to article 5(3) of the OECD Model. Deciding whether it is the common enterprise or, alternatively, the parties the ones that have a PE and whether to apply the 12-month threshold at the level of the "common enterprise" or of the parties (if such common enterprise does not exist) is therefore a question of fact and domestic law.

As a consequence, there is margin for different interpretations by countries if the same facts or legal factors are not given the same weight in all countries. Within the countries studied in the reports of this volume, it seems that only India has specific guidance on the factors to take into account in order to decide when a consortium or joint venture is a "partnership" or joint enterprise for the purposes of charging tax on a separate basis from the partners. In India, CBDT Circular no. 7 of 2016 makes clear that a consortium with the following attributes will not be treated as a separate person: (i) each member is independently responsible for executing its part of the work through its own resources and also bears the risk of its scope of work; (ii) each member earns profit or incurs losses, based on performance of the contract falling strictly within its scope of work; (iii) the men and materials used for any area of work are under the risk and control of respective consortium members; (iv) the control and management of the consortium is not unified and common management is only for the inter-coordination between the consortium members for administrative convenience; and (v) in any case, the fact and circumstances must be considered since there may be other factors that can be taken into account.

6.4. Final note

Although the different issues that can arise when applying article 5(3) of the OECD Model have been dealt with separately, it is common in practice to have all of them or some of them together in the same situation. For instance, in a large contract (i.e. EPCs, turnkey, JOAs) there can be partnerships, general contractors and subcontractors, supervision and on-site planning and the enterprises participating in the contract may or may not be resident of the same country. This makes the application of article 5(3) of the OECD Model a rather complex issue, especially when the countries involved do not follow the same interpretation.

7. Computation of the 12-month time threshold

7.1. Introduction

The 2017 Commentary on Article 5(3) of the OECD Model has added relevant clarifications on this specific issue (paragraphs 54 and 55). Once again, the 2011 Draft OECD Report on Interpretation and Application of Article 5 (Permanent Establishment), paragraph 66, was also of help for the 2017 Update, but, as explained below, there are still some uncertainties and room for different interpretations.

7.2. Initial date

"A site exists from the date on which the contractor begins his work, including any preparatory work, in the country where the construction is to be established, e.g. if he installs a planning office for the construction" (paragraph 54 of the Commentary on Article 5(3) OECD Model (2017)). Although the formulation of the initial date may seem clear upon a first reading, as a matter of fact, it is very ambiguous and different computations may be frequent (the issue is more relevant the shorter the time threshold is for construction PEs in treaties, since the source country may be tempted to accept the initial date that is more favourable for their interest, whereas the residence country may start from a different initial date, later in time).

For instance, as the German report in this volume explains, for Germany, the initial date refers to the time the first worker arrives on-site, irrespective of the activities conducted. It is also possible that materials and machinery arrive first to the site. What date should be chosen as the initial one in those cases? Is it the day when the works start on the site or the day where the first worker, materials or machinery arrive? Since article 5(3) of the OECD Model is directly connected with article 5(1) of the OECD Model, the initial date should refer to the moment in time where the

contractor has the site at its disposal. And this can be marked by objective signs such as the beginning of the works, the arrival of material or machinery or the arrival of the first workers. It seems, therefore, that the reference to when the contractor "begins his work, including any preparatory work" has some margin for clarification in order to avoid different computations by the contracting states in the same tax treaty.

7.3. Final date

The final date of the 12-month period in article 5(3) of the OECD Model is the date when "the work is completed or permanently abandoned" (paragraph 55 of the Commentary on Article 5(3) of the OECD Model (2017)). In this regard, the 2017 OECD Model has added some clarifications in paragraph 55:

– The period of testing is included within the computation.

– Delivery to the client usually represents the end of the period of work, provided the contractor or subcontractor no longer work on the site after its delivery for the purposes of completing the construction.

– Work undertaken pursuant to a guarantee is not included in the original construction period.

– Depending on the circumstances, any subsequent work (including work done under a guarantee) performed on a site during an extended period of time may need to be taken into account in order to determine whether such work is carried through a distinct PE. For example, if after delivery of a project, employees of the contractor or subcontractor remain 4 weeks on the construction site to train the owner's employees, the training should not be included within the computation.

In general, the clarification should be welcome, especially the identification of the

final date with the handover of the project except if work continues on the site after that date. However, the Commentary seems to support splitting up of contracts that are not easily acceptable. In this author's view, it is not justified to exclude from the computation the training period since it appears as an ancillary activity to the execution of the construction, installation or project in general and therefore should be computed within the 12-month threshold. It is true that paragraph 55 mentions that concerns about the splitting-up can be dealt with by the anti-fragmentation clause of paragraph 52 of the Commentary or anti-abuse legislation, but, at the same time, the principle is established that training can be split from the main contract. It appears that the Commentary offers an easy route for splitting up contracts that is shielded from attacks with anti-splitting devices in a case where it is unjustified that ancillary activities are treated differently from the main object of the contract. On the other hand, interventions within the guarantee period, while also ancillary, may not be directly related to the construction activity as directly as training since they may never take place or can be done months or years after the end of the project or construction.

7.4. Temporal interruptions

Paragraph 57 of the Commentary on Article 5(3) of the OECD Model also refers to the causes for temporal interruption of the computation of the 12-month period: seasonal (e.g. bad weather) or temporary (i.e. shortage of materials, labour difficulties) interruptions will not be relevant to stop the computation. In Germany (*see* the German report in this volume), interruptions not founded on operational reasons attributable to the service provider (e.g. caused by client) can be taken into account to stop the 12-month period.

The Commentary, however, does not seem to follow a clear principle on interruptions: some temporary interruptions are not under the control of the service provider (e.g. bad weather) and still do not stop the computation; other examples (e.g. shortage of materials, labour conditions such as the strike of workers) could be

under the service provider's control or not, and, likewise, do not stop computation either (e.g. shortage of materials may be due to a bad planning or to reasons that are completely alien to the service provider). German practice points in the direction that some causes alien to, and not under the control of the service provider, but attributable to the client can be taken into account for temporary interruptions. It is therefore not clear when and if some specific reasons for interruption (e.g. delay in the payments by the client that cause the service provider to interrupt the construction work, delays in the execution or starting/completion of the project that can be attributable to the client or to a third party) will stop the computation or not, or what the reasons behind the causes that provoke the interruption of the period may be (objective or subjective reasons that affect the service provider or the client). It seems that the Commentary and German practice point in the direction that reasons that affect the service provider (under its control or not) will not be taken into consideration, but the Commentary is silent on reasons that may be caused by the client (which the German practice admits) or third parties (e.g. damage caused on a site or project by a third party that has to be repaired by it, governmental interventions that cause the activity to stop, etc.). A more principled approach to interruptions would be welcome to avoid divergences in the computation by the different countries, which means that the Commentary can probably be further expanded in this regard. It can also be interpreted that the Commentary does not admit any temporary interruption once the construction work starts, but if this is the principle, it should be more clearly stated.

8. Attribution of profits and article 5(3) OECD Model

Although this contribution is mainly about article 5(3) of the OECD Model, it is worth mentioning some problems of the allocation of profits to construction PEs. The issue of allocation of profits to this type of PE is mentioned in paragraphs 35-37 of the Commentary on Article 7 OECD Model (2017), which basically remark the following:

– Experience has shown that these types of PEs can give rise to special problems.

– The problems often arise where goods and services are provided by other parts of the enterprise (or related parties) in connection with the building site or construction or installation project.

– The general principle applies that only profits attributable to the activities of the PE (carried on through the PE by the enterprise) can be taxed in the state of the site or project.

– Profits from goods or services supplied from outside the state should not be attributed to the PE.

As the Commentary on Article 7 recognizes, it is highly common in construction or installation projects that parts of the activity are carried out from outside the state where the PE is located, i.e. the initial planning phases, coordination or supervision, specific services (e.g. design, assembly of some parts, provision of some raw materials, hiring of some specialized workers, assistance while the project is executed, etc.). Others (e.g. the material execution of the work), however, are done on-site. Therefore, it is not rare that both countries (residence and source) would not agree on the same attribution of profits to the PE and the different parts of the project being executed through the PE or the head office located in the state of residence. This is not only the case with large projects, but it may also happen with more modest construction works.

However, even provided that both contracting states (source and residence) apply symmetrically articles 5(3) and 7 of the OECD Model and both recognize the different activities/attribution of profits at the level of the head office or the PE, asymmetric attributions of profits are still not uncommon either because, depending on the attribution of profits models used, the outcome can be different (i.e. a country can only accept the attribution of a expense, whereas the other can see

that there is a service provision between the head office and the PE where expense plus a margin of profit is more correct to value the "deemed service"). The Commentary on Article 7 of the OECD Model (2017) does not take into account that there can be very different national approaches to the attribution of profits to construction PEs in the countries involved, depending on the Commentary on Article 7 of the OECD Model they follow or the national legislation in the contracting states. In this regard, not only the distinction between the authorized OECD approach and other approaches is relevant, since there are more models that can be applied by different countries in their domestic legislation or administrative practice (the pre-2008, 2008, 2010-2017 or mixed systems can produce very different outcomes). The problem has not been considered either in the 2018 OECD Additional Guidance on the Attribution of Profits to PEs BEPS Action 7.

As a matter of fact, the Additional Guidance does not even explain how the "aggregation or accumulation clause" proposed and explained in section 4 above will work and whether its application will give rise to one PE, two or more PEs or there will be an approach similar to partnerships (*see* section 6.4.), which adds more uncertainty in the field of attribution of profits.

As a consequence, it seems that provided that both countries interpret article 5(3) of the OECD Model in the same manner, very relevant issues and divergences may arise in connection with attribution of profits, which may not be symmetrical either in both countries, therefore, making the application of article 5(3) (in connection with article 7) of the OECD Model even more difficult.

9. Conclusion

The simple wording of article 5(3) of the OECD Model may be very misleading since it still hides, and the Commentary to it does not resolve after 2017, many problems of interpretation and application that arise upon a closer reading of the article or attempts to apply it to the complex reality of building activities and construction or

installation projects, especially the most challenging and sophisticated ones. The BEPS-derived changes render the application of the article more difficult and will give rise to more issues and divergences in terms of interpreting and applying article 5(3) of the OECD Model. Additionally, article 5(3)(a) of the UN Model seems to present problems in its own that are added to the complexity the construction PE has in the OECD context, and, therefore, it may not be an alternative to the OECD formulation. The problems are all the more difficult to resolve if the different systems of attribution of profits to construction PEs that can be applied internationally are taken into account. This basically means that there is still margin to work on article 5(3) of the OECD Model and the problems of attribution of profits to these PEs.

One of the factors that adds more complexity to the interpretation of article 5(3) and gives more leeway in terms of tax planning is the requirement of geographical and commercial coherence that was introduced in 1977 in the Commentary to this article. In times where it is defended that a state should be considered as a whole for the purposes of taxing the digitalized economy, it may not make sense to maintain this requirement for activities (construction work and installation projects) that can have a reasonable degree of mobility or remoteness (important parts of the project can be done offshore) and lack a permanent fixed place of business as a reference, even if that may imply a more radical reform of the PE threshold. As it happened in the past, once again, article 5(3) of the OECD Model may be used as a laboratory or precursor for more radical changes in the PE concept, although a joint reform or "reinterpretation" of article 5(1) and (3) of the OECD Model is probably a better alternative.

10. Bibliographical note

This contribution is based on the notes used for the conference in Milan, "New Trends in the Definition of Permanent Establishment" on 26 November 2018, and this is why it has been done without footnotes. It is fair, however, to recognize the works that contain ideas that have influenced this chapter, although specific

reference to them is made in the text above when some had a specific impact on this author's position. These relevant works are the following:

– B.J. Arnold, *Article 5: Permanent Establishment*, Global Tax Treaty Commentaries, IBFD.

– J.M. Calderón Carrero, *Beneficios Empresariales (y de Navegación)*, in *Todo Convenios Fiscales Internacionales y Fiscalidad de la Unión Europea* p. 177 et seq. (N. Carmona Fernández ed., Ciss, 2017).

– A. Martín Jiménez, *Preventing the Avoidance of Permanent Establishment Status*, in *UN Handbook on Selected Issues in Protecting the Tax Base of Developing Countries* p. 365 et seq. (2nd edition, A. Trepelkov, H. Tonino & D. Halka eds, United Nations 2017).

– A. Martín Jiménez, *BEPS, the Digital(ized) Economy and the Taxation of Services and Royalties*, 46 Intertax 8/9, p. 620 et seq. (2018).

– H. Pijl, *The Relationship Between Article 5, Paragraphs 1 and 3 of the OECD Model Convention*, 33 Intertax 4, p. 189 (2005).

– E. Reimer, *PE in the OECD Model Tax Convention*, in *Permanent Establishments: A Domestic Taxation, Bilateral Tax Treaty and OECD Perspective* (E. Reimer, S. Schimd & M. Orell eds., Kluwer 2014).

– J. Sasseville & A.A. Skaar, *General Report*, in *Is There a Permanent Establishment* (IFA Cahiers vol. 94A, 2009), Online Books IBFD.

– A. Skaar, *Permanent Establishment* (Kluwer, 1991).

Of course, the country reports in this volume were also a major source of information and inspiration for this chapter.