

INTERNATIONAL TAX ASPECTS OF PROVIDING CONSULTING SERVICES ON THE PREMISES OF THE CLIENT

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Abstract

Among the most important issues in contemporary accounting practice is the handling of independent consultants who work for a firm but who are not officially employed by it and who therefore do not pay withholding taxes. This loss of revenue has important economic consequences, particularly in the developing world. In this article, the author considers the case of consultants who may or may not have an official office in the country in which they practice.

1. INTRODUCTION

1.1. General Remarks

Income from services, particularly from consulting, is a source of controversy between taxpayers and tax authorities, and Thailand is no exception. Contributing factors are that service expenses such as consulting, management fees, research costs, advisory services and technical services or assistance are generally deductible, as are interests and royalties. For the two latter groups of business expenses,

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however, most countries apply withholding taxes, which compensate (in part) for the loss of fiscal revenue caused by the base erosion¹. For expenses related to consulting services, again generally speaking, withholding taxes do not apply².

Because they are of an intangible nature, they are not always easy to audit for tax authorities. Whether the expense can be justified from a business point of view, may also be questioned. Therefore, tax authorities are vigilant, probably not without reason, that the taxable profits of taxpayers are not reduced for tax avoidance purposes only.

Developing countries are particularly conscious of the base erosion³ effect that (consulting) services have (as seen in more detail below), which explains why countries such as India have a specific rule providing

non-resident taxation for such services as “technical fees”⁴ and a corresponding provision in most of its double taxation conventions (an agreement between two countries with provisions to avoid that cross-border situations would be taxed twice. Hereafter: “DTC”).

Thailand itself has a withholding tax on “hire of work” which will apply to much of the consulting services discussed in this article if the service performer carries on business in Thailand (Taw Paw 4/2528 Clause 8 (3)). The tax rate is 3%, but that rate is increased to 5% if the service performer has no “permanent office” in Thailand. Payments made to *foreign* service providers for consulting (and which fall under sec. 40(6) or 40(2) Revenue Code) are subject to a 15% Thai withholding tax, as provided by sec. 70 of the Revenue Code.

Sec. 40 (6) RC refers to the liberal professions mentioned above. Sec. 40 (2) concerns income from personal services that are not rendered in the context of an employment contract under the authority and direction of an employer, such as company directors, consultants, etc. Only consultancy fees that qualify as “income from business” under sec. 40(8) RC are under Thai domestic law not subject to withholding tax. Such would be the case if the expenses for the consultancy company

¹ base erosion is the reduction of taxable profit by deduction of expenses such as interest, royalties, management fees and other expenses.

² Some countries do have withholding taxes or turn-over taxes that apply to consulting services performed by non residents. China has a 5% Business Tax on consulting services. Thailand usually subjects consulting fees paid to non-residents to a 15% withholding tax (sec. 70 and 40 (2) RC) which does not apply in a tax treaty situation if there is no permanent establishment. Besides income tax, the services used in Thailand may be subject to VAT.

³ “base erosion” means the creation of tax deduction by means of deductible expenses such as services, interest, etc.

⁴ Sect. 9(1) vii. Indian Income Tax Act.

related to furnishing the service are relatively high. The Thai Supreme Court (Case 5400/2536) has pointed out that the difference between 40(2) and 40(8) RC must be seen in the perspective of (standard) expense deduction: if a consulting activity requires few expenses made by the consultant for his activity (investment advice, management, marketing, ...) it falls under sec. 40(2) RC, but if high investments and expenses are to be made for setting up the consulting activity (mineral extraction and analysis, quality control, ...) 40(8) RC applies.

It is noteworthy that in case a tax treaty applies, and taxing power is exclusively attributed to the country of residence of the service performer, the 15% withholding tax provided in sec. 70 RC, cannot be levied.

1.2. Different possibilities for source taxation of consulting services

With reference to the above, it can be noted that source taxation of consulting services will in most cases only be achieved if it can be established that the service performer has a permanent establishment in the source country.

With respect to the DTC, source taxation of technical fees paid by an enterprise to a foreign beneficiary may be appropriate under one of the following DTC-articles:

1. The payment constitutes business profits which is connected to a permanent establishment (hereinafter PE) of the supplier of the service in the source country, (art. 7) or
2. The payment can be regarded as a “independent personal service” income, which is attributed to a fixed base (hereafter FB) in the source country, or because of another rule provided in the DTC (art. 14);
3. The payment can be regarded as a royalty paid by a resident of the source country, (art 12) or
4. The payment is subject to a specific rule included in the DTC, which allows the source country to tax income of this nature. (For instance, an article dedicated to “Technical Fees” or “Included Services”).

WARD suggests that technical assistance payments which are neither royalties nor business profits, may be treated as “other income” (art. 21), but this situation lies beyond the boundaries of commercial operations and is not further dealt with in this article⁵.

⁵ WARD, D., AVERY JONES, J.F., “The Other Income Article of Income Tax Treaties”, *B.T.R.*, 1994., 367.; Also TANDON SANDEEP, “Taxability of Royalties and Technical Fees Arising in India”, *Bull.I.F.D.*, 1997, 419.

It is clear that, with respect to business-to-business consulting services, the possibility for source taxation as business profits of a PE is one of the main means for a country to retain taxing power over such income.

There is an alternative way for tax authorities (besides indirect taxes) to “tax” the service income, and that is to deny the deductibility of the correlating expenses in the hands of the payer. By deeming the service expenses not deductible, effectively (and if otherwise tax would have been due) the same result will have been achieved compared to taxing the beneficiary on the income at normal rates.

1.3. P.E.-issue

The UN working party of experts, while drafting the UN Model tax treaty (for double taxation conventions between developed and developing countries), has paid particular attention to the problem of deductible consultancy services.

From the deliberation, it was clear that developing nations are wary that services would be paid not to make new production processes possible, but merely to transfer profits to capital exporting countries⁶. The financial

⁶ “Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries”, UN, New York, 1979, p. 75.

consequences of consulting services performed by developed countries to developing countries are considerable⁷.

The solution to curb this base erosion effect adopted by the UN makes use of the permanent establishment to create a possibility for source taxation of services⁸.

The deliberations of the Group of Experts show the importance of the PE-issue for consulting services. It is, in most cases, the primary possibility for source country taxation. It is also, together with the non-deductibility in the hands of the payer, an important tool to curb base erosion. Especially developing countries seem fond of the “furnishing of services”-PE to curb base erosion where possible⁹.

This is well illustrated by a recent circular of the State Administration of Taxation of China that addresses foreign consultancy services¹⁰. As CHEUNG and LEYSSENS note on the

⁷ MANSURY, R., “Tax Treaties from the Perspective of a non-OECD Country”, 150.

⁸ “Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries”, UN, New York, 1979, p. 77.

⁹ BIR Ruling No. 031-95 Feb. 14 1995 (Philippines tax authorities qualify a French technical advisor to the Railway system, as having a permanent establishment under 5(2)I of the Philippines-French DTC); See also Chinese Foreign Investment Enterprise Income Tax Law, which deems “a site for the furnishing of services” a branch (see also below).

¹⁰ Guo Shui Fa, 2000, nr. 82.

basis of the new instructions (specifying that under certain circumstances, consulting services may be taxable in China even if performed outside of China¹¹): “Although for most consultancies the tax treaties or arrangements will offer a route of escape from the severity of the new regulatory regime, Circular 82 still means that overseas consultancies will have to think hard about their China-strategy and plan their projects rigorously so as *not to be captured by the PE provision* (author’s italics)”¹².

1.4. In this article

Based on the above, in this article the PE concept will be examined from a perspective of the provision of (consulting) services by non-residents. More particularly, the question is addressed how a consulting enterprise can have a PE in another country without having any fixed place of business “of their own”, but performing the consultancy on the premises of the client.

The terminology concerning services of this nature is rather vague.

¹¹ More specifically, revenue allocation rules state that if a foreign consultant is sent to China to provide consulting services, not more than 50% of the fee may be regarded as performed outside of China, irrespective of where the work actually took place (Guo Shui Fa, 2000, nr. 82).

¹² CHEUNG and LEYSSENS, “Foreign Consultancies Face Tougher Tax Regime”, China Tax Review, Vol. 7 number 2, p. 4.

Most DTCs expand the scope of “services” to include consultancy services, managerial services, technical services etc. What kinds of payments are consideration for “services, including consulting services” in the sense of the UN Model, for instance, is as a matter of fact one of the questions that is addressed in this article.

Income that may be characterized as independent services income, royalty or technical fee, director remuneration, etc. falls outside of the scope of this article, but those definitions are still useful to provide negative definitions of the subject matter.

Thailand’s tax treaties are largely based on the OECD Model (model treaty for the avoidance of double taxation, on which most of the world’s tax treaties are based), but some treaties are based on the UN Model treaty. In this article, first those treaties which resemble the OECD Model are discussed, followed by treaties based on the UN Model.

2. THAI TREATIES BASED ON THE OECD MODEL TREATY

Treaties that are mostly based on the OECD Model with respect to permanent establishments (here it mainly referred to the so-called furnishing of services provision as explained in detail below), are those concluded with **Austria, Bangladesh,**

Belgium, Denmark, France, Germany, Italy, Korea, Malaysia, Netherlands, Norway, Poland, Singapore, UK, and Vietnam.

2.1. A fixed place of business for the service provider on the premises of the client?

a) General remarks

Income from services may be taxable in the source country if they are deemed business profit that is connected to a permanent establishment in that country.

“A permanent establishment is a fixed place of business through which the business of an enterprise is wholly or partly carried on.”

For a permanent establishment to exist, the following conditions must be met:

- There must be a place of business;
- That place of business must be fixed;
- The carrying on of the business of the enterprise through this fixed place of business.
- The activity does not figure among the so-called negative cases (such as purchase offices, collecting information, etc¹³.)

¹³ art. 5 par. 4 OECD Model DTC

Secondly, a PE may also exist, even without the presence of a fixed place of business, through a so-called dependent agent. This is the case when a person is acting on behalf of an enterprise and habitually exercises the authority to conclude contracts in the name of the enterprise, unless the activities of that person are limited to preparatory or auxiliary activities¹⁴.

It is noteworthy that Thai tax authorities have previously not considered 5 months to be a sufficiently long period to constitute a PE (Gor. Kor. 0802/7018 of 16th April 1991)

b) A fixed place of business and disposal by another enterprise

As a principle, it is not required that the place of business that is a constituting element of a PE is the property, rented or leased by the enterprise performing the service. The OECD Commentary acknowledges explicitly that

“... the place of business may be situated in the business facilities of another enterprise. This may be the case for instance where the foreign enterprise has at its constant disposal certain premises or a part thereof by the other enterprise¹⁵”.

¹⁴ art. 5 par. 5 OECD Model DTC.

¹⁵ OECD Commentary art. 5 par. 4.

As a principle, it can therefore not be excluded that a consulting enterprise may have a PE on the premises of their client in another country.

There is international case law that supports the possibility of one enterprise having a PE on the premises of another enterprise, more particularly in the relation between a service provider and his client. A Norwegian case, cited by SKAAR, illustrates this¹⁶ as does other Norwegian case law¹⁷. In Belgium, an office that a Dutch company held at the disposal of a Belgian consultant was deemed to qualify as a fixed base under the treaty¹⁸. In its notorious decision concerning the “hotel-management case”, the German Bundesfinanzhof held that a UK service performer had a PE in the premises of a German customer if factual control over certain office space existed, even if the consultant had no legal rights on the premises¹⁹. Earlier German case law had evoked the question if a legal right on the premises was required²⁰.

c) Carrying on of the business proper of the consultant

A fixed base alone is not sufficient to have a PE. The *business of the consultant* must be carried on through that fixed base. The question that now has to be addressed is whether a consultant can be deemed to carry on the business of his enterprise through the mere performing of services on the premises of the client.

In many cases the non-resident performer of services will not have nor need a fixed place of business in the source country, were it not for performing his services in the factory, offices or other facilities of the customer. Is the consultant carrying on the business of the client, or per se also his own?

The answer may be found with reference to the concept “to carry on a business”, a discussion that, with respect to source rules of business profits, is much more familiar to tax lawyers in common-law jurisdictions²¹

¹⁶ Court of Appeal, Utv., 1992, at 221; SKAAR, Commentary on art. 5 of the OECD Model Treaty, IBFD, 20.

¹⁷ Stavanger Byrett in Utv. 1989 at 496.

¹⁸ Court of Appeal Antwerp, 15 January 1996, FJF, 96/84.

¹⁹ BFH, 3 February 1993, I R 80-81/91, BStBl. II, 1993, p. 462.

²⁰ BFH, BStBl, 1990, II, 166.

²¹ Canadian Income Tax Act, s. 248(1) “carrying on business in Canada”; Hong Kong Profits Tax, s. 14 “carrying on a trade, profession or business in Hong Kong”; Indian Income Tax Act, s. 9 “income arising through or from any business connection in India” UK tax law now provides that “A company not resident in the UK shall not be within the charge to corporation tax unless it carries on a trade in the UK *through a branch or agency* ...Income and Corporation Taxes Act 1988, 11 (1).

than to his continental European colleague, where the source taxation of business profits is more often seen in perspective of physical establishment²².

Leaving aside what exactly constitutes “carrying on a business” and what not according to the domestic laws of contracting states, it seems to be generally accepted that a certain regularity or continuity is required. An isolated transaction does not (yet) constitute the carrying on of a business²³. This supports the idea that the use the consultant has of the facilities of his client, and when that use is restricted to the purpose of carrying out the service contract, does not constitute carrying on business. It is carrying out an assignment²⁴.

Of course, the “business” of the consulting enterprise consists of such assignments. The *carrying out of a*

consulting contract must however be distinguished from the *carrying on of a consulting business*. A consultant who performs his service in the premises of his client, can be compared with a foreign company who sells a product to a domestic buyer. Both are only doing business with that country, and not per se in that country.

In other words, the fact that the service performer has a place of business at his disposal from his client does not necessarily mean that this place of business constitutes a permanent establishment for the consulting enterprise. On the other hand, it is not to be excluded either. Important factors here seem to be over with period of time the place of business is at the disposal of the consultant.

The question may be asked why the consultant has the disposal of certain premises of the client: is it to serve the business of the consultant or that of the client? Obviously, certain services can only or best be performed within the premises of the client (services concerning equipment, software programs, quality control to certain products, hotel management services, maintenance, managing a ship or an oil platform, ...). Other services are performed in the offices of the client for his convenience (training of staff, audit, legal and financial advice, ...). In both cases the client offers the use of his facilities to make the dispensing of the service possible or comfortable for a

²² See the introduction of “betriebsstätte” (indicating the place used for the conduct of a business activity in the German empire and Prussian tax statutes of 1885, its consequent absorption in pre-1900 tax treaties and tax laws in continental Europe; SKAAR, A. p. 75-77).

²³ Groetzinger v. Commr. 107 S Ct 980 (1987) (US); Tipke/Lang, Steuerrecht 167 (12th ed) 1989 (Germany); CIT v. RD Aggarwal & Co [1965] 56 ITR 20 (sc) (India).

²⁴ HUSTON, loc. cit. p. 93; VOGEL, K., loc. cit., p. 287 “The power of disposition test would not be satisfied if a customer of an enterprise were to make available certain premises to the enterprise for use by the latter in accomplishing a planning and supervision assignment or performing specific work there”, quoting FG Hessen, 21 EFG 496, 497 (1973).

certain period of time. To whose advantage, or in other words, for whose business purpose the place was at the disposal of the consultant, will become apparent by verifying if the consultant paid consideration in any way for the use of the facilities. If that were the case, or if the consideration was deducted from the fee, it is an indication that also the business of the consultant could have been conducted there.

The condition of the premises being used for the business proper of the consultant is also supported in the Thai Supreme Court landmark case 3867/2531, where a Japanese company with a team of Japanese technicians providing services on the factory floor of the client in Thailand, was not held to have a PE in Thailand.

SKAAR argues that if the consultant is required to be present in the source country, he may have the choice between opening his “own” PE, or using his client’s facilities. It is the opinion of SKAAR, that in such a case, the facilities of the client may be deemed a place of business of the consultant²⁵.

2.2. Can the service provider be deemed a “dependent agent –PE”?

Even if no fixed place of business exists, the presence of a consultant or

²⁵ SKAAR, IBFD, 20-21.

other service performer may still constitute a permanent establishment, if he can be considered “a person who is acting on behalf of the enterprise and who has also habitually exercised an authority to conclude contracts in the name of the enterprise”²⁶.

For this to be so, in the first place the consultant himself and the relationship to “his” enterprise must be considered. Is he an employee, working under the direction and authority of his superior in the head office, unable to take decisions that would legally bind the enterprise? Or is he on the contrary a director of the enterprise himself, fully capable of concluding contracts “on the spot”?

Employees who lack the authority to bind the enterprise may not be considered a (dependent agent-) PE. Such is confirmed by an abundance of international case law²⁷. A technical advisor was considered not to be an “agent” of the foreign company in Indian case law²⁸. Also, in the context of hire of labor, the presence in the source country of employees or consultants usually does not constitute a PE²⁹.

²⁶ art. 5 par. 5 OECD DTC.

²⁷ HUSTON, p. 92 footnote 70.

²⁸ CIT v. New Consolidated Gold Fields Ltd., (1983), 143 ITR 559/15.

²⁹ OECD “Taxation Issues Relating to International Hiring-out of Labor”, 1984, 22; SKAAR, p. 333.

Secondly, it is clear that even when the service performer which is present in the source country in theory has the legal authority to conclude contracts on behalf of the enterprise, this in itself does not suffice for a PE to exist. He must also habitually exercise such authority (and not only for activities mentioned par. 4 of art. 5 OECD DTC). Notwithstanding the fact that the consultant is also the owner of the consultancy company, for instance, his presence in a source country for performing services does not in itself mean that a PE exists if he does not make use of it to conclude contracts.

What is more, the consultant must do so with a certain degree of permanence and regularity to qualify for art. 5 par. 5 OECD DTC³⁰. The re-concluding of the consultancy agreement alone does not suffice³¹.

The specifics of the service performed will also be an important factor to consider whether a dependent agent-PE exists. Some, probably not most, service agreements require a constant decision making-capacity that legally binds the consulting enterprise. Such is for instance the case when the consultant must be able to take decisions himself “on the spot” about the price of the service (or additional

³⁰ VOGEL, loc. cit., p. 332; SKAAR, IBFD, p. 50.

³¹ STORK, A., *Ausländische Betriebsstätten im Ertrag- und Vermögenssteuerrecht*, Frankfurt, 1980, 202; RFH, RStB1 1934 at 1125.

services) that is/are to be furnished to the client. HUSTON indicates that to avoid the creation of a dependent agent-PE in the case of employees or consultants present abroad, they “should have no authority to bind their foreign principal, should regularly consult with home country personnel about customer queries and technical advice given³²”.

2.3. The furnishing of services related to building sites, construction or installation

Services that concern building, constructing or installing are not always within the scope of art. 5 DTC, and thus do not per se constitute a PE. Under the OECD Model DTC, planning and supervisory services are only included in the term “building site or construction project” if they are carried out by the same enterprise as the one that actually does (or at least participates in) the physical construction³³.

³² HUSTON, p. 93.

³³ OECD Commentary, art. 5 par. 17; OECD Working Party Report, 6 January 1966 cited by SKAAR, p. 407. Support may also be found in US Revenue Ruling 77-45, 1977-1 C.B. 415, where a consulting engineering firm that had planned and designed manufacturing plants, constantly evaluated on-site conditions, recommended changes to the construction plans, checked the contractor bills, etc was deemed ‘supervision’ and not construction. Huston p. 60 notes that if ‘supervisory activities’ are not mentioned separately in the

The furnishing of a wide range of services that concern construction or installation are not assimilated with a building site for the purposes of art. 5 DTC unless the consultant also participates in the physical work. As BLUMENBERG puts it: “In some cases the foreign enterprise’s activity may be restricted to the mere planning and supervising of the work, i.e. the enterprise acts only as a consultant of the building contractor. These types of activities do not constitute a PE, neither according to German domestic law, nor according to German treaty law³⁴”. More often than not, the consultant does not participate in the physical construction, or such is easily avoided by establishing separate juristic entities to isolate the (lucrative) consulting work from the taxing power of the source country. Advice on planning, location search, feasibility, geological studies, studies concerning infrastructure and public transport, on a variety of projects such as buildings, roads, railroads, train stations, canals and airports, may be mentioned in this context. Advice on how to install or insert new heavy equipment in the existing production lines would, if the activity is limited to that, not qualify as an activity under art. 5 par. 3 DTC. Services that are even less directly involved with the construction work

treaty, these activities do not constitute a PE if the other conditions of the article are not met.

itself, such as financial services are clearly out of the scope of art. 5 par. 3 DTC.

2.4. Can a fixed place of business or a dependent agent with reference to consulting services be deemed of a preparatory or auxiliary nature?

Even when a fixed place of business exists on the premises of the client, or when a dependent agent is present in the source country, this still does not constitute a PE if it can be shown that the activity carried out is limited to those mentioned in art. 5 par. 4 OECD DTC, most importantly an activity of a preparatory or auxiliary character.

The furnishing of certain services, specifically consulting services, may fall within that scope. In the OECD Commentary several indications to that effect can be found, especially when the furnishing of certain services is secondary to or the consequence of another business transaction that was concluded between the parties.

³⁴ BLUMENBERGER, J., IBFD, Germany, p. 60; also see previous footnote. For the solution under the UN Model, see below.

The servicing of a know-how contract, for example, even if done through a “fixed place of business” is an activity that has a *preparatory or auxiliary character*, and cannot in itself lead to taxation in the source country³⁵. Technical assistance is after all always required when a machine or production line is purchased, and such services should not be seen as separated from the main contract.

Certain services such as technical services are often accessory to another contract, for instance the sale of a machine, a plant or know-how³⁶. The provisions of the OECD Commentary concerning after-sale service are relevant in this regard, and they clearly indicate that such services have, in principle, a preparatory or auxiliary character³⁷. As SKAAR puts it: “In most cases post sales activities cannot be said to be the general purpose of the enterprise, unless performed through a separate legal entity³⁸. This is also illustrated by case law where a German company sent technicians for setting up and rendering the plant productive that

the buyer had bought from the company. Such assistance had to be seen in connection with the main contract, according to the Court³⁹. Other examples include situations where the work to set up a plant and make the plant workable is deemed a part of the sale⁴⁰.

Also the OECD Commentary concerning the leasing of equipment is relevant, as it states that for the leasing of tangibles and intangibles (such as know-how) such activity usually does not lead to having a permanent establishment even if “*the lessor supplies personnel after installation to operate the equipment provided that their responsibility is limited solely to the operation or maintenance of the equipment under the direction, responsibility and control of the lessee.*”⁴¹”

The above illustrates the possibility of consulting services being of a mainly preparatory or auxiliary nature, and consequently not constituting a PE.

³⁵ OECD Model DTC Commentary, art. 5, par. 23.

³⁶ “After-sale services of a technical nature, however, do not necessarily constitute a sufficient business connection with India, even if the deputation of personnel is involved” (CIT v. Fried.Krupp Industries (1981) 128 ITR 27 (Mad)).

³⁷ OECD Model Commentary art. 5 par. 25.

³⁸ SKAAR, loc. cit., p. 300.

³⁹ Andrew Yule & Co vs. CIT (1994) 207 ITR 899 (Cal). In the same vein, the Thai Supreme Court decided (Case 3867/2531) that a team of 15 Japanese technicians working on the factory floor for technical assistance to their Thai customer was not a PE.

⁴⁰ Tekniskil v. CIT (1996) 222 ITR 551 (aar).; See also CIT v. Visakhapatnam Port Trust (1983) 144 ITR 146.

⁴¹ OECD Model Commentary art. 5 par. 8.

3. THAI TREATIESVBASED ON THE UN MODEL TREATY

An important number of Thailand's tax treaties includes the provision (below) on the furnishing of consulting services that is found in the UN Model: **Australia, Canada, China, Czech Republic, Finland, Hungary, India, Indonesia, Israel, Japan, Laos, Luxembourg, Mauritius, Nepal, New Zealand, Pakistan, Philippines, Romania, South-Africa, Spain, Sri Lanka, Sweden, Switzerland, US (90 days or associated enterprise) and Uzbekistan.**

3.1. Treaty text and history

The UN Model DTC extends the meaning of permanent establishment with regard to furnishing of services:

“The furnishing of services, including consultancy services, by a resident of one of the Contracting States through employees or other personnel, provided activities of that nature continue (for the same or a connected project) within the other Contracting State for a period or periods aggregating more than six months within any twelve-month period”.

Even if the enterprise furnishing the services is not accompanied by a fixed place of business in the source country, the mere fact that the service or the consultancy is supplied, is

deemed to be a permanent establishment, and may consequently be taxed on the income by the source country.

The UN working party of experts, while drafting the UN Model Tax Treaty (for double taxation convention between developed and developing countries), has paid particular attention to the problem of deductible consultancy services.

As noted above, the deliberation indicated that developing nations are wary that services would be paid not to make new production processes possible, but merely to transfer profits to capital exporting countries. In the discussion by the experts of the United Nations, it was mentioned that in some cases only patents and processes that have already been fully exploited elsewhere were licensed to developing countries, perhaps even after they have become obsolete⁴², a fear that is shared by some OECD countries⁴³.

This explains why several countries have made reservations to the text of the OECD Model DTC regarding the

⁴² Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries”, UN, New York, 1979, p. 75.

⁴³ Greece and Mexico made a reservation to exclude from the scope of the article, royalties arising from property or rights created or assigned mainly for the purpose of taking advantage of this Article and not for “bona fide commercial reasons” OECD Model DTC and Commentary, c. (12)12.

definition of royalties⁴⁴. Expanding the definition of “royalty” for the purposes of double taxation agreements increases the scope of payments that are subject to withholding taxes. Internationally, as mentioned below, royalties are more often than not subject to withholding taxes, even when double taxation agreements apply.

The UN Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries specifically addresses the question of payments for services in Guideline 12. In the discussion it was raised that technical services were not sufficiently distinguished from know-how in the OECD Model DTC and that a the UN Model DTC should adopt a provision, either in the definition of royalties or in a Protocol, excluding payments of this kind from treatment as royalties. Others disagreed and argued that technical services should be included in the definition of “information concerning industrial, commercial or scientific experience”.

The Group reaches a compromise; Guideline 12 qualifies payments for technical services as business profits, but the definition of “permanent establishment” will be changed to include the provision of these services if they take longer than 6 months.

⁴⁴ Non-Member Countries Positions, OECD, Paris, 1996, (Argentina, The Philippines and Brazil are the other non-OECD member countries that made the same reservation).

“In order to solve the problem of the definition of royalties, the Group agreed to consider income from such activities as business profits and to include in Guideline 5 par. 3 (on permanent establishments, evdb) a new subparagraph (b) which provides that the term permanent establishment should likewise encompass “the furnishing of services, including consultancy services, by an enterprise through employees or other personnel, where activities of that nature continue (for the same or a connected project) within the country for a period or periods aggregating more than six months within any twelve-month period”⁴⁵

According to a 1997 study of the International Bureau of Fiscal Documentation, around 25% of the world’s tax treaties between 1980 and 1997 contain a specific provision for the furnishing of services⁴⁶. The provision has also found its way into domestic law. In Chinese income tax law, establishments are defined to include management and business establishments, offices, factories, etc, ... and *sites for the furnishing of services*. Thus, Chinese domestic tax law incorporates the “furnishing of

⁴⁵ Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries”, UN, New York, 1979, p. 77.

⁴⁶ WIJNEN, W.F.G. and MAGENTA, M., “The UN Model in Practice”, B.I.F.D., 1997, 576.

services - PE” that is described in the UN Model Tax Convention.

3.2. Conditions for applying art. 5 par. 3 b) UN Model DTC

a) The services are furnished

It is both required and sufficient that the services mentioned in art. 5 par. 3 b) UN Model DTC are furnished. The choice for the word “furnished” is not self-evident. After all, the history and purpose of the text shows clearly that the UN experts tried to counteract base erosion, and “the deduction by a resident of the other Contracting State” or “if the consideration for the services is borne by a resident of the other”, as the UN Model DTC does in art. 14 c), would have been a possibility.

The text of the treaty is however clear, and it seems to this author that services that were furnished but were never deducted for tax purposes may still constitute a PE in the sense of art. 5 par. 3 b) UN Model DTC. Such may be the case when the deductibility of the consideration for the payer has been disallowed, or when the payer is reimbursed by another enterprise.

If there is a distinction between the country of the payer of the services and the country where the services were furnished (for instance the holding paying for training and consulting of its subsidiaries) the question arises in which country the services are deemed

“furnished” for the purpose of art. 5 par. 3 b) UN Model DTC. In other words, are services “furnished” where they are paid, or where they are performed? In the opinion of this author it must be assumed that only the place where the services are performed is relevant in this context, and not from where they were paid or deducted. This is supported by the (additional) requirement in the article specifying “... only where activities of that nature continue ...within the same country” (see below). The comparison with case law of mainly common law countries with respect to source taxation of business profits on services is also noteworthy. The income from services is generally taxable there where the service is performed⁴⁷.

b) The services are furnished within the source country

Unlike for example royalties, where only the source of the payment is relevant, the services or consultancy must be furnished within the source state. Services which are furnished in the residence state of the service-performer, or in any other state besides the source country, do not fall within the scope of this rule.

⁴⁷ MITTAL, D.P., 1.19.; RAJARATNAM, S., and VENKATRAMAIAH, B.V., loc. cit., 1.105.

In this context “furnished” must be understood as “performed”⁴⁸, and this condition may not be taken to be fulfilled by the mere communication of the end result. Such may often be the case for the design of plans, writing manuals, and expert opinions. That plans or opinions are drafted abroad and then sent to the source state does not constitute “furnishing” in the source state, as it is clear that they are performed elsewhere.

c) What kind of services are meant in art. 5 par. 3 b) UN Model DTC?

(i) Positive definition

The term “services” is not further defined in art. 5 par. 3 b) UN Model DTC. The article states that “consultancy services” are meant to be included, but no specification of that term is provided either.

What is, and what is not a “service” is consequently to be determined with reference to domestic law, unless the context requires otherwise⁴⁹. Below (negative definition) are some cases where the context of the treaty indeed seems to provide some indication of what may not be treated as a service for the purposes of the treaty.

⁴⁸ VOGEL, p. 310.

⁴⁹ Art. 3 par. 2 OECD Model DTC.

The definition has, in the tax treaty practice of contracting states, been elaborated by also mentioning “management, technical, commercial, ...^{49b}”. The elaboration in the treaty practice of several countries, the history of art. 5 par. 3 b) UN Model DTC and the relationship between art. 5 and art. 7 (business profit) all indicate that the term is in fact a “catch all” phrase, targeting all services relating to the carrying on of an enterprise or a business. The exact nature of the service (financial, management, production, ...) is not really relevant. Such is explicitly confirmed in a ruling of the Indian tax authorities⁵⁰.

(ii) Negative definition

Difference between “service, including consulting service” and royalty.

The *difference between services and royalties for know-how* is specifically addressed by the OECD Commentary:

“In the know-how contract, one of the parties agrees to impart to the other, so that he can use them for his

^{49b} See also art. 14 Argentina-Bolivia “fees for technical, financial, business, any other type of consulting”; Australia-Vietnam Exchange of Notes “consulting, accounting, auditing and commercial services”.

⁵⁰ Advance Ruling P. No. 28 of 1999, 105 Taxmann 218 (AAR-N-Delhi).

*own account, his special knowledge and experience which remain unrevealed to the public*⁷. (On the principle of imparting, see below).

“Know-how differs from contracts for the provision of services, in which one of the parties undertakes to use the customary skills of his calling to execute work himself for the other party”.

“Thus, payments for the consideration for after sale services, services rendered by a seller under a guarantee, for pure technical assistance or for expert opinions given by an engineer an advocate or an accountant do not constitute royalties within the meaning of par. 2”⁸.

⁷ OECD Model DTC Commentary art. 12 par. 11.

⁸ There is a Proposed Amendment to the OECD Commentary on Royalties with reference to technical fees. In order to further elaborate on the difference between technical services and transfer of know how, an amendment to the OECD Commentary was discussed by the OECD Committee on Fiscal Affairs Working Party No. 1. The text above is proposed to read in the future: “*Thus, payments for the consideration for after sale services, services rendered by a seller under a guarantee, for so-called basic or detailed engineering in connection with the erection extension or renovation of an industrial plant (including documentation for operation and maintenance of the plant) as well as for training of the purchaser’s personnel, for contract research for contract studies and for technical assistance or for expert opinions given by an engineer an advocate or an accountant do not constitute*

The criterion for difference between what is a payment for the use of know-how (royalty) and what is a technical service (business profit) in the OECD Model Treaty is the principle of *imparting*. Such is not only explicitly stated in the OECD Model Commentary, but also seems to correspond to an international consensus between scholars on the matter.⁹

royalties.” Though no detailed definition of the terminology is provided, the purpose of the amendment is to state that engineering consulting for the making of factories, training staff of the buyer of a plant, and research and studies is no transfer of know-how. The amendment also suggests deleting the word “pure” in the Commentary with reference to technical assistance. Since nor “technical assistance” nor “pure technical assistance” are clearly defined terms, one can hardly interpret the intention of the amendment, beyond saying merely grammatically that omission of the adjective “pure” leaves a more general notion of “technical assistance”. Certain tax treaties or Protocols already contain explanations to exclude those other services from the scope of technical services: Canada-Indonesia, Italy-Kuwait 12(3), French-Mexico Protocol 7 November 1991, French-Italy Protocol 5 October 1989, cl. 7. Other treaties assimilate consulting services with royalties or “technical fees”: India; China-UK 13(3); Indonesia-Netherlands Protocol ad art. 11; Malaysia-Netherlands 13A; French 13 on the difference between the two see also the Memorandum of Understanding between US and India, 12 September 1989.

⁹ VOGEL, K., *Double Taxation Conventions*, Kluwer, Deventer, 1997, 790.; BAKER, Ph., *Double Taxation Conventions and International Tax Law.*, Sweet & Maxwell, London, 1994, 12-08.; MALHERBE, J., *Droit Fiscal International*”, Larcier, Brussels, 1998, 455.;

“Imparting” is passing on knowledge as a teacher does to a student. The purpose of the exchange for the receiver is to learn how to do something, so that he knows how to do it himself the next time. Applied to know-how, it means paying for information on a certain industrial, commercial or scientific experience, with the purpose of using that information and experience to perform that industrial, commercial or scientific experience. In those cases there is, for the purpose of the treaty, a right to use information concerning an industrial, commercial or scientific experience, payments for which are subject to art. 12 (royalty).

In the case of the rendering of “technical services” there is no imparting. The performer of the service will use his skills to solve the problem himself for the other party. The purpose of the exchange for the receiver is not to learn, but to have the performer of the service execute the work or mission concerned.¹⁰ The transferor uses his

own know-how to give the receiver advisory services.

The principle of “imparting” is easier to explain in theory than in practice. All too often, the purpose of the parties is not or poorly expressed, or a complex transaction involves a mix of technical service *and* imparting know-how. One author argues (about technical services) as follows:

“Of course, an element of know-how transfer from contractor to customer also takes place at the same time. This is, however, either a side-effect which cannot be avoided (hence, not part of the performance agreed upon in the contract) or operational know-how (it is self-evident that the buyer of an industrial plant must be instructed how to use it). This instruction is incidental to the act of handing over the plant and cannot be regarded as being a service in its own right”⁵⁵.

In most cases, it will be useful to ask the question “What can the receiver do with the information he obtained through the exchange?” If the answer is

GOUTHIERRE, B., *Operations Internationales*, EFL, Paris, 1994.; PEETERS, B. “*Dubbelbelastingverdragen*”, Ced. Samson, Brussels, 1991, 165; FLUX, D. and SMITH, D., *Hong Kong Taxation*, Chinese University Press, 1999, 202.; SPRAGUE G.D., WHATLEY, E.T., WEISMAN, R.L., “An Analysis of the Proper Tax Treatment of International Payments for Computer Software Products”, *Asia-Pacific Tax Bulletin*, 1995, 158.;

¹⁰ VOGEL, K., *Double Taxation Conventions*, Kluwer, Deventer, 1997, 794. SPRAGUE G.D.,

WHATLEY, E.T., WEISMAN, R.L., “An Analysis of the Proper Tax Treatment of International Payments for Computer Software Products”, *Asia-Pacific Tax Bulletin*, 1995, 158.

⁵⁵ SONNTAG, K., “The Tax Treatment of Engineering in International Large-Project Contracting”, *Intertax*, 1997, 9-12.

⁵⁵ SONNTAG, K., “The Tax Treatment of Engineering in International Large-Project Contracting”, *Intertax*, 1997, 9-12.

that predominant, he can now master an industrial reproduction of a product or a process under the same conditions as the grantor, which would have been difficult or impossible without the grantor's experience on the subject, there was an imparting of knowledge.

Or, from the point of view of the grantor: "What does the grantor have to do in preparing the exchange?" If the answer predominantly involves the experience the grantor already has, without getting too much involved in the receiver's particular situation, there is most likely an imparting of knowledge, not a technical service.

Difference between "service, including consulting service" and sale

It is not always easy to distinguish between a service and a sale. Particularly with reference to intellectual property, technology transfers and payments for information, one may find it hard to determine whether a service has been performed or a right (to use) acquired.

With respect to the treaty characterization of e-commerce payments, and earlier in its Report on software, the OECD has had the opportunity to outline the broad criteria and principles on the basis of which a distinction can be made. According to the TAG Report on the treaty characterization of e-commerce

payments, the basic distinction is whether the consideration for the payment is the acquisition of property from the provider. Generally speaking, if the client owns the property after the transaction, and such belonged before to the other party, there has been a sale. If however, the client becomes the owner of an item that is merely ancillary to the transaction, it must still be regarded as a service. The TAG cites the example of a consultant handing over a report containing his recommendations. The transfer of the ownership of the report was merely incidental to the transaction of providing advisory services itself⁵⁶.

The situation would be different if a consultant has used his skill and experience to draft a report containing research or other information. If the consulting enterprise transfers the ownership of that document as it is to a client, without adapting it to the particular needs of that client, there has been no furnishing of a service. The question remains what is the exact legal nature of the payment, particularly if it concerns a sale or a royalty for know-how. If the "client" has been imparted or taught certain information, without affecting the rights or possibilities of the consultant to use the information (again) himself, the payment must be deemed a royalty for know-how. If the consultant has lost the right to use the

⁵⁶ TAG on Treaty Characterization Issues arising from E-commerce, 1 February, 2001.

information himself, there has been a sale. The latter might be the case when a technical research enterprise “discovers” certain information that is consequently sold (including a transfer of the researchers who made the discovery) to a production company.

The distinction between a sale and a royalty has been addressed repeatedly by case law around the world, mostly in function of deciding if the tax treatment should be that of income or that of a capital gain. Lord Denning would not have agreed with this author’s contention above that know-how is indeed susceptible of being sold. “You cannot sell your brains” is a dictum which indicates that payments for the information and experience are always income, and not capital payments⁵⁷. In the meantime the realities of business organization have evolved, and it is far from impossible that processes, know-how and technical information are developed outside of the juristic entity that will develop or commercialize the results. Cost sharing, group R&D special purpose vehicles, joint programs with universities or other enterprises all illustrate this point. The Evans decision by Upjohn that was upheld in the House of Lords by the way acknowledged these possibilities: “The company parted with its secret process to the Burmese government for ever...After the expiry of the contract (but not

⁵⁷ *Evans Medical Supplies Ltd v Moriarty* UK House of Lords (1957) 3 All ER 718; 37 TC 540. (at p. 733).

before) the company was at liberty to impart its know-how in relation to these matters to others in Burma.”⁵⁸ The *Jeffrey v. Rolls Royce*⁵⁹ and *Musker v. English Electric Co Ltd*⁶⁰ cases indicate, where the parting of a capital asset was not accepted, however how the particular facts of every case must be weighed.

For the purpose of art. 5 par. 3 b) UN Model DTC, the difference between a sale and a service can also be seen from the perspective of the time threshold that the article contains. A sale is concluded in one moment, and should after sale services be provided, they would fall under the scope of auxiliary or preparatory activities. In practice, it may often happen that a sales contract is concluded with (accessory) consulting services.

Difference between “service, including consulting service” and independent personal services

The relationship between consulting services as used in art. 5 of the UN Model DTC, and independent personal services is important to take into consideration when defining the scope of “services” which are meant by art. 5. The furnishing of services in the UN PE definition is only relevant with

⁵⁸ Upjohn J, page 551.

⁵⁹ 1962, 1 All ER 801; 40 TC 443.

⁶⁰ 1964 41 TC 556.

respect to art. 7 (business profit) and not for other income. This is underlined by the fact that art. 14 (independent personal services) have their own mechanism of source taxation, specifically under the UN Model treaty.

Exactly which activities fall under the scope of art. 14 DTC is even within the Fiscal Committee of the OECD not clear. In a recent report on Issues Related To Art. 14 DTC, the Fiscal Committee had to admit: “It is, however, far from clear which activities fall within article 14”⁶¹.

In practice, the different classification does not always matter, since the principles of PE or fixed base are comparable. Taxation under the one or the other article will lead to the same result. But for many developing countries the difference does matter. Their DTCs are not always consistent regarding the periods required for art. 5 on the one hand and the ones required for art. 14 on the other hand. Where the 6-months or 183 days rule was provided for a (consulting-) PE and not for a fixed base (see below) or vice versa, the problem stops being purely academic. In Thailand’s treaty practice both instances occur. The DTC with Spain for instance includes a 6 month rule in art. 5 but not in art. 14⁶². On the contrary, on many occasions the period

provided for art. 14 is shorter than that for art. 5⁶³. Another example can be found in India. The French/Indian DTC has no reference to a furnishing of services PE in art. 5, but art. 15 of that treaty does provide for a 183 days rule for independent personal services. Therefore, the question which activities fall under the scope of art. 14 rather than under art. 7 remains important in practice.

The term “professional services” is fairly comprehensive and illustrated by examples, including that of an engineer. A clear definition is however not available in the DTC nor in the Commentaries with respect to “other activities of an independent character”. VOGEL assumes that it must concern an activity that can also be performed *dependently*, within the scope of art. 15⁶⁴. Important is, according to this learned author, that what is involved is a service (not manufacturing, or sales) and that it is “similar” to professional services⁶⁵.

This leaves us with a large scope of consultants and other service providers (management advisor, technical consultant, production process advisor, telecommunications consultant,

⁶¹ VOGEL, K., *Double Taxation Conventions*, Kluwer, Deventer, 1997, 287.

⁶² See also the DTC’s with The Czech Republic, Laos, Mauritius and The PRC.

⁶³ Austria, Canada, Denmark, Finland, Italy (40days) The Philippines, Sweden, US and Uzbekistan.

⁶⁴ VOGEL, K., *Double Taxation Conventions*, Kluwer, Deventer, 1997, 860.

⁶⁵ VOGEL, K., *Double Taxation Conventions*, Kluwer, Deventer, 1997, 859.

programmers, photographers, structure-analyst, organizational consultants, surveyors, geologists, feasibility-experts, marketing advisors, e-commerce consultant, quality control and testing consultant, technical support advisor, environmental advisor, management advisor, brokers, financial advisors...) which might be included in art. 14, once it has been established that they perform their services in an independent way.

Often it is thought that payments to a legal person fall outside the scope of article 14⁶⁶. They do not. The Fiscal Committee of the OECD states: “*It has sometimes been argued that the use of the pronoun ‘his’ in paragraph 1 of the Article 14, indicates that the article was intended to apply to individuals only. The Committee however, found the argument to be far from convincing ...*”. On the other hand the Fiscal Committee of the OECD also pointed out that in practice, the article is almost only applied to individual service performers⁶⁷.

The question is therefore relevant how to distinguish taxation under art. 5/7 or art. 14 with reference to consultancy services performed on behalf of a juristic entity. The OECD report above seems to indicate that

⁶⁶ See e.g. SKAAR, p. 274: “A corporation or similar entity cannot perform personal services”.

⁶⁷ Issues in International Taxation Related to Art. 14 DTC, No. 7, par. 14 etc.

there should be no distinction between taxing an incorporated or a non-incorporated lawyer, doctor or engineer.

It is noteworthy that, as from 2000, the OECD has removed art. 14 from its Model Treaty^{67b}.

Consulting services and employees’ or director’s remuneration

When the consultant has concluded an employment agreement or is appointed a director of the client, respectively art. 15 and 16 apply to the income paid to the consultant, and not art. 7 and 5. The services of the consultant in that context cannot constitute a PE. Obviously, source taxation may be in order under the provisions of art. 15 or 16, as the case may be. It is noteworthy that the UN model assimilates salaries paid to top-level managers with director’s fees.

(iii) Exclusions in tax treaty practice

Some tax treaties may exclude certain specific kinds of services or consulting from the scope of art. 5 par. b) UN Model DTC. Such is the case in the Chinese treaties with Austria (consulting in connection with the sale

^{67b} DE KORT, J, “Why Art. 14 was deleted from the OECD Model Tax Convention”, Intertax, 2001, 72.

or lease of machinery), Bulgaria (*idem*) and Switzerland (in the Protocol, consultancy about the installation, materials, training and design in connection with the sale or lease of equipment).

d) “by employees or other personnel engaged by the enterprise for such purpose”

The physical *presence and intervention* of natural persons is required to fulfill art. 5 par. 3 b) UN Model DTC. This is clear from the coherence with the requirement that the activity is performed within the source state, and besides that explicitly mentioned in the UN Commentary⁶⁸. Indeed, the furnishing of the service must take place *by* the employees or other personnel.

If, the furnishing of the service happens without human intervention, it is doubtful whether the provision of such services in the source state can ever qualify for art. 5 par. 3 b) UN Model DTC. This excludes the furnishing of services by automatic equipment, such as cash dispensers, computer servers, etc. (that may or may not constitute a fixed place of business in the sense of art. 5 par. 1 DTC).

It also excludes the performance of services “by remote” through modern

means of communication. A doctor that diagnoses patients with the help of sensors and other equipment attached to a subject (although this falls of course in the scope of art. 14 DTC and not art. 5 DTC and 7 DTC), training through videoconferencing, intervention and problem shooting on computer programs by remote over the Internet, are all examples of services that may be argued to be at least in part performed in the source country, but without the physical presence of the service performer. Such services cannot be taken into account for art. 5 par. 3 b) UN Model DTC in the opinion of this author.

It is irrelevant what the exact nature of the legal relationship is between the consultant and the enterprise. He might be an employee or a director, but it is unclear what is meant by “other personnel”. Does a self-employed consultant, or employees of another enterprise fit this description? The context seems to indicate that “personnel” includes natural persons with who the enterprise has concluded an employment agreement and natural persons with who the enterprise did not conclude an employment agreement. (“employees or other personnel”). The “engaged for such purpose” seems to relate to the “other personnel”, which supports the impression that indeed not only employees of the enterprise but also specifically hired personnel from other enterprises or self-employed persons fall within the scope of the article.

⁶⁸ UN Commentary on art. 5 par. 3.

This presents us with a difficult problem. What if the consulting enterprise (A) hires employees of a second enterprise (B), also foreign to the source country, to furnish services to the client (C). Imagine A concluding a contract with C but appealing to B's employees for their specialized knowledge on a part of the assignment. A, B and C are established in different countries, having concluded tax treaties that include art 5 3 b) UN Model DTC. Who has the furnishing of services-PE in country C: A or B or both? It seems to this author that the employees of B are carrying out the business of A more than that of B, so it may be argued that A has the PE. On the other hand, B also qualifies for the letter of the article.

e) time threshold and connected projects

The activity continues for more than six months in that source state for the same or a connected project within any 12 month period. In bilateral negotiations, however, shorter periods have been agreed upon⁶⁹. Notable examples different time thresholds in case of associated enterprises⁷⁰.

The six-month requirement must be fulfilled within any 12 month-period, irrespective of the tax-year for which

the service-provider is being assessed. If this specification is omitted, as is often the case, the minimum period must be reached within the tax-year concerned. In some treaties, the period of reference has been replaced by a longer time (24 months)⁷¹.

To calculate the time threshold with respect to connected projects, the UN Commentary refers to the OECD's clarifications on the subject of building sites⁷². Consequently, a consulting assignment must be viewed as a "unit", and it is immaterial whether the contract for one "unit" was concluded with one or several clients. If a client requires a consultant to advise on-site on the setup of a new plant, for instance, it is immaterial whether the first 4 months he was under contract with the foreign holding and the last 4 months with the local subsidiary.

The fact that certain consulting activities are not carried out on the same spot may be inherent to the assignment (such as training the staff of different local branches of a bank) and does not preclude the existence of a PE. Tax treaty practice may specify this, such as in Armenia/Georgia/Turkmenistan (for single or related facilities) arts.

⁶⁹ China-Malta (8 months), China-Slovenia (12 months); Denmark/ Singapore; US-Indonesia (120 days).

⁷⁰ Thai-US, India-Canada, India-Australia.

⁷¹ China-Israel, China-Mauritius.

⁷² UN Commentary on art. 5 par. 3.

f) UN Model and consulting services of an auxiliary or preparatory nature

It must be pointed out that the UN Model does not in any way deviate from the OECD Model with respect to the treatment of a PE of a auxiliary or preparatory nature. Consequently, also with respect to art. 5 par. 3 b) UN Model DTC, services of such a nature are not taken into account, nor for the possible existence of a PE, nor specifically for the time threshold. In other words, if the consulting services are auxiliary to i.e. a sale or a transfer of technology, a PE will not begin to exist, whatever the duration of the contract. If (consulting) services are furnished in the sense of art. 5 par. 3 b) UN Model DTC, the preparatory or auxiliary services related to the contract (meeting before concluding the contract, feasibility, ...) are not taken into account to determine if 6 months have passed.

3.3. Supervisory services regarding construction under the UN Model Treaty

Supervisory activities lead to a PE if they are “in connection with” a building or construction site. Even when the service performer is not itself participating in the physical construction, the (“intellectual”) services may still constitute a PE under the UN Model treaty if those services concern the envisaged

construction activity.

4. SOME CONCLUDING REMARKS

The source taxation of consideration for services, especially consulting services, under the treaties concluded by Thailand differs considerably depending on whether the treaty in question is based on the UN or the OECD Model. Under the OECD Model Treaty, consulting services performed by a non-resident consultant may lead to having a PE in the source country, but it is not very likely that such would happen if the consultant only has the business premises of the client at his disposal. If it can be shown that the consultant uses those premises to conduct his business proper, a PE exists and source taxation of the consulting fee is in order if the other conditions to do so are also met. A good and practical indication if such (use for business proper) is the case, is the fact whether the consultant has to pay any consideration (in whatever form) to the client for the use of facilities. A PE must also be assumed to exist if the other business income is realized in the source country with the help of the facilities that the consultant uses from his (main) client.

A dependent agent -PE is not very likely to occur as a consequence of the presence of a consultant on the premises of a client, unless he indeed has and exercises the authority to

conclude contracts. However, as was demonstrated above, some particular kinds of consulting do require such a level of authority, and a PE is consequently unavoidable.

The rather limited possibilities for source taxation of consultancy under the OECD Model treaty is obviously the reason why the UN Model treaty introduced the “furnishing of services”-PE, and not surprisingly, the scope for source taxation here is much wider. Some interpretation problems remain here, particularly concerning the definition of “services” (difference with royalty, sale, etc.) and the interaction between art. 14 DTC and art. 5 DTC. The latter seems of only academic interest since source taxation in the UN Model is provided in both cases, but actual tax treaty practice shows plenty of examples where the two regimes are not consistent.

Consulting enterprises and their clients will, if they desire to stay out of the scope of a PE, prefer to structure their services through countries that did not conclude a UN Model treaty with the country of the client. A review of the tax treaty practice of most (developing) countries will show that this particular clause has almost never been written in each and every treaty. In other words, it will often be possible (in theory at least) to avoid the application of art. 5 par 3 b) UN Model treaty. Also, they will attempt to maximize the performance of services outside of the client’s country, which is possible for

quite a number of services (design, planning, expert advice, research, ...). Finally, even under the UN approach, source taxation of consulting can be avoided if it can be shown to be accessory to another transaction, such as a sale of equipment or a transfer of technology.

Tax authorities on the other hand, will focus on scrutinizing (large) payments for consultancy by their taxpayers, but have in general little information (without a specific query) on the nature of the consultant’s facilities on the premises of the client. In practice therefore, their attention is mostly drawn by cases where the presence of the consultant is obvious and important. Thailand also seems vulnerable with respect to treaty shopping on service fees, the 15% withholding tax on which may be avoided if such services are furnished by the intermediary of tax treaty countries without a UN-type “furnishing of services PE” provision. For developing countries with limited tax audit resources it may be more efficient to impose (low) withholding taxes or turnover taxes to compensate for the base-erosion effect. Especially turnover taxes may be effective since they are not addressed by double taxation conventions. Thailand’s VAT (which applies on payments to non-resident suppliers if the service is being used within Thailand: sec. 83/6 RC) may, to a certain extent, be expected to play such a role already.
