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# The Agency Permanent Establishment

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Your business guide to the Netherlands.

- Dynamics between basic rule PE, sales agency PE and the “negative list”
- Agent’s connection to the country
- Dynamics between negotiating, approving and signing the contract
- Crucial parts of the OECD 2017 model treaty text and commentaries (= MLI)
  - Habitually concludes contracts or
  - habitually plays the principal role leading to the conclusion of contracts that are
  - routinely concluded without material modification
- If time allows: The Dependence Test

*Not to be discussed: UN Model Treaty, Commissionaire, group entity as a PE etc.*

# Article 5 OECD model treaty



- Par. 1      **Basic Rule PE**  
*fixed place of business*
  
- Par. 2      Positive list
  
- Par. 3      Construction PE
  
- Par. 4      **Negative List (also applies to the agency clause)**  
*auxiliary or preparatory*
  
- Par. 5      **Sales Agency PE**

*The UN model allows PE taxation to a larger extent*

# Sales Agency PE (OECD 2017 model)



Par. 5 Sales Agency PE

Par. 6 Exception for independent agents

Par. 7 Company controlled by another company

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

Par. 8 Closely related enterprises

“A fixed place of business through which the business ... .. is ... .. carried out”

## Cumulative tests:

### 1. Place of business

*Agency clause: not only offices and factories but also individuals and corporations may serve as a “place of business” .*

### 2. Right to use the place of business

*Agency PE: right to “use” an agent is enough.*

3. Right of use must be maintained with a certain degree of “permanence” (**duration test**)

*Under the agency clause it’s a question of the permanence (or **durability**) of the position (the agency) **itself and not the position of a specific individual or corporate body.***

4. The place of business must be located at a “distinct geographical place” (**location test**)

*The agent does not need to be located in a certain area within the country.*

*The “**personal connection through an agent**” has completely replaced the “**location test**” of the basic-rule.*

## **Conclusion**

the agency clause is a subordinated alternative tot the basic-rule and replaces some but not all the conditions for a PE under the basic rule.



# Basic-rule PE vs sales agency PE

Norwegian administrative case (1980):

- Swedish entity established sales office in Norway (rented an office).  
The **employees** at the **sales office** were engaged in soliciting orders but were **not authorized to conclude contracts** and therefore did not create a sales agency PE.
- However, the office constituted a fixed place of business (basic-rule PE) and soliciting orders was considered a core business activity under the basic rule.

## Conclusion

The existence of an agency does not influence the effectiveness of the basic-rule.

The agency clause is without significance in all cases where the enterprise has at its disposal a physically located place of business.

# Agent's connection to the country (i)



A certain presence is needed in the country where business is pursued.

What kind of presence:

- resident;
- habitual abode; or
- merely transient presence?

- Residency is not needed (*OECD Comm. 2017 no. 83*);
- **Habitual abode** is sufficient;
- Merely transient presence is not enough (*OECD Comm. 2017 no. 98*)

## German case (1934)

The presence of agents in Germany had to be **more than transient or occasional**.  
Occasional dispatching of traveling agents did not constitute an agency PE.

# Agent's connection to the country (ii)



A salesman traveling **in and out** of a country does not constitute an agency PE, even if the visits are regular and frequent. However, visits that last for a substantial period of time, for example six months, cannot be considered “transient” in this respect.

**German Supreme Court “Portugal” (2006)** supports “habitual abode” requirement:

*Manager concluded several contracts in Germany but **did not live or have a habitual abode in Germany.***

*He traveled in and out of Germany for this purpose. He stayed in Germany for two to six days an altogether **60 days in a calendar year** (in the course of 4 years, he was in Germany 8 times, 10 times, 13 times and 14 times).*

Court: these stays were so short that no agency PE was constituted.

A **habitual abode** is probably always enough when the “**permanence test**” is met.

An agency PE exists even if the agent is merely traveling around if he has a habitual abode in the country.

# The place where the contract is signed



## Question

Has the place for signing of the contract any significance for the constitution of an agency PE?

## Answer

Text OECD model treaty: does not provide clarity.

Commentaries 2017 (no. 87): it is immaterial where the signing of the contracts takes place, if the agent has performed the core part of his or her activity in the PE state with binding effect on the principal.

# Sole conclusion of contracts, no power to negotiate?

**Question:** Agency PE in country A or B, or possibly in both?

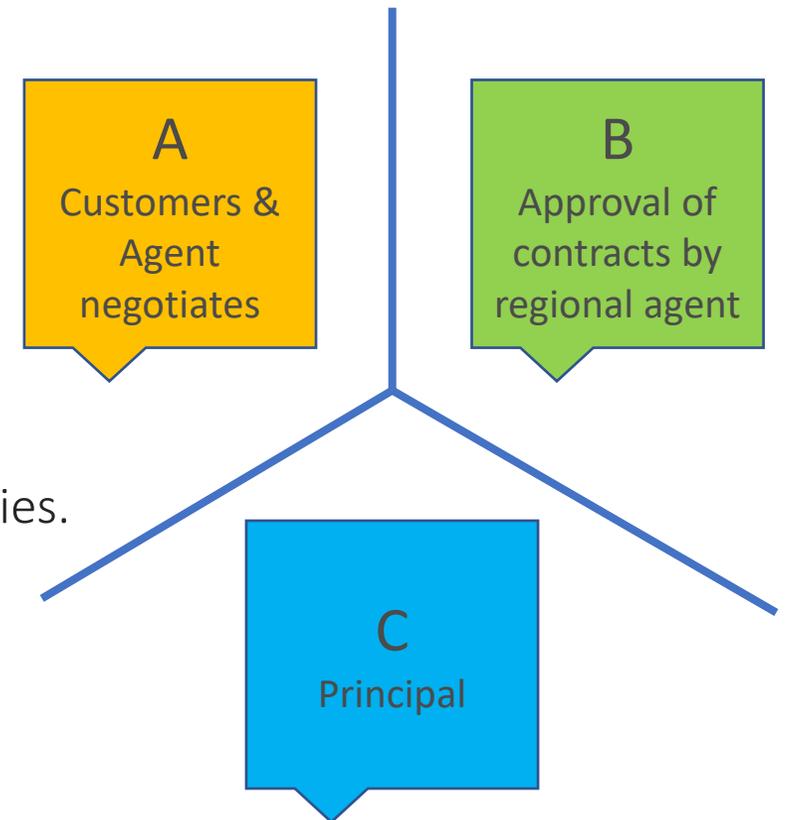
**Answer:** agency PE should be attributed to the country where the major part of the business activities is performed, and where the customers are.

This is normally the country where the contract is negotiated, even if it is signed in another country. Anti-abuse considerations support this view.

This conclusion does not follow from the text of the OECD-based treaties.

However, the activity of the agent in the country where the contract is solicited and negotiated involves the principal in business within that country.

PE taxation in this country (i.e., **Country A**) conforms to the (general) intentions of the model treaty (*OECD Comm. 2017 no. 83*).



# Text Agency PE OECD 2017 model treaty



... where a person is **acting on behalf of** an enterprise and ... **habitually concludes contracts,** or habitually plays the **principal role leading to the conclusion of contracts** that are **routinely concluded** (TG: “honored”, “accepted” or “executed” etc.) **without material modification** by the enterprise ... that enterprise shall be deemed to have a PE

- “authority to conclude contracts” is not needed anymore, although this is still the crucial point.
- It’s sufficient for a PE that the agent “involves the enterprise to a particular extend in business activities”.
- A (low risk) distributor does not constitute an agency PE (*OECD Comm. 2017 no. 96*).  
There is a **transfer of the ownership** of the goods (“**flash title**”).  
Hence, the **distributor is not acting on behalf of** the enterprise.

Habitually concludes  
contracts

# Habitually concludes contracts (i)



The agent should use his authority “repeatedly and not merely in isolated cases”.  
*The signature of one contract does not meet the required frequency.*

## Commentaries

The regularity of the exercise of authority has to be determined on the basis of the commercial realities of the situation. It depends on the nature of the contracts and the business of the principal.  
It's not possible to lay down a precise frequency test. (*OECD Comm. 2017 no. 98*).

## Norwegian Supreme Court: Alphawell (1994)

Does the renewal of a standard contract, once a year, meet the PE requirement?  
No.

# Habitually concludes contracts (ii)



## **Concluding one contract in the course of two years?**

This cannot be considered a habitually exercised authority, even if the business in question does not require more than one contract for this period of time.

## **Two or three contracts per year?**

Should be sufficient, if that's all that is required by the nature of the business.

## **Employee concludes one contract on behalf of a consultancy firm?**

No agency PE. To constitute a PE, the enterprise has to meet the conditions under the basic rule.

## **Conclusion**

Decisive is the relative frequency, compared to the nature of the business involved.

The duration of the agent's activity in a country must in practice meet the same duration as under the basic rule.

Habitually plays the principal role leading to the conclusion of contracts

# Playing a principal role (i)



There was a clear trend toward such a rule in practice, but difficult to establish under the wording of the pré-2017 model treaties.

Collecting or accepting offers from third parties, without negotiations?

> May be sufficient

Soliciting and negotiating contracts but the decision to conclude the contract and signing are made by the principal?

> May be sufficient (*OECD Comm. 2017 no. 87*)

Interviewing prospective customers and notify their requirements to the principal, while the contracts are negotiated and concluded by “principal resident” employees of the principal.

> Should not create an agency PE.

*Agency PE was also denied by Canadian court case (1951): “American Wheelabrator”*



# Playing a principal role (ii)

Seek out possible customers, demonstrate the products and take orders for subsequent approval by the principal?

> Denial of agency PE by Norwegian Ministry of Finance (1972): the authorization was limited to receiving buying offers from the customers, as opposed to having power to commit the company.

Marketing agent without pricing power and no right to accept or reject orders?

> Denial of agency PE by the IRS

## Pre-2017 OECD model treaties

Negotiating of contracts is also insufficient if the draft contracts are subject to a genuine subsequent approval by the principal.

An agency is constituted, however, when the approval of the contract is a pure formality and not a real part of the conclusion of the contract.



# Playing a principal role: main characteristics

**Sales force of the enterprise:** Playing a principal role = the person that identifies the customers based on, for example, an analysis of their needs, approaches them, negotiates terms subject to approval and uses his or her relationship skills to persuade the customer to order the product.

**Example OECD 2017 Comm. no. 89:** Merely promoting and marketing goods does not create an agency PE (might also be exempt under the “negative list”).

**Example no. 90:**

- Convincing the client
- Use relationship skills
- Revenue-based remuneration
- **Standard contract terms and prices**

*This should not deprive the agent of the power to conduct business required under the “**business activity test**”. An agent who is authorized to perform only **auxiliary** activities, for example, as a messenger, does not constitute a PE. (Finanzgericht Berlin in EFG 19710, at 327)*

**Conclusion: the threshold is high!**

Routinely concluded  
without material  
modification

# Contract must be executed routinely without material modifications (i)



An agency is constituted if the orders are routed to a warehouse from which the goods are delivered without any material modifications.

The test is not whether the orders are automatically delivered to the warehouse, but whether the orders are honored without material modifications.

An agency PE is constituted even if the orders are scrutinized, as long as no material modifications are made.

The enterprise should not have to make modifications in all orders coming from the agent. The review must be a **real review of all the orders and some of the orders are either significantly changed or disapproved.**

# Contract must be executed routinely without material modifications (ii)



## Example

- Insurance agents of life insurance company solicit, negotiate and receive applications from the clients customers.
- The policies are not binding upon the insurance company before the company has reviewed and approved the medical tests and reports of the applicant.
- If these tests and reports are not satisfying to the insurance company, the policy will not be approved.
- 3% of the policies are disapproved.

## Agency PE?

All orders are subject to a bona fide substance review, resulting in the rejection of a number of policies. This would not be an agency PE because all the draft contracts are subject to a review, and some were subject to material modification (rejection).

# Contract must be executed routinely without material modifications (iii)



- What if the review does not include all contracts but only a selection (a sample), and only a few of the contracts are randomly reviewed.
- The purpose of the reviews is not to identify contracts which it does not want to approve, but to control the work of the agents.

## Agency PE?

In many cases yes:

The requirement under the OECD-based treaties is that the agent is involving the enterprise in business activities to a particular extent. This is the case in this example.

# Contract must be executed routinely without material modifications (iv)



## Question

What should a principal do if he wants to prevent PE taxation based on an agency PE by retaining a right for himself to subsequent approval of the contract?

## Answer

He must make this clear to the customers dealing with the agent.



# Dependence Test

# Dependence test (i)



- **Par. 5(6) OECD 2017 model treaty**

There is no agency PE if the agent carries on business as an independent agent and acts in the ordinary course of that business.

The agent is not independent if he or she:

- (i) acts exclusively or almost exclusively for the principal(s), **and**;
- (ii) is closely related to the principal (*par. 5(8)*).

- Same conclusions will normally be reached under older model treaties.

- **Practical differences**

- \* Only “burden of proof” for the tax office is to establish that the enterprises are closely related.
- \* the agent’s work for all closely related enterprises will count under the 2017 model treaty.



# Dependence test (ii)



- Both legal and economic independence are required to escape taxation as agency PE.  
*OECD Comm. 2017 art. 5 no. 102 et seq.*
- Starting point is statement in the (1977 and) 2017 commentaries (*OECD Comm. 2017 art. 5 no. 104*):

*Whether a person is independent ... depends on the extent of the obligations which this person has vis-à-vis the enterprise. Where the person's commercial activities ... are **subject to detailed instructions or to comprehensive control** by it, such person **cannot be regarded as independent**.*

- The core of the “dependence test”:  
persons who act as intermediaries at arm’s-length distance do not constitute an agency.

- German Supreme Court: **Insurance 1975**

The agents **wide discretionary power of attorney** was decisive for the commercial independence of the German enterprise toward the Dutch principal.

- South African Supreme Court: **Downing 1975**

Three criteria were emphasized for the conclusion of independent agents:

- \* the principal took no part whatsoever in the management of the portfolio;
- \* the **wide discretion and unqualified power** of management given to the agent; and
- \* the degree of permanency relating to this discretion and power.

# Economic dependence: examples judicial practice & OECD commentaries



## Indication of dependence exists if:

- the principal runs the entrepreneurial risk (risks related to the core business i.e., market risk) (*OECD Comm. 2017 art. 5 no. 38 and German court case “Container” 1984*)
- the principal owns the equipment or facilities used by the person (*Court of Appeal of Ghent 1933*);
- the principal has the right to take over the premises when the assignment is ended;
- Employment should suffice for the “dependence test” of the OECD model treaty (*OECD Comm. 2017 art. 5 no. 83 and 103*)

## Indications of independence:

- Responsible for reaching certain results, for example, certain financial results.
- Offering an expertise that the principal does not possess itself;
- Providing substantial market or business relevant information to the enterprise (*OECD Comm. 2017 art. 5 no. 106 and 108*).

- Under the UN model treaty, a single client is sufficient to prove the agent's dependency, even for otherwise independent agents.
- This aspect is also highly relevant to the OECD-based treaties  
*(OECD Comm. 2017 art. 5 nos. 103, 108 and 111).*
- OECD 2017 model treaty has introduced the term to **work “exclusively or almost exclusively” for one client**. It is in principle possible to be an independent person and still work primarily for one client, although this must be considered a very rare situation  
*(OECD Comm. 2017 art. 5 no 111).*
- Having a large number of clients will support the conclusion that the agent economically is independent.

- Allows an agency PE to be constituted regardless of whether the person may be independent.
- Does not apply unless the person **acts exclusively or almost exclusively** for enterprises to which the person is closely related.  
Hence, an agency PE exists always if the conditions under art. 5(5) are met and the person is closely related to the enterprises.
- The only way to avoid an agency PE in a case where the person is working for closely related enterprises is to avoid working almost exclusively for such related enterprises.

# What is “closely related”?



Definition OECD 2017 model treaty:

*... if one has **control** of the other ...*

*In any case, a person or enterprise shall be considered to be closely related if one possesses **directly or indirectly more than 50%** of the **beneficial interest** in the other (or in case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) ...*

## Control

For example: control Board of Directors or Annual meetings.



# Deemed dependency: the ordinary course of business test



A distinction must be made between:

- habitually acting in the name of the principal; and
- acting in the ordinary course of the “agent’s” own business.

An agent is deemed to be dependent if his activity is not performed within the course of his ordinary business.

*See also art. 5(6) OECD model treaty: “... acting in the ordinary course of that business ...” .*

*See also example OECD Comm. 2017 no 110*

Reasoning behind the example: the agent’s activities shall be compared to the activities that are *typical for the industry* the agent is active in as an *agent*.

- US insurance company selling insurance policies to airline passengers through Dutch insurance brokers from a stand at an airport in NL (and by traveling persons authorized by the insurance brokers).
- The brokers were not authorized to negotiate the terms of the contracts. They concluded (signed) contracts based on two standard insurance policies and explained the differences between the two contracts, however without being able to accept any amendments.
- The brokers were to follow the instructions in a Franchise Manual prepared by the insurance company.

**Supreme Court:** The problem in the case was not whether this activity was ordinary for the actual brokers. The standard in this respect was how the insurance brokers normally performed their business. The Court found that the activity of the brokers fell outside the ordinary course of business of such “person’s”. Thus, PE in The Netherlands.

*This case also considers the question if an agency PE can be constituted when the authority is limited to **fixed prices and other fixed conditions** determined by the principal.*

# Lower court of The Hague 1970



- Dutch real estate broker administered an apartment building for a German real estate investment company.

## Lower court

PE in the Netherlands

*TG: this conclusion seems justified because it must be considered outside the ordinary course of a realtor's business to administer apartment buildings.*



- U.K. agent for South African company.
- The agent paid the freight and marine insurance of the goods (neither was connected with the sale of goods, but with their procurement).
- The agent invoiced the customers and collected the money.
- The agent had many other clients, but these clients generated <5% of the total turnover of the agent.

## High Court

Paying the freight and marine insurance is **uncharacteristic of brokerage**.

The agent is not a negotiator for commission, which is considered to be the **essence of a broker's activity**.

Since 95% of the agent's turnover was related to the South African company, the Court also concluded that it lacked the generality of custom **which characterized brokerage**.

*The rationale of the decision is that the "ordinary course of business test" was to be related to normal brokerage.*

- Belgian architect that handled the advertising and sale of apartments built in France by a French company.

## Supreme Court

The French company has an agency PE in Belgium.

*TG: this decision seems to support the position that the important issue is what is typical for the industry rather than typical for that particular agent.*

- Danish resident had invested in a helicopter, which was commercially used by a German company in Germany.
- The helicopter was rented out in the name of the German company, but for the account of the Danish resident.
- The German company had several other helicopters for rental and rented the other helicopters in the same way.

## Supreme Court

The German company's authority to conclude contracts on behalf of the taxpayer did not qualify as an agency PE, because the agent (the principal) was independent of the Danish resident.

The agent acted on behalf of the taxpayer in the ordinary course of its business.

The business of the agent himself is not a relevant argument when deciding whether the activity is outside his or her ordinary course of business.

*The text of the model treaty and the commentaries supports this position.*

An agency PE may then be constituted if an otherwise independent person acts outside his or her ordinary course of business.

The determinative issue must be what is ordinary in that particular line of business that is performed by the agent as an agent.

*This view has support in case law and in the commentaries.*

# Summary: 3 basic rules



1. The agent will be considered as acting outside the course of his ordinary business, thus constituting an agency PE, if he or she performs an activity different from the activity the agent normally performs.
2. An activity which is similar or usual for the industry to which the agent belongs, does not constitute an agency PE
3. No agency PE is constituted if the agent's activity is unusual for the industry and performed in an independent manner.

# Questions?



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