

**IFA 2009 VANCOUVER CONGRESS
AUSTRALIA**

SUBJECT 1 - IS THERE A PERMANENT ESTABLISHMENT?

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Summary and conclusions

The recent double tax agreements (**DTAs**) entered into by Australia (such as the Australia/South Africa Protocol¹, Australia/Japan DTA², Australia/Finland DTA³, Australia/France DTA⁴, Australia/Norway DTA⁵) are more expansive and provide greater clarity in respect of various treaty articles, including the definition of 'permanent establishment' (**PE**). Further, when the relevant DTAs are enacted in Australia they are each accompanied by an Explanatory Memorandum (**EM**) - as well as the relevant Minister's second reading speech in parliament - which provides interpretative guidance in respect of the articles included in the DTA. These EMs have also in recent years been more expansive and detailed providing greater certainty at least as to the intention of the Australian Government in entering into these DTAs.

There are a number of interpretative tools which assist in the interpretation of Australian DTAs. Specifically, the Australian courts have referred to the following sources to aid in the interpretation of Australian DTAs:

- Vienna Convention;
- OECD Model Convention *for the Avoidance of Double Tax with respect to Taxes on Income and Capital* (**OECD Model**) and Commentary of the OECD Model (**OECD Commentary**);
- Australian cases;
- EMs accompanying the Act enacting a DTA;
- Australian Taxation Office (**ATO**) guidance including tax rulings, determinations, interpretative decisions and practice statements;
- Foreign cases;
- Foreign text of DTAs.

We note that Australian cases and ATO guidance have not referred to the model tax convention prepared by the United Nations (**UN Model**) and Commentary of the UN Model (**UN Commentary**).

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¹ The Bill containing the Australia/South Africa Protocol was passed by the House of Representatives and the Senate. The Bill is currently waiting to receive royal assent before it is enacted.

² The Act containing the Australia/Japan DTA received royal assent on 3 October 2008.

³ The Act containing the Australia/Finland DTA received royal assent on 24 September 2007.

⁴ The Act containing the Australia/France DTA received royal assent on 3 September 2007.

⁵ The Act containing the Australia/Norway DTA received royal assent on 3 September 2007.

The Australian Government is currently reviewing its tax treaty policy and programme. As part of this review process, the Australian Assistant Treasurer on 25 January 2008 announced that the Australian Government was inviting public comment and submissions on Australia's future tax treaty negotiation programme and policy. In particular, public submissions were invited on: the countries with which Australia may be desirable to negotiate or update a tax treaty; and the appropriateness of Australia's tax treaty policy and drafting approaches as reflected in recent treaties.

On 26 June 2008, the Australian Assistant Treasurer provided an update on submissions received pursuant to the Government's review of the tax treaty negotiation and policy. The Australian Assistant Treasurer highlighted the following key themes on Australia's tax treaty program which emerged from the consultation:

- Priority for emerging economies, the Asian region and 'Most favoured nation' (*MFN*)⁶ countries;
- A more residence based approach, rather than taxation of income at source, including by increasing the time period before which activities undertaken in a treaty partner country become a PE;
- Lower dividend and royalty withholding tax rates;
- Special provisions to deal with Real Estate Investment Trusts (*REITs*);
- Treatment of capital gains aligned with the OECD position;
- Time limits on transfer pricing audits as is the case under the recent Australia/Japan DTA;
- Greater use of arbitration clauses.

The Australian Government's review was not finalised as at the date of this report.

Australia has concluded DTAs with 43 countries and most of these DTAs are based on the OECD Model with some relatively minor changes. The Australian Government is currently negotiating DTAs with New Zealand, the Netherlands and Germany.

The 'PE' article included in Australia's DTAs reflects to a large extent the definition included in the OECD Model. Further, the interpretation in Australia of the 'PE' definition has also to a large extent been influenced by the OECD Commentary.

In Australia, several key cases provide significant guidance on the interpretation of various DTAs, including specifically in respect of the PE article, particularly the Full Federal Court decision in *McDermott Industries (Aust) Pty Ltd v FCT*⁷ (*McDermott's case*). Other cases, including *Thiel v FC of T*⁸ (*Thiel's case*), *FC of T v Lamesa Holdings BV*⁹ (*Lamesa's case*), and most recently *Virgin Holdings SA v*

⁶ A MFN clause in a tax treaty obliges a country to renegotiate that treaty should they subsequently enter into a tax treaty with another country on more favourable terms.

⁷ 2005 ATC 4398 at paragraph 38.

⁸ 90 ATC 4717.

⁹ 97 ATC 4752.

*Commissioner of Taxation*¹⁰ (*Virgin Holding's case*) also provide strong guidance on the appropriate approach to the interpretation of our DTAs.

The ATO has also issued many tax rulings, determinations, interpretative decisions and practice statements which provide some level of guidance in respect of the ATO's approach to the interpretation of DTAs. These documents do not have the force of law, and are not necessarily supported by the Courts as recently evidenced in the *Virgin Holding's case*. However, these ATO documents in certain situations are binding on the ATO.

There have been two main variations to the 'PE' definition as included in the Australian DTAs when compared to the OECD Model. Firstly, a number of Australian DTAs have a clause which deems an enterprise to have a PE in a Contracting State where there is substantial equipment present in that Contracting State. Secondly, many Australian DTAs include an anti-avoidance clause in the PE definition. This anti-avoidance clause is included to ensure that where associated enterprises carry on connected activities, the periods will be aggregated in determining whether an enterprise has a PE in the country in which the activities are being carried on.

The concept of 'PE' is also commonly used in Australian domestic law, including the income tax legislation and the goods and services tax (GST) legislation. The definition contained in the income tax legislation is modeled on the OECD Model and therefore, its interpretation is reflective of the OECD Commentary. The GST legislation adopts the income tax definition with certain carve outs/exclusions.

The DTAs are evolutionary in nature and current DTAs are in the continual process of re-negotiation and renewal to reflect the changing trade, broader economic and global environment. In this process, the concept of 'PE' is also evolutionary.

1. Introduction

From an Australian perspective, the principles of interpretation applicable to other international treaties are equally applicable to double tax treaties: *Lamesa's case*. The interpretation of Australia's international treaties was considered in detail by the Australian High Court in *Applicant A v Minister for Immigration and Ethnic Affairs*¹¹ (*Applicant A's case*).

In *Applicant A's case*, the appellants, a husband and wife, lodged applications under the *Migration Act 1958* (Cth) for recognition as refugees in Australia. Pursuant to section 4(1) of the Act, the term refugee had the same meaning as it had in Article 1 of the *Convention Relating to the Status of Refugees 1951*.

The respondent refused the applications for refugee status. The appellants appealed to the Federal Court, Full Federal Court and the High Court. The primary issue required interpretation of Article 1A(2) of the *Convention Relating to the Status of Refugees 1951* and hence consideration of principles of treaty interpretation.

McHugh J in *Applicant A's case* set out the following propositions relating to the interpretation of international treaties:¹²

" This use of the singular indicates that Art 31 [Vienna Convention] is to be interpreted in a holistic manner...

¹⁰ [2008] FCA 1503 at paragraphs 19 to 24.

¹¹ (1997) 142 ALR 331.

¹² Applicant A's case at pp 351-352.

Secondly, ...The text of the treaty, being the starting point in any investigation as to the meaning of the text, necessarily has primacy in the interpretation process...

Thirdly, the mandatory requirement that courts look to the context, object and purpose of treaty provisions as well as the text is consistent with the general principle that international instruments should be interpreted in a more liberal manner than would be adopted if the court was required to construe exclusively domestic legislation...

Fourthly,... in my opinion, Art 31 of the Vienna Convention requires the courts of this country when faced with a question of treaty interpretation to examine both the 'ordinary meaning' and the 'context ... object and purpose' of a treaty."

The principles espoused by McHugh J in Applicant A's case were confirmed by the Full Federal Court in *McDermott's case* and the recent decision of the Federal Court in *Virgin Holding's case*.

Despite the comments by McHugh J in *Applicant A's case* to interpret the international agreements in a more liberal manner and to look to the context, object and purpose of the treaty provisions, the Federal Court in *GE Capital Finance Pty Ltd (as trustee for the Highland Finance Unit Trust v FCT)*¹³ (***GE Capital's case***) noted the courts could only give meaning to the words of the provision even if this interpretation did not implement the purpose that was intended. In this regard, the Federal Court in *GE Capital's case* stated:¹⁴

"The Court would need to embark upon the task of impermissibly re-writing the Agreements Act to facilitate the result the respondent seeks. I would need to transform a provision dealing only with the scope of the taxing power into one that effectively imposes a tax.

We note that the comments by the Federal Court in *GE Capital's case* related to the interpretation of domestic legislation.¹⁵

Further, recent Australian DTAs (such as, the Australia/Japan DTA and the Australia/UK DTA) contain notes attached to the end of the DTA. These notes provide interpretative guidance in respect of various articles in the DTA and are stated to be an agreement between the two Contracting States and enter into force at the same time as the DTA.

Use of the Vienna Convention and the OECD Commentaries

Ordinarily with the interpretation of Australian domestic legislation, sections 15AA and 15AB of the *Acts Interpretation Act (Cth)* provide that regard may be had to the purpose or object of the relevant Act and that extrinsic materials may also be used in prescribed circumstances. These provisions operate in a similar manner in respect of domestic legislation to Articles 31 and 32 of the Vienna Convention.

As discussed above in *Applicant A's case*, the Vienna Convention is an important interpretative tool in respect of international treaties. The Australian High Court in *Thiel's case* stated that the rules for the interpretation of international treaties, as codified in the *Vienna Convention* and the OECD Model and OECD Commentary were important tools in the interpretation of DTAs.

¹³ 2007 ATC 4487.

¹⁴ *GE Capital's case* at paragraph 46.

¹⁵ The view adopted by the Federal Court in *GE Capital's case* was endorsed by the Full Federal Court in *FCT v Word Investments Limited* [2007] FCAFC 171. The Full Federal Court in this case limited the ability of the Court to rewrite legislation albeit that the current interpretation by the Court did not accord with the intention of the Parliament.

In *Thiel's case*, the taxpayer was a Swiss resident who carried on a business in Switzerland of importing and selling earthmoving equipment. The taxpayer purchased six units in a private unit trust and converted the units into 600,000 shares, 252,000 of which he sold. The ATO assessed the taxpayer on a profit of \$590,000 representing the separate gains from the conversion of the units and the sale of the shares.

The taxpayer challenged the assessment primarily on the ground that the acquisition of the units and the sale of the shares constituted an "enterprise carried on by a resident of Switzerland" within Article 3(1)(f) of Australia's DTA with Switzerland. He argued that the profits assessed by the ATO were, therefore, the profits of an enterprise which were only taxable in Switzerland in accordance with Article 7(1) of the Australia/Swiss DTA.

In respect of interpretation, McHugh J stated the following in *Thiel's case* in the course of discussing the Australia/Swiss DTA:¹⁶

"... the interpretation provisions of the Vienna Convention reflect the customary rules for the interpretation of treaties, it is proper to have regard to the terms of the Convention in interpreting the Agreement, even though Switzerland is not a party to that Convention"

Although, the majority judgement of Mason CJ, Brennan and Gaudron JJ in *Thiel's case* made no direct reference to the question of principles of interpretation of the DTA, their Honours approved¹⁷ the reasons given by McHugh J in considering the OECD Model and OECD Commentary.

In *Thiel's case*, Dawson J also concluded that the OECD Model and OECD Commentary were a supplementary means of interpretation which could be used pursuant to Article 32 of the Vienna Convention. However, Dawson J added a caveat to this view that the OECD Model and OECD Commentary were only applicable to those bilateral treaties subsequently concluded.¹⁸

The Federal Court in the recent decision of *Virgin Holding's case*¹⁹ also agreed with the views espoused in *Thiel's case* above in relation to the use of the supplementary means of interpretation contained in the OECD Model and the OECD Commentary in interpreting the DTA.

The ATO have also endorsed the use of the OECD Model and OECD Commentary for the purposes of interpretation of a DTA.²⁰ We note that Australian cases and ATO guidance have not referred to UN Model and UN Commentary.

Use of decisions by foreign courts

In *Lamesa's case*, Einfeld J in the Federal Court opined that recourse could only be had to decisions by foreign courts where the foreign courts were considering the interpretation of a DTA Australia had with the foreign country. He opined that decisions of a foreign court in the interpretation of DTAs between the foreign country and countries other than Australia would not be inadmissible.²¹

¹⁶ *Thiel's case* at p 4727.

¹⁷ *Thiel's case* at p 4719.

¹⁸ *Thiel's case* at p 4723.

¹⁹ *Virgin Holding's case* at paragraph 24.

²⁰ Taxation Ruling TR 2008/7 at paragraph 95.

²¹ *Lamesa's case* (Federal Court) at p 4238.

However, the Full Federal Court on appeal in *Lamesa's case* disagreed with Einfield J's opinion and was of the opinion that if there had been some decision of an appropriate foreign court interpreting a DTA with identical or similar language, the decision of the foreign court may be admissible.²²

There are conflicting views in Australia whether recourse can be had to decisions by foreign courts in the interpretation of treaties. We are of the opinion that the Full Federal Court's view is to be preferred for a number of reasons, including: the Full Federal Court is a higher court; there is general uniformity in the drafting of double tax treaties; and the wide use of the OECD Model and OECD Commentary.

Use of foreign text of agreement

The Australian High Court in *Thiel's case* noted that evidence of the meaning of terms used in a DTA can be construed using such extrinsic materials as may be relevant, including evidence of the meaning of the corresponding foreign text.²³

Further, we note the Federal Court in *Lamesa v FC of T*²⁴ was given detailed evidence concerning the Dutch text of the Australia/Netherlands DTA.

ATO's administrative guidance

There have been several tax rulings, determinations, interpretative decisions and practice statements issued by the ATO that provide some level of guidance in respect of the ATO's approach on the interpretation of DTAs. These documents do not have the force of law, and are not necessarily supported by the Courts as recently evidenced in *Virgin Holding's case*. However, these ATO documents in certain situations are binding on the ATO.

2. The basic definition of a PE (paragraph 1 of Article 5)

The Australian DTAs generally contain a similar basic definition of 'PE' as that contained in the paragraph 1 of Article 5 of the OECD Model (*Basic rule PE*). The Australian DTAs are given force by enacting a domestic Act which is accompanied by an EM. The EM provides interpretation guidance.

The EM to various recent Australian DTAs states the following in respect of the basic definition of PE:²⁵

"To be a permanent establishment within the primary meaning of that term, the following requirements must be met:

- *there must be a place of business;*
- *the place of business must be fixed (both in terms of physical location and in terms of time); and*
- *the business of the enterprise must be carried on through this fixed place."*

The ATO in *McDermott's case* argued that Sub-article 4(1) of the Australia/Singapore DTA (article substantially similar to the Basic rule PE) operated to govern or constrain the interpretation of each of the sub-articles which follow it.

The Full Federal Court rejected the ATO's argument stating:²⁶

²² *Lamesa's case* (Full Federal Court) at p 4757.

²³ *Thiel's case* at p 4719.

²⁴ 97 ATC 4229.

²⁵ Australia/Japan DTA (2008) at paragraph 1.54; Australia/France DTA (2007) at paragraph 1.42; Australia/Finland DTA (2007) at paragraph 1.52; Australia/UK DTA (2003) at paragraph 1.50.

"As a matter of interpretation we can see no reason why Article 4(3) should be read down by reference to Article 4(1) as the Commissioner submits."

2.1 What is a "place of business"

It would appear that tangible equipment, including computer equipment such as a server could constitute a 'place' of business in Australia, although the parameters of this risk to taxpayers have not been fully tested in the courts.

The ATO in Tax Determination TD 2005/2 considered the issue of whether a resident of a country with which Australia has a DTA, may have a PE solely from the sale of trading stock through an internet website hosted by an Australian resident internet service provider (**ISP**).

The ATO considered the Basic rule PE and referred to the OECD Model and OECD Commentary in respect of whether computer equipment in electronic commerce operations can constitute PEs. In this respect, the ATO stated the following:

'Where an ISP is only in the business of providing access to the internet it operates as a mere conduit for the business activities of the non-resident enterprise. The agreement with the ISP would not typically specify which server the website will be hosted on and the ISP may change the server used at their discretion. The space used for a specific website on the server of the ISP is not at the disposal of the entity that owns the website. Thus, the enterprise does not have a fixed place of business in Australia.'

The ATO concluded in TD 2005/2 that where the sole presence of an enterprise in Australia is a website hosted by an Australian ISP, the enterprise does not have a PE in Australia.

2.2 What is a "fixed" place of business in terms of geographical location (the location test)?

As indicated above, several of Australia's EM's have stated that in order for there to be a PE within the Basic rule PE, the place of business must be fixed in terms of physical location.

The ATO in Taxation Ruling TR 2002/5 considered what is 'a place at or through which [a] person carries on any business' in the definition of PE contained in Australian domestic provisions (discussed below). We note that the definition of PE contained in Australian domestic provisions is based on the same concept of PE used in Australia's DTAs. This ruling discusses the need for permanence and provides that this is a question of fact and degree. The ruling provides guidance from the ATO on the issue of geographic permanence and provides:²⁷

"A place at or through which a person carries on any business in the context of the definition of PE in subsection 6(1) must be geographically permanent. Any area, viewed commercially and as a whole, may, in relation to the business concerned, be a place. Examples include business premises such as a factory, office, farm, mine or market. Thus a market is a place (and a place at or through which a trader carries on business) where that trader operates a stall regularly in that market. This is the case even if the stall is set up at different locations within the market at different times. It is the market which is, in relation to the trader, the distinct or discrete commercial area and it is

²⁶ McDermott's case at paragraph 61.

²⁷ TR 2002/5 at paragraph 29.

therefore a place (and a place at or through which the trader carries on their business) within the definition of PE in subsection 6(1)."

The ruling also provides several practical examples as to in what circumstances a PE would exist, for example a touring players/theatre group performing 'one-off' shows in various towns throughout Australia would unlikely have the 'geographical permanence' required of a PE.

The Full Federal Court in *McDermott's* case discussed the definition of PE in some detail and commented on the meaning of "fixed place of business".

In *McDermott's case*, the taxpayer was a resident of Australia and carried on business in Australia. It chartered vessels from a Singaporean resident and entered into a lease agreement in Singapore. The charters were 'bare boat' charters (involved charter of only the boat and not the crew). The taxpayer paid \$43M by way of charter fees for 'the use of, or the right to use, industrial, commercial or scientific equipment' and constituted a royalty under Australian tax law. The issue arose whether the Singaporean resident had a PE in Australia?

The Full Federal Court held that the Singaporean resident was deemed to have a PE in Australia as the barges, being admittedly substantial equipment, were being used in Australia (that is, used only in Australian waters). The Full Federal Court stated the following in respect of fixed place of business:²⁸

"It may be accepted that generally there is, underlying the ordinary definition of 'permanent establishment', the notion of a fixed place of business (see the Singapore Agreement, Article 4(1)) having some degree of permanence (see per Gzell J in Unisys, who held that merely temporary rented premises were not a permanent establishment in the sense used in s 128B of the Assessment Act)."

In ATO ID 2005/289, a New Zealand company sold products to unrelated Australian entities. The sales orders were taken by two employees who emailed the orders to New Zealand for approval. The employees had a home office and had undertaken this business for a number of years. The ATO were of the view that the New Zealand company (referred to as the taxpayer) had a PE in Australia as the employee's home constituted a 'fixed place' of business.

The ATO endorsed its views in ATO ID 2005/289 in subsequent similar circumstances in ATO ID 2006/263.²⁹

2.3 What is a "fixed" place of business in terms of the time that the place is used (the duration test)?

The ATO in TR 2002/5 (discussed above) also provides guidance on the issue of temporal permanence. In particular, the ATO provides the following:³⁰

"The second criteria for a place at or through which a person carries on any business to exist for the purposes of the definition of PE in subsection 6(1) is temporal permanence, ie the business presence must not be of a purely temporary nature. In other words, the business must operate at that place for a period of time. Again, this has to be judged in the context of the particular business and is a question of fact and degree."

²⁸ McDermott's case at paragraph 48.

²⁹ ATO ID 2006/263 at p 2.

³⁰ TR 2002/5 at paragraphs 30-35.

Permanent in this context does not mean forever. As Sheppard J said in Applegate v. FCT 78 ATC 4054 at 4060; (1978) 8 ATR 372 at 378 in discussing the meaning of permanent in the phrase permanent place of abode:

...permanent is used in the sense of something which is to be contrasted with that which is temporary or transitory. It does not mean everlasting. The question is thus one of fact and degree.

This is the sense in which permanence is used in this ruling.

Whether temporal permanence exists is a matter of fact and degree. However, as a guide, if a business operates at or through a place continuously for six months or more that place will be temporally permanent.

Because each case is a question of fact and degree the six month guide is not a hard and fast rule. The circumstances may for example indicate that a period of less than six months is sufficient to lead to the conclusion that temporal permanence exists. Where the period in Australia is less than six months there may still be temporal permanence where the connection with Australia is very strong. One example would be where the business returns to a particular location in Australia on an on-going and regular basis but for short periods each time. Another example would be where a place is set up in Australia with a view to carrying on business permanently in Australia at or through that place but the business ceases after a short period of time. One instance of this would be where the taxpayer dies after a short time but their intention had been to carry on business in Australia at or through a place for more than six months. "

Similarly, TR 2002/5 provides several practical examples dealing with temporal/duration permanence, often using the purported six month threshold as a useful guide to duration permanence.

In ATO ID 2005/289 (discussed above), the ATO were of the view that an employee operating from their home for a number of years satisfied the required degree of temporal permanence as required by the PE definition.³¹

2.4 Meaning of “through which the business of an enterprise is wholly or partly carried on”: does the place of business have to be owned or rented by the taxpayer (right of use test)?

There have been limited Australian cases or administrative guidance in respect of this issue.

However, this issue arose in respect of the 'PE' definition as contained in Australian domestic law. In *Unisys Corporation Inc v FCT*³² (*Unisys' case*), the issue arose whether the business conducted by Unisys Licencing Partnership (ULP) was carried on at or through a PE in the US? The Supreme Court held in respect of this issue that while each leased room constituted a place which was at the exclusive disposal of ULP, it was not a place at or through which ULP carried on its business as the storage and retrieval of documents could hardly constitute the carrying on of ULP's business. On this basis, the court held that the rented rooms were not PEs. We have discussed the facts and conclusions reached in this case in detail under paragraph 9 below.

³¹ ATO ID 2005/289 at p 2. This view was endorsed by the ATO in subsequent similar circumstances in ATO ID 2006/263.

³² 2002 ATC 5146.

The ATO commentary suggests that the place of business does not have to be owned or rented by the taxpayer. In particular, the ATO were of the view, in ATO ID 2005/289³³ (discussed above), that an employee operating from their home was sufficient to constitute a PE for the foreign enterprise ie taxpayer.

2.5 *Meaning of “through which the business of an enterprise is wholly or partly carried on”*: is it the foreign enterprise’s business that is carried on at that place?

There is limited specific Australian authority from cases or EMs in respect of this issue. Our general observations in respect of this issue are discussed below.

Firstly, the general statutory interpretation approach - as outlined in 1 above - would be required to determine how the general PE definition contained in the Basic rule PE paragraph relates to the more specific following sub-articles. A foreign enterprise would only have a PE in Australia where it satisfied the key criteria in the Basic rule PE.

Secondly, as there is limited guidance on this issue, the OECD Commentary is relevant in Australia in determining whether it is the foreign enterprise's business that needs to be carried on at that place to constitute a PE. In this regard, we expect this means that persons who, in one way or another, are dependent on the enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated; as in ATO ID 2005/289 and ATO ID 2006/263. We would expect that a customer's premises or that of a sub-contractor could similarly qualify as a PE in appropriate circumstances.

This analysis indicates that the foreign enterprise's business must be carried on at a place in Australia in order to constitute a PE in Australia. This view is implied by the ATO.³⁴

2.6 *Meaning of “through which the business of an enterprise is wholly or partly carried on”*: other aspects of the relationship between the place and the enterprise’s business

There is very limited Australian authority from cases or EMs in respect of this issue.

However, this issue arose in respect of the Australian domestic law. In *Unisys' case*, the taxpayer argued that it was not liable for royalty withholding tax under s128B of the *Income Tax Assessment Act 1936* (Cth) (*ITAA36*) as the royalties paid to it were incurred by ULP in carrying on business at or through a PE in the US. The ATO argued that the concept of 'business' for the purposes of s128B ITAA36 required some sort of business activity conducted through the branch and that the activities carried on by ULP (taking on licence and sub-licensing of intellectual property rights) were an investment activity and not a business activity. The court held that the term 'business' was broadly defined in the domestic legislation and there was no need to confine the term to activities of a business conducted through a branch.

Further, in *Unisys' case*, the court held that while each leased room constituted a place which was at the exclusive disposal of ULP, it was not a place at or through which ULP carried on its business as the storage and retrieval of documents could hardly constitute the carrying on of ULP's business. On this basis, the court held that the rented rooms did not constitute PEs. We have discussed the facts and conclusions reached in this case in more detail under paragraph 9 below.

³³ ATO ID 2005/289 at p 2.

³⁴ Taxation Ruling TR 2002/5 at paragraph 18.

We are of the opinion that there needs to be a direct relationship between the place and the enterprise's business in order to constitute a PE pursuant to the Basic rule PE. This is based on the OECD Commentary as discussed in paragraph 2.5 above.

3. *The listed examples of a PE (paragraph 2 of Article 5)*

The Australian DTAs all list examples of a 'PE' similar to that contained in paragraph 2 of Article 5 of the OECD Model.

The EM to the recent Australian DTAs provides that:³⁵

"As paragraph 2 of this Article is subordinate to paragraph 1, the examples listed will only constitute a permanent establishment if the primary definition in paragraph 1 is satisfied."

The ATO in TD 2005/2 (discussed above) in considering whether a resident in a country with which Australia has a DTA, may have a PE from the sale of trading stock through an internet website hosted by an Australian ISP made the following comments:

"Article 5(2) of Australia's Tax Treaties contains a list of examples each of which can be regarded as constituting a permanent establishment such as a place of management, an office, a branch, a factory or a workshop, or agricultural, pastoral or forestry property, etc. The website being a combination of software and data does not, of itself, fall within the list generally contained in Article 5(2)."

On this basis, the ATO concluded that the foreign resident did not have a PE in Australia pursuant to Article 5(2).

4. *The special rule for construction sites (paragraph 3 of Article 5)*

Most Australian DTAs provide a special rule for building or construction sites or installation projects similar to that contained in paragraph 3 of Article 5 of the OECD Model.

Generally, a deemed PE arises where the project lasts for more than 12 months. The EM for recent Australian DTAs states the following:³⁶

"The term 'building site or construction or installation project' includes not only places used for the construction of buildings but also for the construction of roads, bridges or canals, the renovation (involving more than mere maintenance or redecoration) of buildings, roads, bridges or canals, the laying of pipelines and excavating and dredging. Planning and supervision are considered part of the building site if carried out by the construction contractor. However, planning and supervision carried out by another unassociated enterprise will not be taken into account in determining whether the construction contractor has a permanent establishment in Australia."

However, some of the recent Australian DTAs have decreased the 12 month period to a 6 month period, such as the Australia/Finland DTA and Australia/South Africa DTA.

³⁵ Australia/Japan DTA (2008) at paragraph 1.56; Australia/France DTA (2007) at paragraph 1.44; Australia/Finland DTA (2007) at paragraph 1.56; Australia/UK DTA (2003) at paragraph 1.53.

³⁶ Australia/Japan DTA (2008) at paragraphs 1.58 and 1.59.

The ATO in Interpretative Decision (ATO ID 2002/850) considered when a foreign company has a PE. The facts detailed in this ATO ID are as follows:

- The foreign company enters into a contract with an unrelated Australian company for a supply, construction and installation project in Australia and two further contracts for the expansion, operation and maintenance of the project. All the contracts existed for more than twelve months.
- Risk and title to all equipment and software comprising the project remain with the foreign company until the final acceptance certificate is issued.
- During all stages of the project, no foreign company employees were ever present in Australia. All personnel from the foreign company became employees of the subsidiary company upon entering Australia. The employees of the subsidiary are thus made up of personnel from the foreign company and local staff with those from the foreign company taking up a greater proportion.

After consideration of the abovementioned facts, the ATO was of the view that the foreign company had a PE in Australia for the following reasons:³⁷

"As the head contractor for the project, the foreign company bears the ultimate legal obligation and risk regarding performance of the project work in Australia, ie the foreign company has undertaken the performance of a comprehensive project that has a construction and installation period greatly in excess of twelve months.

It is considered by the Commissioner that it is irrelevant whether or not the foreign company itself performs any activities in Australia in connection with the project or undertakes the project work or subcontracts the work to others, either wholly or partly. "

We note that a number of Australian DTAs a PE is deemed to exist where certain supervisory or consultancy activities are undertaken. In particular, the Australia/Japan DTA provides that a PE is deemed to exist where an enterprise of a Contracting State:³⁸

"undertakes supervisory or consultancy activities in the other Contracting State in connection with a building site or construction or installation project which is being undertaken in that other Contracting State, and those activities last more than 12 months."

Apart from the DTAs, Australian domestic tax legislation requires payments to non-residents for 'works or related activities' performed in Australia to be subject to withholding tax at 5%.³⁹ This provision applies regardless of whether the non-resident has a PE in Australia. The term 'works' takes its ordinary meaning as understood in the construction / infrastructure sector⁴⁰ and also specifically includes the construction, installation and upgrading of buildings, plant and fixtures including water treatment plants⁴¹. The term 'related activities' means activities *associated with* the construction, installation and upgrading and includes: administration; assembly; de-commissioning plant; design; commissioning and operation of facilities; costing; engineering; erection, fabrication, hook-up; installation; project and site management;

³⁷ ATO ID 2002/850 at p 2.

³⁸ Sub-article 5(5)(a) of the Australia/Japan DTA.

³⁹ S12-315 *Taxation Administration Act 1953* and Regulation 44C of the *Taxation Administration Regulations*.

⁴⁰ Taxation Ruling TR 2006/12 at paragraph 5.

⁴¹ Sub-regulation 44C(3) of the *Taxation Administration Regulations*.

supervision and provision of personnel; supply of plant and equipment; and warranty repairs.⁴²

Accordingly, the payer will be required to withhold tax at 5% from the payment unless the non-resident applies to the ATO for, and is granted, an exemption from (or reduction in rate of) withholding tax.⁴³ The circumstances in which the ATO will typically grant a non-resident a variation to the withholding rate will be where the ATO forms the view that the non-resident is not required to pay tax in Australia through the operation of a DTA or where the tax on the expected profits is less than the amount of withholding.⁴⁴

5. The exception for “preparatory or auxiliary” activities (paragraph 4 of Article 5)

Most Australian DTAs provide an exception for preparatory or auxiliary activities similar to that contained in paragraph 4 of Article 5 of the OECD Model.

The EM of recent Australian DTAs provides guidance on the interpretation of this article:⁴⁵

"Certain activities do not generally give rise to a permanent establishment (eg, the use of facilities solely for storage, display or delivery).

These activities are ordinarily of a preparatory or auxiliary character and are unlikely to give rise to substantial profits. The necessary economic link between the activities of the enterprise and the country in which the activities are carried on does not exist in these circumstances."

The following are some examples of 'preparatory or auxiliary activities':

- Pre-sales activities (promotion, advertising and solicitation);
- Post sales activities (service and supply of spare parts); and
- Collecting information (market information, credits reports and reporting agencies collecting information).

The ATO in ATO ID 2005/352 that activities of the Australian branch (staffed by one employee who provided product advice to customers) of a Japanese resident company was considered to be in the nature of collection of information and of auxiliary character.⁴⁶

6. The “agency PE” (paragraphs 5 and 6 [OECD] or 7 [UN] of Article 5)

Most Australian DTAs provide an agency PE similar to that contained in paragraphs 5 and 6 of Article 5 of the OECD Model.

The EM of recent Australian DTAs provides guidance on the interpretation of these articles:⁴⁷

" A person who substantially negotiates all essential parts of a contract on behalf of an enterprise will be regarded as exercising an authority to conclude

⁴² Sub-regulation 44C(3) of the *Taxation Administration Regulations*.

⁴³ S15-15 *Taxation Administration Act 1953*.

⁴⁴ Practice Statement PS LA 2006/10.

⁴⁵ Australia/Japan DTA (2008) at paragraphs 1.72 - 1.75; Australia/France DTA (2007) at paragraphs 1.46 - 1.49; Australia/UK DTA (2003) at paragraphs 1.68 - 1.71.

⁴⁶ ATO ID 2005/332 at p 3.

⁴⁷ Australia/France DTA (2007) at paragraphs 1.60 - 1.62 and 1.66; Australia/Finland (2007) at paragraphs 1.72 - 1.75 and 1.79; Australia/UK DTA (2003) at paragraphs 1.72 - 1.75.

contracts on behalf of that enterprise within the meaning of this provision, even if the contract is subject to final approval or formal signature by another person.

Consistent with the OECD Model and the United Kingdom's treaty practice, this paragraph excludes the excepted activities of paragraph 5 from the scope of dependent agency. Activities of a dependent agent will not give rise to a permanent establishment where that agent's activities are limited to the preparatory and auxiliary activities mentioned in paragraph 5.

...

Business carried on through an independent agent will not, of itself, give rise to a permanent establishment, provided that the independent agent is acting in the ordinary course of that agent's business as such an agent."

In the Australia/Japan DTA, the term 'substantially negotiate' has been included to remove any doubt as to the existence of a PE where contracts that have been negotiated in one country by an agent are formally concluded in the other country by signature by another person in that other country.⁴⁸

The ATO in TD 2005/2 (discussed above) in considering whether a resident in a country with which Australia has a DTA, has a PE from the sale of trading stock through an internet website hosted by an Australian ISP made the following comments:

"In most cases, an ISP will not constitute a permanent establishment by virtue of it being a dependent agent, because the ISP is not an agent of the enterprise and would lack the authority to conclude, and would not regularly conclude contracts on behalf of the non-resident enterprise. The website itself does not constitute a dependent agent as it is not a 'person' as defined in Australia's tax treaties. Furthermore, the ISP could constitute an independent agent acting in the ordinary course of their business if, amongst other things, they host websites for a number of different enterprises."

On this basis, the ATO concluded that the foreign resident did not have a PE in Australia pursuant to Article 5(5).

Further, the ATO considered in ATO ID 2004/546 whether a South African company which exported magazines to Australia for sale had a PE in Australia. The magazines were delivered to an independent distribution company in Australia for distribution to newsagents and retail outlets. The South African company did not have any legal or economic control over the Australian distribution company and did not have any offices, place of business or employees in Australia. The South African company paid the Australian company according to the number of copies of magazines sold. The Australian distribution company had no authority to conclude contracts on behalf of the South African company and serviced a large number of publishers. The ATO in considering whether the Australian distribution company qualified as an agent of independent status in the ordinary course of business as an agent referred to paragraph 37 of the OECD Commentary and stated that the Australian company will only come within this independent agent exclusion if:⁴⁹

⁴⁸ Australia/Japan DTA (2008) at paragraph 1.78.

⁴⁹ ATO ID 2004/546 at page 3.

- "* *the person is independent of the enterprise both legally and economically, and*
- * *the person acts in the ordinary course of the business when acting on behalf of the enterprise."*

The ATO in ATO ID 2004/546 concluded based on the facts that the Australian distribution company was an agent of independent status in the ordinary course of business as an agent and therefore, the South African company did not have a PE in Australia.

An issue which arises in respect of the funds industry (such as hedge funds and private equity funds), is whether an Australian entity established solely to provide investment management services to an offshore fund can qualify as an 'independent agent acting in the ordinary course of their business'? The Australian entity may not be commonly owned by the offshore fund or associates of the offshore fund but may provide services solely to the offshore fund. There is an argument that if the Australian entity solely provides services to the offshore fund, it is then difficult to argue that the Australian entity is in the business of independently providing these services. This issue is currently open to discussion and debate in Australia.

7. *Application of the PE definition in the case of related companies (paragraph 7 [OECD] or 8 [UN] of Article 5)*

Most Australian DTAs include an application of the PE definition in the case of related companies similar to that contained in paragraph 7 of Article 5 of the OECD Model.

The EM of recent DTAs provides the following comments in respect of this article:⁵⁰

"Generally, a subsidiary company will not be a permanent establishment of its parent company. A subsidiary, being a separate legal entity, would not usually be carrying on the business of the parent company but rather its own business activities. However, a subsidiary company gives rise to a permanent establishment if the subsidiary permits the parent company to operate from its premises such that the tests in paragraph 1 of Article 5 are met, or the subsidiary acts as an agent such that a dependent agent permanent establishment is constituted.

From a practical perspective, this related companies article is an issue of potential concern for offshore funds which enter into investment management agreements with Australian companies. The Australian investment manager is commonly established specifically for the purpose of providing investment management services to a specific offshore fund and is usually commonly owned by the offshore fund or its related entities; eg offshore manager. This raises issues whether the Australian investment manager may give rise to a PE for the offshore fund or its related entities where other incidental services (other than investment management services) are provided by the Australian investment manager to the offshore fund or related entities/managers? This issue is currently open to debate in Australia.

8. *Interpretation of common variations of the "PE" definition*

Substantial equipment clause

⁵⁰ Australia/Japan DTA (2008) at paragraph 1.85; Australia/France DTA (2007) at paragraph 1.67; Australia/Finland (2007) at paragraph 1.80; Australia/UK DTA (2003) at paragraph 1.76.

Australia in many of its DTAs has a clause which deems an enterprise to have a PE in a Contracting State where there is substantial equipment present, maintained or operated in that Contracting State.

For example, Sub-article 4(3)(b) of the Australia/Singapore DTA provides the following:

"(3) An enterprise of a Contracting State shall be deemed to have a permanent establishment and to carry on trade or business through that permanent establishment in the other Contracting State if:

(b) substantial equipment is being used in that other State by, for or under contract with the enterprise."

In *McDermott's case*, the Full Federal Court made the following comments in respect of this sub-article.⁵¹

"It is obvious from the text itself that the equipment must be 'substantial'. Just how substantial is not stated and need not be considered here, for it is conceded by the Commissioner that the barges represented equipment that was substantial. Whether the concession was correctly made is not a matter with which we are presently concerned.

However, it is clear that the article is concerned with equipment that is not, either in a relative, or in an absolute sense, insubstantial. Floating oil rigs are a good example of equipment which would properly be treated as substantial. It does not seem surprising that the owner of such a rig which had granted rights of use under a bailment agreement for reward should be treated as having a permanent establishment in the place where the rig is and where it is used, and thus be liable to be assessed for tax on the basis of the income derived from the rig in the jurisdiction where the rig is and where it is used and not the place of residence of the owner. Construction cranes employed in large construction projects would likewise be properly characterised as "substantial equipment" and suggest another example where payment of the right to use, under a bailment agreement, might readily be seen as properly taxed in the place where the equipment is used and not the place of residence of the owner."

It was argued by the ATO that the words "by, for or under contract" in sub-article 4(3)(b) of the Australia/Singapore DTA did not stipulate three different and alternate occasions of usage but rather, the words stipulated a single complex idea. The Full Federal Court firmly rejected this argument.

The ATO has issued Taxation Ruling TR 2007/10 which discusses the abovementioned sub-article in respect of the treatment of shipping and aircraft leasing profits of US and UK enterprises.

In respect of the equipment being 'substantial', the ATO have made the following comments:⁵²

"the Commissioner considers that whether the equipment in question is 'substantial' is a question of fact and degree to be determined:

- on balance, according to the facts and circumstances of each particular case; and*
- in an absolute sense, that is, when viewed independently; not in comparison with something else; or*
- in a relative sense; that is, by comparing it to something else."*

On this basis, the ATO is of the view that it would be extremely rare for ships or aircraft not to be substantial equipment due their size alone.⁵³

⁵¹ *McDermott's case* at paragraphs 54-55.

⁵² Taxation Ruling TR 2007/10 at paragraph 110.

Further, the ATO considers a US lessor enterprise 'maintains' substantial equipment in Australia where its actions are directed towards keeping the ships or aircraft in Australia. Where the lessor enterprise's actions are not so directed, this indicates that the lessor is not maintaining ships or aircraft in Australia.⁵⁴

The ATO consistent with paragraph 6.1 of the OECD Commentary on Article 5 of the OECD Model requires that the substantial equipment needs to be physically present within Australia for a continual period of more than 12 months in order to satisfy the more than 12 month period. The ATO states that short breaks for holidays, repair time or other natural incidents of business do not constitute a break in the continuity of the period of the equipment being maintained within Australia for the purposes of calculating the more than 12 month period.⁵⁵ However, the ATO accepts that what constitutes a temporary interruption to the time period of more than 12 months for Article 5(4)(b) purposes depends on the facts and circumstances of each particular case and the period of temporary interruption will not be included in calculating the continual period of more than 12 months.⁵⁶

We note that Australia has been including a more prescriptive definition of 'substantial' as discussed above in TR 2007/10 in recent tax treaties entered into with other countries (for example, Australia/Japan DTA).

The EM to the recent Australia/Japan DTA adopts the views taken in *McDermott's case* and the ATO above in TR 2007/10 (discussed above), states the following:⁵⁷

"If an enterprise operates substantial equipment in a country for longer than 183 days in any 12-month period, the activity will be deemed to be performed through a permanent establishment. For the purposes of calculating this period, days during which the substantial equipment is used in the exploitation of, or exploration for, natural resources are not included.

...

The terms 'operation' and 'operates' have been included to clarify that only active use of substantial equipment assets will be captured by subparagraphs 4(b) and (c). This means that an enterprise that merely leases substantial equipment to another person for that other person's own use in a country, would not be deemed to have a permanent establishment in that country under these provisions.

...

The meaning of the term 'substantial' depends on the relevant facts and circumstances of each individual case. Factors such as the size, quantity or value of the equipment, or the role of the equipment in income producing activities, are relevant in determining whether the equipment is substantial. "

The ATO in ATO ID 2007/20 applied the principles espoused in *McDermott's case* and TR 2007/10 (as discussed above) in determining that packing machines did not constitute substantial equipment for the purpose of the Australia/US DTA.

This issue is highly relevant for an offshore online software providers who maintains small/minor value computer related equipment in Australia for the purpose to allow

⁵³ TR 2007/10 at paragraph 112.

⁵⁴ TR 2007/10 at paragraph 116.

⁵⁵ TR 2007/10 at paragraph 140.

⁵⁶ TR 2007/10 at paragraph 141.

⁵⁷ Australia/Japan DTA at paragraphs 1.62 - 1.67.

their services to run faster for Australian/other customers and who does not have an office, employees or any other presence in Australia. The factors mentioned above in *McDermott's case* and TR 2007/10 (such as, size, value, quantity and importance of the computer related equipment) need to be considered in order to determine whether the software provider has a PE in Australia.

Anti-avoidance clause

A number of Australian DTAs provide include an anti-avoidance clause in the PE definition. For example, sub-article 5(5) of the Australia/Japan DTA provides the following anti-avoidance clause:

"a) The duration of activities under paragraphs 3 and 4 shall be determined by aggregating the periods during which activities are carried on in a Contracting State by associated enterprises provided that the activities carried on in that Contracting State by an enterprise are connected with the activities carried on in that Contracting State by its associated enterprise.

b) The period during which two or more associated enterprises are carrying on concurrent activities shall be counted only once for the purpose of determining the duration of activities.

c) For the purposes of this Article, an enterprise shall be deemed to be associated with another enterprise if:

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

(ii) the same persons participate directly or indirectly in the management, control or capital of the enterprises."

The purpose of the need for such an anti-avoidance clause is explained by the EM to the Australia/Japan DTA:⁵⁸

"Given that Article 5 contains certain timeframes, an anti-avoidance rule is included to ensure that where associated enterprises carry on connected activities, the periods will be aggregated in determining whether an enterprise has a permanent establishment in the country in which the activities are being carried on. Activities will be regarded as connected where, for example, different stages of a single project are carried out by different subsidiaries within a group of companies or where the nature of the work carried on by the associated enterprises in respect of such project is the same.

This provision is an anti-avoidance measure aimed at counteracting contract splitting for the purposes of avoiding the application of the permanent establishment rules.

...

This Convention provides that an enterprise shall be deemed to be associated with another enterprise if one enterprise participates directly or indirectly in the management, control or capital of the other enterprise or the same persons participate directly or indirectly in the management, control or capital of the enterprises. It also provides that a period of concurrent activities by such associated enterprises is only counted as one period for aggregation purposes."

Practically, this article in the PE definition needs consideration where for example, employees from related entities are seconded to Australia to carry out various

⁵⁸ Paragraphs 1.68 -1.71.

components of an installation project at various times during the year. In this scenario, detailed records of days spent in Australia by the employees are required to ensure that the requisite time period as allowed by the relevant DTA is not exceeded.

9. Guidance related to non-treaty uses of the PE or similar concepts

Domestic income tax law

The concept of PE is also commonly used in a number of provisions contained in Australian domestic tax law, for example, sections 23AH, 24L, 121C, 121EA, 128B of the ITAA36 and sections 136-25, 136-30, 320-35 of the *Income Tax Assessment Act 1997 (Cth)*⁵⁹.

Section 6(1) of the ITAA36 contains the following definition of PE:

"permanent establishment", in relation to a person (including the Commonwealth, a State or an authority of the Commonwealth or a State), means a place at or through which the person carries on any business and, without limiting the generality of the foregoing, includes:

- (a) a place where the person is carrying on business through an agent;*
 - (b) a place where the person has, is using or is installing substantial equipment or substantial machinery;*
 - (c) a place where the person is engaged in a construction project; and*
 - (d) where the person is engaged in selling goods manufactured, assembled, processed, packed or distributed by another person for, or at or to the order of, the first-mentioned person and either of those persons participates in the management, control or capital of the other person or another person participates in the management, control or capital of both of those persons — the place where the goods are manufactured, assembled, processed, packed or distributed;*
- but does not include;*
- (e) a place where the person is engaged in business dealings through a bona fide commission agent or broker who, in relation to those dealings, acts in the ordinary course of its business as a commission agent or broker and does not receive remuneration otherwise than at a rate customary in relation to dealings of that kind, not being a place where the person otherwise carries on business;*
 - (f) a place where the person is carrying on business through an agent:*
 - (i) who does not have, or does not habitually exercise, a general authority to negotiate and conclude contracts on behalf of the person; or*
 - (ii) whose authority extends to filling orders on behalf of the person from a stock of goods or merchandise situated in the country where the place is located, but who does not regularly exercise that authority;**not being a place where the person otherwise carries on business; or*
 - (g) a place of business maintained by the person solely for the purpose of purchasing goods or merchandise;"*

⁵⁹ Please note that this is not a complete list of all tax sections which refer to PEs.

We note that the domestic definition of PE does not require a 'fixed place of business' unlike the OECD Model definition. However, the ATO does not consider it significant that the word 'fixed' does not appear in sub-section 6(1) definition of PE.⁶⁰

In *Unisys' case*, the Supreme Court considered this definition of PE as contained in Australia's domestic legislation.

In *Unisys' case*, the taxpayer was a US resident and conducted a US service involving the storage of documents. Unisys Licencing Partnership (**ULP**) paid rent to the taxpayer under a sub-lease and was an Australian resident. Unisys Australia Ltd (**UAL**) was incorporated in the US but carried on business in, and was a resident of, Australia for the purposes of Australian tax law.

The taxpayer entered into an intellectual property agreement with ULP that gave ULP a non-exclusive licence to reproduce, distribute and use the taxpayer's intellectual property throughout the world. This agreement was executed at the taxpayer's offices in the USA. At the same offices, a sub-licence was executed from ULP to UAL to utilise the intellectual property in Australia and its territories. The royalty payments were set at 50% of UAL's software revenue under a sub-licence while the royalties under the head licence were set at 99.5% of the royalties received from UAL.

The ATO issued a notice claiming withholding tax was payable on the royalties pursuant to Australian domestic tax law, together with penalties and interest. The issue arose whether the business conducted by ULP was carried on at or through a PE in the US? The Supreme Court held in respect of this issue that while each leased room constituted a place which was at the exclusive disposal of ULP, it was not a place at or through which ULP carried on its business as the storage and retrieval of documents could hardly constitute the carrying on of ULP's business. On this basis, the court held that the rented rooms did not constitute PEs.

A submission was made that ULP's business was carried on by USI as its agent and it had its place of business at USI's business premises and ULP's business was conducted at or through USI's place of business. The court held that the existence of a general authority to conclude contracts was not sufficient to constitute a PE. The word "or" in sub-section 6(1)(f)(i) of the definition of 'PE' (see above) meant "and". In this case, the only contracts executed that constituted the business activity were the licence and sub-licence agreements. The court held that in this case there was not a sufficient repetition of contractual activity to constitute the habitual exercise of a general authority to negotiate and conclude contracts.

In particular, the Supreme Court made the following comments in respect of comparing the PE definition as contained in Australian domestic law to that in the OECD model:⁶¹

"Under the Income Tax Assessment Act 1936, it is the place where the person carries on business through an agent that constitutes the permanent establishment.

Under the OECD formulation, it is not every dependent agent who constitutes a permanent establishment. The provision is limited to an agent with authority to conclude contracts in the name of the enterprise who habitually exercises that power. "

⁶⁰ Taxation Ruling TR 2002/5 at paragraph 19.

⁶¹ Unisys' case at paragraphs 62 to 64.

The ATO in ATO ID 2006/337 considered whether computer system located in a non-DTA country and used by the taxpayer to trade in securities was 'substantial equipment' for the purposes of sub-paragraph 6(1)(b) ITAA36 of the PE definition? The computer system consisted of approximately ten pieces of hardware, including servers and routers, and software for market access and trading algorithms. The approximate dimensions of each piece of the taxpayer's computer system ranged from 4.40 x 44.70 x 71.10cm to 46.00 x 26.20 x 68.80cm. Collectively, the computer system measures 260cm x 398cm x 470cm. The approximate weight of the computer system was 164 kilograms, and its value was \$200,000. The ATO referred to *McDermott's case* and to its tax ruling TR 2007/10 in determining that in the present case the computer system was not substantial equipment. The factors considered by the ATO in making this determination were the size, quantity, value and importance of the computer system. In particular, the ATO stated the following in respect of applying these factors to the present case:⁶²

"Given the dimensions of the individual items of the taxpayer's computer system, the Commissioner considers that those individual items of equipment are each not large enough to be considered substantial in an absolute sense. Furthermore, the individual items of equipment are part of a unified process, but when the size of the individual items of equipment are viewed in aggregate, the dimensions of the entire computer system again indicate that the computer system is not substantial equipment by reason of its size.

As there are only 10 individual items of equipment, the Commissioner considers that this factor does not indicate that the computer system is substantial equipment.

The Commissioner considers that the taxpayer's computer system, valued at \$200,000, is not of sufficiently high value for it to constitute substantial equipment on the basis of its value.

As only 50 percent of the taxpayer's business activities involve electronic trading through the computer system, the Commissioner considers that the computer system does not play a core role in the taxpayer's income-producing activities.

On balance, there are insufficient grounds for the Commissioner to conclude that the taxpayer's computer system is 'substantial equipment' for the purposes of paragraph (b) of the definition of permanent establishment in subsection 6(1) of the ITAA 1936."

We note that certain telecommunication providers may be faced with PE issues due to the presence of 'substantial equipment' in certain jurisdictions even where there are no local branches.

There have been a number of other cases which have referred to particular Australian DTAs but have not considered the PE article in any detail, such as *Roche Products Pty Ltd v FCT*⁶³ and *Daihatsu Australia Pty Ltd v FCT*⁶⁴.

Goods and Services Tax (GST)

The concept of PE is also used in the Australian GST law. The concept has a number of uses, but its principal relevance is to the 'connected with Australia' rules (the

⁶² ATO ID 2006/337 at p 4.

⁶³ 2008 ATC 10-036.

⁶⁴ 2001 ATC 4268.

equivalent of the place of supply rules in Europe). These rules primarily determine whether an entity has a GST liability.

Relevantly, a supply of anything other than goods or real property is connected with Australia if, among other things, the supplier makes the supply through an enterprise that the supplier carries on in Australia (section 9-25(5)(b) of the *A New Tax System (Goods and Services Tax) Act 1999* (the **GST Act**)). Section 9-25(6) of the GST Act incorporates the concept of PE as follows (an asterisk refers to a defined term in the legislation):

"When enterprises are carried on in Australia

*(6) An *enterprise is carried on in Australia if the enterprise is carried on through:*

(a) a permanent establishment (as defined in subsection 6(1) of the Income Tax Assessment Act 1936); or

(b) a place that would be such a permanent establishment if paragraph (e), (f) or (g) of that definition did not apply."

There has been no case law in Australia concerning this provision. GST ruling GSTR 2000/31, *Goods and services tax: supplies connected with Australia*, which sets out the ATO's views, states:⁶⁵

"There is no specific set of circumstances which must be satisfied before a supply is connected with a permanent establishment. Rather, each case will be determined on the basis of the individual facts and circumstances. However, some factors that will usually indicate that the supply is made through a permanent establishment include:

- the permanent establishment has the authority to sign contracts or accept purchase orders for the supply;*
- the permanent establishment has the authority to make important decisions in respect of the supply;*
- the permanent establishment physically makes for example, manufactures or produces, the supply;*
- if the supply is a service, the service is provided by the permanent establishment;*
- if the supply is the provision of advice or information such as a legal opinion, the permanent establishment provides that advice or information;*
- if the supply is the grant, creation, assignment, transfer or surrender of a right, the permanent establishment grants, creates, assigns, transfers or surrenders that right."*

The abovementioned discussion is a statement of legal principles as at 15 October, 2008.

⁶⁵ Paragraphs 84 - 87.

