Bulletin

Important news

Tax

Is there a permanent establishment?

July 2009

Speed Read

As part of the 63rd Congress of the International Fiscal Association (IFA), Patrick Mischo and Marie Junius, Partner and Counsel respectively in Allen & Overy Luxembourg's tax group and Yves Prussen, Partner at Elvinger, Hoss & Prussen discuss the tax concept of permanent establishment in an article published by the IFA in "Les Cahiers de Droit Fiscal international", Volume 94 a in June 2009.

Summary and Conclusions

For the most part, the provisions on permanent establishments (PEs) contained in the tax treaties entered into by Luxembourg closely follow the wording of the OECD Model. Luxembourg case law confirms that tax treaties based on the OECD Model should be interpreted in the light of the OECD commentaries. Save for this pragmatic assertion, official guidance on the interpretation of article 5 of the OECD Model is very scarce in Luxembourg, with only a handful of court decisions available to the public, hardly any useful protocols to the tax treaties, and almost no official positions from the Luxembourg tax administration. Even the bills of law to the tax treaties are of little use for interpretation purposes, since they merely highlight the differences, if any, to the OECD Model.

A concept similar to the OECD's PE concept exists in Luxembourg domestic tax law. The domestic PE concept has its origins in German law and is defined in much broader terms than that of the OECD Model. Even though there is no case law confirming that Luxembourg or German case law precedents pertaining to the domestic PE concept may be used in a tax treaty context, there is little doubt that the interpretations of this domestic PE concept may influence the Luxembourg courts' interpretation of article 5 of the OECD Model, at least if the OECD commentaries do not provide any answers and provided that the domestic PE concept is compatible with the tax treaty provisions at hand.

According to Luxembourg case law, the term "place of business" implies the existence of infrastructures in Luxembourg, which are at the disposal of the enterprise concerned. It appears that the actual

physical space of such premises and the legal basis of such disposal is unimportant, as long as the enterprise has the right to use them on a regular basis and at least part of the business activities are carried on through them.

A place of business is considered "fixed" if it is fixed in terms of geographical location (location test) and in terms of the time that the place is used (duration test). Unfortunately, existing case law in a tax treaty context does not define or clarify the criteria for these two tests, but only acknowledges if the tests have been met. However, case law related to the domestic PE concept clarifies, much in line with the OECD commentaries, that separate installations may be considered as a single place of business, provided that they are connected to each other and form an integrated economic unit.

Based on case law related to the domestic PE concept, the facilities of an enterprise may represent a fixed place of business of another enterprise in cases where there is a trust or a fiduciary arrangement between those enterprises or, more generally, if the interaction between both enterprises results in a factual partnership (*société de fait*). In any case, the business activities would have to be geographically linked to that place to be considered as being carried on through the fixed place of business. Case law has also stated that the mere holding of the shares of a foreign subsidiary may not be considered as a PE of an enterprise.

In line with the OECD commentaries, Luxembourg courts do not treat the listed examples of PEs as an exhaustive list and analyse in each case if the criteria of the general definition are fulfilled, whereas as for the special provision for construction sites, the construction site will be deemed to be a PE as soon as it lasts for the period of time determined in the relevant tax treaty. Conversely, case law has confirmed that a construction site cannot be treated as implicitly covered by any situation deemed to constitute a PE under the general definition.

Concerning "agency PEs" there is little guidance under Luxembourg law to determine when an agent must be considered as independent. However, both for domestic law and tax treaty purposes, it may be assumed that the agent is independent when he acts for more than one client. Likewise, depending on the factual situation, a partner of a partnership may either be considered as a dependent or independent agent of the other partners. It is however unclear if the agent must be a resident of the State where he operates or if he should have a place of operation in that State. Some personal link with the country may however be sufficient. As to the authority to conclude contracts in the name of the enterprise, the determining criterion is that the agent should be able to commit the enterprise, based on the factual situation.

In some tax treaties signed by Luxembourg, the PE definition varies from the OECD Model to follow the definition contained in the UN Model. In some of these tax treaties, insurance companies are deemed to have a PE in another State, if they collect premiums in the territories of that other State or insure risks situated therein through a person other than an independent agent. Another common variation of the PE definition taken from the UN Model relates to the furnishing of services, including consultancy services, through employees or other personnel engaged in the other State (the so-called service PE) provided, in most cases, that the activities continue for a certain period of time.

1. Introduction

In Luxembourg, there are relatively few sources of guidance with respect to the interpretation of article 5 of the OECD Model.

Tax treaties entered into by Luxembourg are ratified by the Luxembourg Parliament by way of the enactment of a law. Interpretative provisions, which are typically found in a bill of law, provide little information for the purposes of interpreting the PE definition and only highlight the differences between the provisions on PEs of the treaty and article 5 of the OECD Model. However, the mere fact that reference is made to the OECD Model in the interpretative provisions, constitutes in our view an indicator of the relevance of both the OECD Model and commentaries for the purposes of the interpretation of tax treaties entered into by Luxembourg.

Furthermore, there are some protocols to tax treaties which are relevant for the interpretation thereof and a few court decisions regarding the interpretation of the PE provisions of tax treaties. Finally, there is not much official guidance issued by the Luxembourg tax authorities by way of circular letters or otherwise. In the publications which contain the tax treaties entered into by Luxembourg[1], officers of the tax authorities have inserted a number of explanatory footnotes on the PE provisions of various tax treaties which replicate the interpretation given in the bills of laws ratifying the treaties.

[1] *Code fiscal luxembourgeois*, volume 1a and 1b.

In the past, the Luxembourg administrative courts[2] often relied on the commentaries on the OECD Model, when it came to interpreting treaty provisions. Without referring to the Vienna Convention on the Law of Treaties of 23 May 1969 and without further questioning the authority of the OECD commentaries as guidance to construe treaty provisions, courts have taken a pragmatic approach and simply made reference to the relevant commentaries. The Administrative Court of Appeal has also confirmed that a tax treaty based on the OECD Model should be construed in accordance with the OECD commentaries[3]. Hubert Dostert, by a tax analysis published in 1979 in the *Etudes Fiscales* regarding tax treaties[4], confirmed that the OECD commentaries may serve as guidance to interpret treaty provisions, provided these provisions are based on the OECD Model. Although this publication cannot be treated as an official source of governmental interpretation, it is worth noticing that all the articles (but one) contained therein, were written by officers or former officers of the Luxembourg tax authorities. The courts also regularly refer to international and domestic commentators. As there is little guidance available in Luxembourg on the interpretation of the treaty definition of PE, Luxembourg courts would in our view primarily turn to the commentaries on the OECD Model for the purposes of interpreting the PE definition.

However, there are similar concepts used by Luxembourg domestic tax law, since paragraph 16 of the Tax Adaptation Law (*Steueranpassungs-Gesetz*) defines a concept of PE (*Betriebstätte*). Indeed, if a non-resident enterprise carries out a business in Luxembourg through a PE, the profits realised by such a PE are subject to Luxembourg taxes pursuant to domestic law. There are some court decisions in respect of this domestic law concept from which guidance may also be sought for purposes of interpreting the PE definition of the OECD Model. A Luxembourg court, bound to interpret the PE provisions of a tax treaty, is therefore likely to turn to these decisions, in addition to the OECD commentaries, to seek guidance.

[2] There are two administrative courts in Luxembourg dealing with direct taxation matters. The Administrative Court (*Tribunal administratif*) and the Administrative Court of Appeal (*Cour administrative*). Decisions of the Administrative Court may be appealed against in front of the Administrative Court of Appeal. The decisions of the latter are final and binding.

[3] Administrative Court of Appeal, 17 January 2006*, SA XXX v/Administration des Contributions*, n°20316C.

[4] *Etudes Fiscales*, February 1979, n°57/58. "La double imposition internationale en matière d'impôts sur le revenu et la fortune et les conventions tendant à l'éliminer".

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

The Luxembourg tax authorities have issued an Explanatory Note in relation to the law of 3 October 1991 regarding the establishment of enterprises operating a transport business[5], which provides some guidance on the PE definition. In order to obtain an authorisation to operate a transport business in Luxembourg, an enterprise is required to provide a certificate, to be issued by the Luxembourg tax authorities, confirming that it has a PE in Luxembourg. In the Note, the tax authorities mention that the concept of PE is typically referred to in tax treaties and explains how the concept comes into play in a cross-border context. They then state that, for the purposes of a tax treaty, PE means a fixed place of business through which the business of an enterprise is wholly or partly carried out. Furthermore, the tax authorities set out the criteria which need to be met for there to be a PE:

- a place of business must exist, i.e., a facility such as premises;
- the place of business must be fixed, i.e., it must be established at a distinct place with a certain degree of permanence;
- the business must be carried on through this fixed place of business, which usually 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 of business is situated; and
- there can be no PE if the fixed place of business merely has a preparatory or auxiliary character.

Without making any explicit reference to the OECD Model and/or the OECD commentaries, the Luxembourg tax authorities set out the actual wording of the OECD Model and commentaries in the Note. Even though the Note does not directly relate to the interpretation of tax treaty provisions, but rather to the interpretation of the concept of PE for the purposes of the Law of 3 October 1991, in our view, the fact that the tax authorities make reference to the OECD Model and commentaries is a clear indication that they would closely follow the OECD commentaries in interpreting the definition of PE in a tax treaty entered into by Luxembourg.

[5] Note II / 169-92 HE/G dated 26 March 1992.

2.1 WHAT IS A "PLACE OF BUSINESS"?

In the *Esch* case[6], a German enterprise argued that its construction activities in Luxembourg amounted to a Luxembourg PE under the Germany-Luxembourg tax treaty and that the profits attributable to such PE should be taxed in Luxembourg. The Luxembourg tax authorities disagreed on the existence of such PE. The enterprise filed an appeal against the decision of the tax authorities in front of the Administrative Court.

The Court held that a fixed place of business (*feste Geschäftseinrichtung*)[7] requires the existence of an infrastructure in Luxembourg, which must be at the disposal of the enterprise concerned. The German enterprise actually rented premises in Luxembourg and the Court stressed that as a result of the lease, the premises were indeed at the disposal of the German enterprise. It seems that the Court's position is in line with the OECD commentaries, pursuant to which an enterprise simply needs to have a certain amount of space at its disposal, the legal basis for such disposal being irrelevant.

In the case at hand, the area of the premises was quite limited and did not allow for the storage of all the goods necessary to carry out the activities of the German enterprise in Luxembourg. It is interesting to note that the Court considered that the limited dimensions of the premises did not *per se* exclude the existence of a PE.

In an earlier judgment of 8 April 1981[8], the Council of State[9] interpreted paragraph 16 of the Adaptation Tax Law (*Steueranpassungs-Gesetz*) in the context of a specific shipping business and held that wharfs or landing stages located in Luxembourg may be constitutive of a Luxembourg PE of a shipping enterprise since they were used by the shipping enterprise in the context of its transportation business.

[6] Administrative Court, 9 March 1998, *Esch v/Administration des Contributions*, n°10117 and Administrative Court of Appeal, 9 February 1999, *Administration des Contributions v/ Esch,* n°10674C. It should be noted that the Court of Appeal quashed the decision of the Court, which confirmed the existence of a PE, on appeal and held that there was no PE in Luxembourg as no real economic activity was carried on through the rented premises.
[7] Art. 2(1)2: "der Begriff "Betriebsstätte" eine feste Geschäftseinrichtung, in der die Tätigleit des Unternehmens ganz oder teilweise ausgeübt wird".
[8] Council of State, 8 April 1981, *Navigation Touristique de l'Entente de la Moselle luxembourgeoise v/ Administration des Contributions*, n°6491.
[9] Which in the past exercised the function of an administrative court.

2.2 WHAT IS A "FIXED" PLACE OF BUSINESS IN TERMS OF GEOGRAPHICAL LOCATION (THE LOCATION TEST)?

In the *Esch* case, the Administrative Court held that, to be deemed as being fixed, the infrastructure must be situated in a specific geographical location. However, the Court then merely went on to acknowledge that because of the premises rented by the German enterprise in Luxembourg this test was met, but the judgment does not provide further details.

In a decision of 21 May 1987[10], the Council of State addressed the issue of the geographical location of a PE under paragraph 16 of the Adaptation Tax Law. Even though this decision does not refer to the treaty definition of PE, it nevertheless sheds some light on how the location test may be analysed by Luxembourg courts in a treaty context.

The question arose as to whether the installations of an enterprise, which were established on the territories of two different municipalities, constituted a single PE or two PEs. The Council of State held that the installations must be connected and form an integrated economic unit to be considered a single PE[11]. In the case at hand, the Luxembourg steelmaker Arbed had factories on the territory of one municipality and mines on the territory of another one. The factory and the mines, even though not adjacent to each other, were related by way of various means of communication and transport (e.g., mine galleries, rail tracks, and canals). Further, from an organisational and technical point of view, the factory and the mines could be considered as forming an integrated economic unit. Therefore, the Council of State decided that the factory and the mines should be deemed constitutive of a single PE.

The Council of State's decision seems to be in line with the OECD commentaries, according to which a single place of business will generally be considered to exist where a particular location, within which the activities are moved, may be identified as constituting a commercial and geographical whole with respect to the business.

[10] Council of State, 21 May 1987, *Administration de Kayl v/ Ministère de l'Intérieur*, n°7407.
[11] These criteria have been referred to, and confirmed, by the Administrative Court in a judgment dated 24 July 2002 (*Administration communale de S. v/Administration des Contributions*, n°12348).

2.3 WHAT IS A "FIXED" PLACE OF BUSINESS IN TERMS OF THE TIME THAT THE PLACE IS USED (THE DURATION TEST)?

In the *Esch* case, the Administrative Court merely acknowledged that the premises rented by the German enterprise were at its disposal during the entire period in respect of which it was argued that a PE existed.

Even though under paragraph 16 of the Adaptation Tax Law, a minimum six-month period must be met for a construction site to be considered as a PE, in a treaty context, it is in our view not possible to draw any conclusions from this legal provision for the purposes of the duration test.

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)?

The place must make it possible to carry out the business of the enterprise. Thus the test comprises two main elements, a fixed place available to the enterprise and an activity of the enterprise carried out at such place. The place may be used by virtue of a formal right or even without any specific right. The landing stage used along the Moselle river was considered as sufficient by the Council of State, although the place was neither owned, nor rented by the enterprise[12]. This court precedent is in line with German precedents and the commentary of the OECD Model, which consider a taxi stand as a PE and, even if a place is used illegally, there is no reason, in our opinion, why the use for the purpose of an activity of an enterprise would not constitute a PE[13].

The premises of a tax transparent partnership are normally considered as a place where there exists a PE of the partners. This is the case even if no formal partnership is established. In the *Alliance* case[14], the Council of State came to the conclusion that there was a *de facto* partnership between a Luxembourg enterprise and a Belgian enterprise as a result of the carrying out by the Luxembourg enterprise of the business of the Belgian enterprise in Luxembourg, whereby there was evidence that the Belgian enterprise had invested in the business and that it had a real profit share therein. The conclusion was drawn that consequently the premises of the Luxembourg enterprise did constitute a PE through which part of the business of the Belgian enterprise was carried out. In our opinion this principle may be applied to similar situations: thus, in the unlikely case where a business is carried out by a trust for the benefit of a beneficiary, then such beneficiary will similarly be deemed by the tax authorities to have a PE at the facilities of the trust from which the business is carried out. The same would apply to fiduciary arrangements.

Although no official guidance is available on this subject, the tax authorities are likely to consider that premises used by an agent of an enterprise may sometimes be (although are not necessarily) considered to be at the disposal of the enterprise and in such event constitute a PE. A PE will exist if the enterprise has a right to use the premises, or if the representative carries out the activity of the enterprise in such premises. The private home of an employee may only be considered to be at the disposal of the employer, if the enterprise itself can use it as place for its activities. The mere use of premises by the employee should not be sufficient, even if he does work for the enterprise from a remote place, to conclude that the business of the enterprise is carried out at such place. In this respect, the administration would in our opinion look to the commentary of the OECD Model, but its way of thinking would be influenced by German precedents and doctrine.

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?

On the place of business, the enterprise must participate in the economic life and it should not limit the use of the place to that of a mere storage area. In the *Esch* case, the Administrative Court of Appeal has concluded that the participation in the economic life requires that at least part of the activities are actually carried out in such place. The actual commercial or industrial activity[15] must thus be geographically linked to that place[16].

---

[12] Council of State, 8 April 1981, *Navigation Touristique de l'Entente de la Moselle luxembourgeoise v/ Administration des Contributions*, n°6491.
[13] OECD Modell Vogel/Lehner, *Doppelbesteuerungsabkommen*, Kommentar 5. Auflage, Anm. 16, Hübschmann, Hepp, Spitaler, AOFGO, Kommentar, § 12 Anm.16a.
[14] Council of State, 3 April 1957, *Alliance v/ Administration des Contributions*, n°4940.

[15] Hübschmann *op.cit*., § 12 Anm. 21; Tipke/Kruse op.cit.,§ 12 Anm. 19.
[16] Vogel *op. cit*., Anm. 22.

As is shown by the *Alliance* case, the business may also be carried out through another enterprise if the interaction between both enterprises is that of a *de facto* partnership (*société de fait*), in which case the facilities of the other enterprise (or partner) are considered as a PE[17]. The kind of relationship between the parties, the profit sharing arrangements and investments made by the foreign enterprises in the Luxembourg business were the criteria considered by the Council of State. It seems however unlikely that this could apply to the case where an independent subcontractor carries out his own business without interference of his client's enterprise, save to ensure compliance with the terms of the contract.

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

In the *Esch* case, the Administrative Court of Appeal concluded that the mere storage of material was insufficient, but mentioned that the existence of a small office at the place would have been taken into account. It was the absence of evidence of any activity linked to the place that led to the conclusion that there was no PE. In this case therefore, it could be said that the court required part of the activity, although in our opinion not necessarily a core activity, to take place at this precise location.

3. Listed examples of a PE (paragraph 2 of article 5)

All tax treaties entered into by Luxembourg comprise a positive list of examples of a PE. Such a list always comprises the examples given in the OECD Model and in the UN Model plus, in rare cases only, some other examples, such as sales offices, warehouses (in relation to a person providing storage facilities for others), plantations and farms.

By reference to the OECD and UN commentaries, these examples should not be viewed as necessary criteria and the list should not be seen as an exhaustive one. Such a list only gives examples of situations that could be regarded, *prima facie*, as constituting a PE but must not be seen against the background of the general definition of the PE.

In the *Esch* case, we note that the taxpayer argued that it had an office in Luxembourg through which the activities of its Luxembourg PE were coordinated. The Administrative Court instead made a factual analysis of the situation to determine whether the criteria referred to in the general definition of the PE as provided for in the Germany-Luxembourg tax treaty were met (e.g., place of business and location test).

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

As stressed in the report of the Finance Commission of the Luxembourg Parliament in relation to the bill of law approving the Netherlands-Luxembourg tax treaty, Luxembourg is a small country and as such, is largely dependent on foreign entrepreneurs for large-scale construction projects within its territory. To a certain extent, this may have an impact on the interpretation of the special rule for construction sites included in the tax treaties concluded by Luxembourg, whose drafting generally follows the OECD Model with, from time to time, some variations taken from the UN Model (usually, with respect to the duration of the construction site and/or any related supervisory activities).

In its decision of 3 June 1976[18] relating to the interpretation of the Belgium-Luxembourg tax treaty (in a version dated 9 March 1931, prior to its revision in 1970), the Council of State held that if construction sites are not expressly referred to in the treaty definition of a PE, they cannot be considered as implicitly covered by any other situations deemed to constitute a PE. The construction clause should thus act as a provision creating a PE that would not otherwise exist. It should also constitute an exception preventing a PE from existing if it does not last for more than a certain period of time (from 5 to 12 months depending on tax treaties).

With respect to the exact scope of the activities covered by the construction clause, the terms "building site" "construction project" and "installation project" should, in our view, be broadly interpreted. Some explanatory footnotes may be found in this respect in the fiscal codes containing respectively the France-Luxembourg and Belgium-Luxembourg tax treaties. These refer to the OECD commentaries and state that the terms "building site", "construction

[17] This case dealt with the Luxembourg-Belgian tax treaty of 1939.

[18] Council of State, 3 June 1976, *Constructions et Entreprises Industrielles SA v/ Administration des Contributions*, n°6436.

project" and "installation project" include digging and dredging activities.

Edmond Maquil published in 1966 a tax analysis in the *Etudes Fiscales* about construction sites and installation projects that are deemed to constitute a PE, both in a domestic context and in the context of the five tax treaties in force at that time[19].

Commenting on the construction clause in paragraph 16 of the Adaptation Tax Law, Edmond Maquil stated that the intent of the Luxembourg legislator was to create a presumption of law where a construction project, by essence temporary and precarious, should be deemed constitutive of a PE, provided the project lasts for more than six months. In a treaty context, such interpretation seems in line with the OECD commentaries, according to which a building site or construction or installation project which does not meet the duration condition, does not of itself constitute a PE.

He further gave details of the definition of a construction site (e.g., to what extent renovating an existing building or erecting a building for the entrepreneur's own purpose are covered by the construction clause) and the precise rules for calculating the period of time of six months referred to in paragraph 16 of the Adaptation Tax Law (starting point, ending point and calculation of periods of work interruption) with numerous references made to German precedents[20]. He stressed that the solutions identified in a domestic context could only be used in a treaty context if not otherwise provided for in the relevant tax treaty. Thus, in the absence of any specific guidance in a tax treaty and/or in the OECD or (if applicable) UN commentaries, a judge could, in our view, refer to the solutions identified by Edmond Maquil in the *Etudes Fiscales,* when deciding on the merits of a case.

5. The exception for "preparatory or auxiliary" activities (paragraph 4 of article 5)

The German-Luxembourg tax treaty provides for a list of "preparatory or auxiliary" activities[21]. In the *Esch* case, the Administrative Court considered that the Luxembourg construction activities of the German enterprise need to be wholly or partly carried on through the existing infrastructure in Luxembourg and that such activity should exceed the scope of the simple storage of goods, which would not constitute a PE in accordance with article 2(1)2(b) of the treaty. As a matter of fact, the treaty provides that the term PE shall not be deemed to include the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise.

The Administrative Court analysed the underlying factual situation in order to determine whether the activity exceeded the scope of the simple storage of goods. It considered that the presence of the German enterprise in Luxembourg was not limited to the mere storage of goods or merchandise (even though the Administrative Court of Appeal ultimately came to a different result).

Even though article 2(1)2(b) of the German-Luxembourg tax treaty refers to the concept of activities, which have a preparatory or auxiliary character for the enterprise, it does, contrary to the OECD Model, not explicitly lay down a general restriction to the general definition of PE. Indeed, pursuant to the OECD Model and commentaries, preparatory or auxiliary activities, whatever their nature, do not result in a PE, even if the activities are carried on through a fixed place of business. In the *Esch* case, the Administrative Court focused on one of the exceptions provided for under the list, but did not further elaborate on the meaning of preparatory or auxiliary activities, nor on the question whether there is a general restriction to the general definition of PE.

6. The "agency PE" (paragraphs 5 and 6 (OECD) or 7 (UN) of article 5)

Luxembourg tax treaties generally follow the OECD Model. Domestic law also refers to the concept of the permanent representative, generally an agent or

---

[19] *Etudes Fiscales*, 1 November 1966, n°18/1-6, "Les chantiers de construction ou de montage considérés comme établissements stables".

[20] Decisions of the German *Reichsfinanzhof* during the Second World War (after the dissolution of the Luxembourg Council of State in the autumn of 1940) and of the German *Bundesfinanzhof* in the 1950s.

[21] Art. 2(1)2(b): "Als Betriebstätten gelten nicht: (aa) die Benutzung von Einrichtungen ausschließlich zur Lagerung, Ausstellung oder Auslieferung von dem Unternehmen gehörenden Gütern oder Waren, (bb) das Unterhalten eines Bestandes von dem Unternehmen gehörenden Gütern oder Waren ausschließlich zur Lagerung, Ausstellung oder Auslieferung, (cc) das Unterhalten eines Bestandes von dem Unternehmen gehörenden Gütern oder Waren ausschließlich zur Bearbeitung oder Verarbeitung durch ein anderes Unternehmen, (dd) das Unterhalten einer festen Geschäftseinrichtung ausschließlich zum Einkauf von Gütern oder Waren oder zur Beschaffung von Informationen für das Unternehmen, (ee) das Unterhalten einer festen Geschäftseinrichtung ausschließlich zur Werbung, zur Erteilung von Auskünften, zur wissenschaftlichen Forschung oder zur Ausübung ähnlicher Tätigkeiten, die für das Unternehmen vorbereitender Art sind oder eine Hilfstätigkeit darstellen".

employee, who makes it possible for the enterprise to exercise a commercial activity within the country and who acts in lieu of the enterprise, which he/she represents. Although there is no official guidance on this subject, it may be assumed that for domestic provisions as well as for treaty purposes, the concept of independence implies that the independent sales agent or commission agent has other customers and does not act exclusively for one enterprise. The most recent treaties specifically refer to this requirement, but in our opinion the older treaties are to be interpreted in the same manner.

If a partner in a partnership acts as representative of the partnership, he will be deemed a PE for the partnership and, thus, for the other partners. However, nothing prevents a partner from being an independent agent of the partnership of which he is a member. The two capacities in which he/she acts are then entirely separate.

There is no official guidance as to whether the agent must be a resident in the State in which he/she operates or must have a place of operation in such State[22]. Courts are likely to be influenced by the commentary to article 5 of the OECD Model and by German doctrine, which both express the view that the activity in that country (i.e. not implying a principal establishment)[23] is relevant, even though he/she does not reside therein.

The authority to conclude contracts in the name of the enterprise is generally interpreted that the agent must be entitled to represent the enterprise and act as representative of his/her client in a manner whereby the enterprise is committed. The key question is therefore not whether he/she has signatory powers, but whether he/she actually commits the enterprise by confirming a deal. This is in line with the commentary to article 5 of the OECD Model and consistent with the principle of the overriding factual analysis of the economic activities (*wirtschaftliche Betrachtungsweise),* which is applied in domestic tax law. However in practice, the authorities might have difficulties in proving that the signing of the contract by the head-office of the enterprise, is a mere rubber-stamping exercise and that the contract actually comes into existence when confirmed by the agent[24].

The existence of an actual power of attorney, which entitles the representative to enter into agreements, is not required. The factual circumstances should suffice.

7. Application of the PE definition in the case of related companies (paragraph 7 (OECD) or 8 (UN) of article 5)

In its decision of 29 April 1959[25], the Council of State analysed the question of whether an equity participation held by a Luxembourg company in a foreign subsidiary may constitute a PE under paragraph 16 of Adaptation Tax Law, in the context of a litigation regarding the application of Luxembourg municipal business tax. Even though this decision does not refer to the treaty definition of PE, it provides some guidance as to how this issue may be analysed by Luxembourg courts in a treaty context.

In the case at hand, the Luxembourg public limited company *Le Tabac du Globe* operated two factories producing cigarettes, one in Luxembourg and one in Algeria. In 1939 the Luxembourg factory was closed. The company then contributed all its Algerian assets to an Algerian company in 1947 and was subsequently converted into a pure holding company.

The tax authorities imposed municipal business tax on the income derived by *Le Tabac du Globe* from the participation held in its Algerian subsidiary. The Luxembourg company argued that it did not carry on any commercial activity in Luxembourg and should be exempt from municipal business tax. The Council of State held that the activity of a public limited company was by nature to be considered as being a commercial activity, but since 1947 the company had no more PE in the meaning of paragraph 16 of the Adaptation Tax Law in Algeria, and stated that the mere holding of the shares of the Algerian subsidiary was not constitutive of an Algerian PE of the Luxembourg company. The Council State's decision is in line with the provisions of the OECD Model and the OECD commentaries.

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

Some of the tax treaties entered into by Luxembourg comprise variations of the PE definition, which are usually taken from the UN Model.

[22] Hübschmann *op. cit*.,§13 Anm. 5b.
[23] Hübschmann *op.cit*., §13 Anm. 5c NB: Opinion based on an analysis of domestic law.
[24] Vogel *op.cit*., Hübschmann, *op. cit*., § 5, Anm. 117-118.

[25] Council of State, 29 April 1959, *Société anonyme holding Le Tabac du Globe v/ Administration des Contributions*, n°5510.

For instance, 9 tax treaties[26] (out of 51 in total) provide for the specific situation where an insurance company (reassurance companies are usually excluded) is deemed to have a PE in another State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an independent agent. According to the provisions of the Belgium - Luxembourg tax treaty, in its version dated 1970, an agent who acts on behalf of an insurance enterprise and habitually exercises an authority to conclude contracts in the name of that enterprise is deemed to be a PE of the insurance company. In some detailed comments to the Belgium-Luxembourg tax treaty prepared by the Luxembourg tax authorities (*Administration des Contributions*) and attached to the bill of law approving the tax treaty in 1971, it is stressed that such a variation of the PE definition from the OECD Model is an advantage for Luxembourg considering the large number of Belgian insurance companies operating in Luxembourg. We note that such comment is still relevant now that Luxembourg has become an attractive financial services hub, with a focus on banking, insurance and investment funds.

Another common variation of the PE definition taken from the UN Model may be found in six tax treaties[27] and relates to the furnishing of services, including consultancy services, by an enterprise of a contracting State through employees or other personnel engaged in the other contracting State (the so-called service PE). Except in the case of the Singapore-Luxembourg tax treaty dated 6 March 1993, the existence of a PE is however always subject to the condition that the activities continue, for the same project or a connected project, for a certain period of time or periods aggregating a certain period of time (from six to nine months). There is no specific guidance with respect to the factors which are relevant in order to determine if and to what extent activities are related to the same project or to a connected project.

A less common variation of the PE definition may be found in the protocol to the San Marino-Luxembourg tax treaty dated 27 March 2006 which states that the term "PE" may include a server.

Finally, neither in a domestic nor treaty context, is there specific guidance with respect to the interpretation of the concept of fixed base used in article 14 of the UN Model (and in article 14 of the OECD Model before the deletion of such article in the revised OECD Model in 2000) although all tax treaties entered into by Luxembourg (except tax treaties entered with respectively Brazil, Israel, San Marino, and Singapore) refer to such concept of fixed base (*base fixe* or *point d'attache fixe* in the tax treaty with France) when dealing with the treatment of income derived in respect of professional services or other activities of an independent character and whether it should be interpreted in the same way or differently from the concept of PE. It is however mentioned in the bill of law approving the Austria-Luxembourg tax treaty dated 18 October 1962 that a fixed base for independent personal services is what the PE represents for commercial enterprises.

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

The concept of the PE is referred to in article 156 of the Income Tax Law and defined by paragraph 16 of the Adaptation Tax Law. This definition is broader than that contained in double tax treaties and the OECD Model and *inter alia* considers as PE mere places of storage of goods, places used for the purchase of goods or any other business installations, which are used by the enterprise or its PE. The concept of PE is used outside the treaty context for the taxation of non-resident persons as well as for domestic purposes, for the computation of the municipal business tax and its allocation among the municipalities within which an enterprise has a PE.

Similarly, the concept of the permanent representative used in domestic tax law is broader than that of the treaty provision. Domestic provisions do for instance not require that such representative has power to commit the enterprise[28].

The commentary to the Income Tax Law specifically refers to the fact that the concepts of domestic law differ from those of the tax treaties There is however little doubt that the influence that German precedents have had since World War II on the manner to assess a factual situation, reflects on the manner in which the definitions of the OECD Model are interpreted in practical cases.

The Luxembourg law of 9 February 1979, as amended, on value added tax, which has

[26] Tax treaties entered into by Luxembourg and respectively Germany, Austria, Belgium, Brazil, Indonesia, Mexico, Mongolia, Uzbekistan and Singapore.
[27] Tax treaties entered into by Luxembourg and respectively China, Portugal, Romania, Thailand, Vietnam, and Singapore.

[28] In this context the former German precedents developed for §2 GewStG are relevant; see also Hübschmann, *op.cit.*, §13 Anm. 5b.

implemented the Directive 77/388/EEC, refers to the concept of the place where a supplier has established the seat of its economic activity from which a service is rendered, which may be a PE. The interpretation of that concept is in line with the guidance provided by the ECJ and requires the permanent presence of the minimum human and technical resources, which are necessary for supplying the services. The definition of the law on VAT is thus different from that used for treaty purposes and by the domestic legislation on direct taxes on income or net wealth, and is therefore less relevant for the interpretation of the treaties.

Key contacts

If you require additional information on any of the matters raised in this document, please call your usual contact at Allen & Overy Luxembourg.

Tel +352 44 44 55 1

Patrick Mischo, Partner
patrick.mischo@allenovery.com

Marie Junius, Counsel
marie.junius@allenovery.com

Allen & Overy Luxembourg

33 avenue J.F. Kennedy, L-1855 Luxembourg; PO Box 5017, L-1050 Luxembourg. Tel +352 44 44 55 1 Fax +352 44 44 55 222
www.allenovery.com