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Article 5: The meaning of “connected projects”

NOTE ON UNITED NATIONS MODEL TAX CONVENTION ARTICLE 5:
THE MEANING OF “CONNECTED PROJECTS”

Summary

This note has been prepared by Ms Claudine Devillet in consultation with certain other Committee of Experts on International Cooperation in Tax Matters (“Committee”) Members and observers. At its seventh annual session the Committee noted in its report that: “[t]he need to clarify the meaning of the word “connected” to describe projects that were sufficiently related to be added together in paragraph 12 [of the Commentary on Article 5] was also raised and it was decided to include it in the Catalogue of Issues for future discussion.¹” The Committee requested Ms Claudine Devillet to provide a paper on the meaning of “connected” in relation to Article 5.²

This paper was prepared by Ms Devillet in response to that Mandate.

¹ Report of the seventh annual session, E/2011/45 at paragraph 31.

² Ibid, at paragraph 118.

Article 5: the meaning of “the same or a connected project”

1. Article 5(3)(b) of the UN Model addresses the situation of an enterprise that performs services in a Contracting State through employees or other personnel in relation to “the same or a connected project”. There is no guidance in the Commentary on Article 5(3)(b) with respect to the meaning of the terms “the same or a connected project” and Contracting States may interpret these terms in different ways. Some rules and some examples could be included in the UN Commentary in order to clarify this issue.

The view has been expressed within the Subcommittee on Services that the term used in Article 5(3)(b) is the “furnishing” of services and that the entire note proceeds on the assumption that furnishing means performing activities in the source country. Indian tax administration has been of the view that services can be furnished without the physical presence in the source country.

Even if the Article uses the terms “furnishing of services”, the test provided for in the Article in order to create a permanent establishment is the presence in the source country of employees or other personnel the activities of which continue (for the same or a connected project) within the source country for a specified period of time. In order to clarify the meaning of the terms “for the same or a connected project”, I consider that it is therefore appropriate to refer to the performance of activities within the source country in relation to one or several projects.

This issue should be discussed by the Committee.

2. The following paragraphs 12.1 to 12.8 could be added immediately after paragraph 12 of the Commentary on Article 5(3). Basically, the rules in these paragraphs are in line with paragraphs 42.39 to 42.41 of the OECD Commentary on Article 5 which relate to the alternative provision proposed by that Commentary with respect to the taxation of services.

12.1. As Article 5(3)(b) deals with the furnishing of services by an enterprise, the issue of whether the activities are performed for “the same or a connected project” should be considered from the perspective of the enterprise that furnishes the services and not from the perspective of the customer.

12.2 An enterprise may provide services to a single customer pursuant to two different projects whilst those services may relate to a single project for the customer. In such case, one should not consider that services are performed for the same project.

Example 1 An enterprise provides services for the maintenance of several medical devices used by a customer as well as services for the training of medical staff operating different devices recently sold to that customer. Two contracts have been

types of services are performed by different employees. Those services are performed in the framework of two different projects even if, for the customer, they are part of a single project that relates to the operation of its medical equipments and is managed by a same department.

The following view has, however, been expressed within the Subcommittee:

Based on paragraph 42.40 of the OECD Commentary on Article 5, in our view, the OECD perspective-of-the-supplier interpretation is produced when interpreting the meaning of the expression "same project" and not when dealing with the meaning of "connected project" (paragraph 42.41). The following modification is therefore proposed in paragraph 12.1: "As Article 5(3)(b) deals with the furnishing of services by an enterprise, the issue of whether the activities are performed "for the same or a connected project" should be considered from the perspective of the enterprise that furnishes the services and not from the perspective of the customer."

The following view has, also, been expressed within the Subcommittee:

There is no justification to determine the issue as to whether the activities are performed "for the same or connected project", from the perspective of the enterprise that furnishes the services and not from the perspective of the customer. The language of the Article only requires that the project or the connected project for which the services are furnished should be in a Contracting State and rendering of services should meet the duration test. In my view if from the perspective of the supplier or from the perspective of the recipient, services are for the same or connected project and the duration test is met, the source country can assert creation of a PE. I, therefore, do not agree with the guidance suggested in paragraph 12.1 and the example given in paragraph 12.2.

I consider, however, that a same approach should be followed while determining whether an enterprise furnishes services for a same project or whether it furnishes services for connected projects. The commercial coherence should be considered from the perspective of the enterprise that furnishes the services and not from the perspective of the customer.

This issue should be discussed by the Committee.

12.3. Conversely, an enterprise may provide services to several related enterprises in the framework of a single project whilst these services relate to a different project for each of the customers. In such case, one should consider that the services are performed for the same project.

Example 2 An enterprise provides services for the maintenance of several similar machines used by a number of related companies. A single contract was signed by the director of the supplying enterprise, on the one hand, and by a representative of the parent company, on the other hand, and the services are performed by the same

employees. The contract provides for favorable conditions taking into consideration the large number of machines covered. Those services are performed in the framework of a single project.

12.4. The reference to “a connected project” is intended to cover cases where, even though the services are provided in the framework of separate projects, those projects are carried on by a single supplying enterprise and are commercially connected. This aggregation rule addresses in particular abusive situations under which the supplying enterprise would artificially divide its activities into separate projects in order to avoid meeting the 183-day threshold. The determination of whether projects are connected will depend on the facts and circumstances of each case. Factors that would be relevant for that purpose include:

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same Group are deemed to be carried on through a permanent establishment that the enterprise has in that State.

Example 6 Company LAMBDA, a resident of State X, obtains a contract for the maintenance of equipment situated on the industrial site of Company FIR, a resident of State Y. Those activities are supposed to be performed through several employees and to last 220 days. In such case, 180-day threshold would be met and Article 5(3)(b) would apply. However, Company LAMBDA and Company FIR agree to split the project into two separate contracts:

- a first contract concluded between FIR and LAMBDA covers the maintenance of the equipment from 1 January to 30 June (120 days each year) for an annual fee of 240.000 euros; and
- another contract between FIR and Company DELTA, a member of the same Group as LAMBDA and a resident of State X, covers the maintenance of the equipment from 1 July to 31 December (100 days each year) for an annual fee of 200.000 euros.

The 120 days of activity performed by LAMBDA through its employees and the 100

calculating the 183-day threshold provided during that day, the enterprise performs its activities through, at least, one of its employees or other personnel or – if the anti-abuse provision suggested in paragraph 5 is included in the treaty – one of the employees or other personnel of an associated enterprise present in that State. However, a day will count only as a single day regardless of how many employees or other personnel – of the enterprise itself or of associated enterprise – are present in that State and performing services during that day.

Example 8 Company LAMBDA, a resident of State X, obtains a contract for the maintenance of several equipments situated at several industrial sites of Company FIR, a resident of State Y. Those activities are supposed to be performed through several employees and to last from 15 January 2012 to 31 October 2012 (i.e. 220

12. (...) However, some countries find the “project” limitation either too easy to manipulate or too narrow in that it ~~omit~~ preclude taxation in the case of a continuous number of separate projects, each of 120 or 150 days’ duration. In order to avoid this type of manipulation and simplify the application of the permanent establishment concept to services, some countries prefer to eliminate this requirement in Article 5(3)(b) by deleting the expression: “(for the same or connected project)”

They understand that the original main purpose of including paragraph 3(b) of Article 5 was to avoid the difficulties of applying the requirements of paragraph 1 to the service activities. The “same or connected project” requirement implies limitations that undermine this objective (e.g. the commercial coherence limitation). For these reasons they consider that this view should be clearly stated in the Commentary.
