Netherlands/South Korea - The Netherlands Supreme Court Decides a Triangular Case under Article 15 of the OECD Model

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The Netherlands Supreme Court Decides a Triangular Case under Article 15 of the OECD Model

In this article, the authors discuss the Supreme Court's decision in *BNB* 2019/164, wherein it was held that the PE concept in the tax treaty between the employee's residence state and the work state is decisive under article 15(2)(c) of the OECD Model (2017) rather the treaty between the employer's residence state and the work/PE state. Nevertheless, it found that there was neither a fixed place of business PE nor a construction or project PE in the case at hand.

1. Introduction

The Supreme Court held in *BNB* 2019/164 (19 July 2019) that the permanent establishment (PE) concept in the tax treaty between the employee's residence state (the Netherlands) and the work state (South Korea) is decisive under article 15(2)(c) of the OECD Model (2017) rather than that of the treaty between the employer's residence state (Switzerland) and the work/PE state (South Korea). The Supreme Court, however, ultimately decided that there was neither a fixed place of business PE (article 5(1) of the OECD Model) nor a construction or project PE (article 5(3) of the OECD Model) under the tax treaty between the employee's residence state and the work state.

2. Case

2.1. Facts

The taxpayer in question (X) resided in the Netherlands. X was an employee of A Co.[1] A Co was established in Switzerland and performed worldwide offshore oil and gas drillings.[2] X was assigned by A Co to supervise the construction of a drill ship and related test runs. X participated in the assignment of overseeing the construction of a vessel that A Co had ordered from a Korean company (B Co)[3] from 8 March to 29 July 2010 and of conducting a sea trial of the vessel from 30 July to 20 November of that same year. X and other employees of A Co had access to certain office space of B Co in South Korea (4 rooms were made available to A Co's employees including X). X had an office at his disposal from March 2010 to December 2010. X was present in South Korea for a period or periods not exceeding in aggregate 183 days in 2010.[4]

2.2. Issue

With respect to the salaries that were attributable to the period X worked in South Korea, wage tax was withheld and accordingly paid to the South Korean tax authorities. However, X's salary that was attributable to the activities that were carried out in South Korea also formed part of his worldwide income on which he was taxed as a resident taxpayer of the Netherlands. The Netherlands tax inspector denied X's claim for relief from double taxation. According to the tax inspector, A Co did not have a PE in South Korea that bore the salary relating to the services rendered by X in that state. As a result, the three conditions of article 16(2) of the Korea-Netherlands Income Tax Treaty (1978) (the Treaty), which generally follows article 15(2) of the OECD Model, were satisfied.[5] In the tax inspector's view, the Netherlands was entitled to tax the

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1. The file of the proceedings in NL: HR, 19 July 2019, *BNB* 2019/164, contained a response from the Korean National Tax Service to questions posed by the Netherlands tax inspector that implied that the taxpayer was "an employee of the U.S. branch of [A Co], a Swiss company". *See* the decision in NL: CA, 5 Dec. 2017, Case No. 16/01250, legal consideration 2.4, Case Law IBFD and NL: Advisory Opinion of Attorney-General Niessen, 26 Mar. 2019, accompanying *BNB* 2019/164, para. 2. Although the Court of Appeal mentioned the element of the taxpayer working for the US branch of the Swiss head office, no further consideration was given thereto. In the Netherlands, the District Court and the Court of Appeal establish the facts. The Supreme Court is compelled by statute to base its reasoning on the facts as established by the lower courts. The Supreme Court may reverse the lower court's decision on questions of law or on the basis that the requirements of due process were not followed.
2. In fact, it was a Swiss group of companies that was active in offshore drilling for the purpose of oil and gas exploration.
3. B Co was unrelated to A Co.
4. According to art. 16(2)(a) of the *Convention between the Kingdom of the Netherlands and the Republic of Korea for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (25 Oct. 1978) (as amended through 1998), Treaties IBFD (the Treaty), the 183 days have to be calculated by taking into account the fiscal year, which equals the calendar year. According to the *OECD Model Tax Convention on Income and on Capital: Commentary on Article 15* para. 4.1 (21 Nov. 2017), Models IBFD, the fiscal year of the work state, i.e. South Korea, is decisive in this respect. As of the 1992 amendments to the text of *OECD Model Tax Convention on Income and on Capital* art. 15(2)(a) (21 Nov. 2017), Models IBFD, the 183-day period was calculated over "any 12-month period commencing or ending in the fiscal year concerned". The rationale behind this change was avoiding schemes that would allow a person to be employed in a state for as many as 365 days without being liable to pay tax in that state by dividing the period of employment between fiscal periods; compare para. 4 *OECD Model: Commentary on Article 15* (2017).
5. Compare para. 4 *OECD Model: Commentary on Article 15* (2017), confirming that the three conditions of art. 15(2) have to be satisfied cumulatively to give the employee's residence state the authority to tax the salary relating to the employee's activities carried out in the work state.

entire salary without being compelled to relieve double taxation. X disagreed with the tax inspector's approach. X was of the opinion that article 16(2)(c) of the Treaty was not satisfied because (i) his employer (A Co) maintained a PE in Korea and (ii) X's salary that was attributable to his activities carried out in South Korea was borne by that PE. According to X, the taxation right on this part of his salary was assigned to South Korea. Accordingly, X should have been entitled to relief from double taxation via the exemption method (article 23(2)of the Treaty), which is comparable to article 23A of the OECD Model). In dispute, therefore, was whether the Netherlands tax inspector rightfully denied relief from double taxation.

2.3. The Netherlands Supreme Court decision

Confirming the decision of the Arnhem-Leeuwarden Court of Appeal, the Supreme Court held that A Co did not have a PE in South Korea.[6] The supervisory activities of X did not constitute a PE maintained by A Co pursuant to article 5(1) of the Treaty (comparable to article 5(1) of the OECD Model, i.e. a fixed place of business PE). The supervisory activities relating to the construction of a drill ship are far away from the profit-generating drilling activities.[7] This made it difficult to allocate any profit to the supervisory activities performed in South Korea.[8] In fact, A Co did not allocate any profits to the activities performed in South Korea.[9]

Moreover, X's activities did not form an essential or significant part of the activities of A Co as a whole.[10] The activities were regarded as activities of a preparatory or auxiliary nature in accordance with article 5(3)(e) of the Treaty, which corresponds to article 5(4)(e) of the OECD Model.[11]

The shipyard was not regarded as a construction or project PE in the sense of article 5(2)(h) of the Treaty because the ship was not built by A Co, who was acting as the principal, but by B Co. Article 5(2)(h) provides the following: "The term 'permanent establishment' shall include especially … h) a building site or construction, installation or assembly project or activities of providing personal services such as supervisory, technical or any other professional services in connection therewith, where such site, project or activity exists for more than six months". Consequently, A Co did not have a PE in South Korea in respect of which X's salary was borne. The taxation right, therefore, on X's entire salary was assigned to the Netherlands. The tax inspector had rightly held that X's salary was not exempt from tax in the Netherlands.

3. Comment on the Case

3.1. General

This case of the Netherlands Supreme Court is interesting because it involved a triangular case[12] with respect to a provision based on article 15 of the OECD Model, i.e. article 16 of the Treaty. The employee was a resident of the Netherlands. According to the facts, he was an employee of A Co (a Swiss resident company) and the question was raised whether he worked for a PE maintained by his Swiss employer. Before examining whether a PE existed, it needs to be established which tax treaty was the relevant one in determining the existence thereof. In this respect, there are two possible views.

3.2. Object and purpose versus grammatical interpretation

The Netherlands Supreme Court relied on the object and purpose of article 16(2)(c) of the Treaty (comparable to article 15(2)(c) of the OECD Model) in deciding that the question of whether there is a PE should be determined under that Treaty. The object and purpose of article 16(2)(c) of the Treaty implies that the taxation right on the salary attributable to the services rendered in the work state (South Korea) must be assigned to that state. This is based on the circumstance that the employee's remuneration lowers the PE's tax base in the work state.[13] Giving the work state the authority to tax the employee's salary can be regarded as compensation for allowing for a decrease in the PE's tax base.

It is questionable whether or not this view may be reconciled with the strict wording of the Treaty.[14] Article 16(2)(c) of the Treaty establishes a connection with article 7,

6. The English language is the only authentic language of the Treaty and the Dutch version is only a translation. Therefore, only the English language version is relevant. Nevertheless, the Netherlands Supreme Court, in its decision, only referred to this unauthentic Dutch language version; *see also* R.X. Resch, *The Interpretation of Plurilingual Tax Treaties*, dissertation, p. 123 et seq. (Leiden University 2018). A similar approach was followed in NL: HR, 18 Jan. 2019, No. 17/04584, 22 ITLR, p. 121 et seq. (2019) (with annotation by F. Pötgens; *see*, in particular, p. 127 of this annotation) and NL: HR, 18 Jan. 2019, No. 17/04584, *BNB* 2020/8, Case Law IBFD regarding the interpretation of the most-favoured nation (MFN) clause included in the dividend provision of the *Convention between the Republic of South Africa and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital* art. 10(10) (10 Oct. 2005) (as amended through 2008), Treaties & Models IBFD.
7. Legal consideration of the *Hoge Raad* in *BNB* 2019/164, No. 2.4 in connection with legal consideration No. 4.8 of the decision of the Arnhem-Leeuwarden Court of Appeal.
8. Legal consideration No. 4.8 of the decision of the Arnhem-Leeuwarden Court of Appeal. Compare also para. 58 *OECD Model: Commentary on Article 5(4)* (2017).
9. Legal consideration No. 4.8 of the decision of the Arnhem-Leeuwarden Court of Appeal.
10. Legal consideration of the *Hoge Raad* in *BNB* 2019/164, No. 2.4 in connection with legal consideration Nos. 4.7 and 4.8 of the decision of the Arnhem-Leeuwarden Court of Appeal. The Court of Appeal referred, in this respect, to paras. 58 and 59 *OECD Model: Commentary on Article 5* (2017).
11. Art. 5(3)(e) Treaty provides the following: "The term 'permanent establishment' shall not be deemed to include: [...] e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise".
12. *See*, for triangular cases under tax treaties, K. van Raad & S. Chen, *Triangular Cases – Global Tax Treaties Commentaries* sec. 4, Global Topics IBFD (last updated 1 Dec. 2017) and E. Fett, *Triangular Cases: The Application of Bilateral Income Tax Treaties in Multilateral Situations* (IBFD 2014). Compare also P. Pistone, *Article 15: Income from employment – Global Tax Treaty Commentaries* sec. 3.2.1.1.4., Global Topics IBFD (last updated 1 Jan. 2019).
13. Compare para. 6.2 *OECD Model: Commentary on Article 15* (2017). Compare also Pistone, *supra* n. 12.
14. Compare F. Pötgens, *Income from International Private Employment* p. 775 (IBFD 2007) and S. van Weeghel, annotation to *BNB* 2019/164, point 4.

which deals with the allocation of profits and expenses to a PE (compare also article 7(3) of the Treaty, which is based upon the pre-2010 version of article 7 of the OECD Model). Article 7(1) of the Treaty refers to the profits of an "enterprise of one of the States", which is defined as "an enterprise carried on by a *resident*[15] of one of the States" (article 3(1)(f) of the Treaty, which follows article 3(1)(d) of the OECD Model). The PE definition of article 5(1), as such,[16] would not exclude the possibility that it could be maintained by a resident of a third state.[17] The relationship between (i) article 5 and article 7 and (ii) between article 7 and article 16(2)(c), would then entail that the PE should be maintained by a resident of, in this instance, the employee's resident state, i.e. the Netherlands. This would also mean that article 16(2)(c) cannot be satisfied because, in this instance, the employer resided in a third state. Consequently, the taxation right on the employee's salary relating to the services rendered in South Korea would be assigned to the employee's resident state (in *BNB* 2019/164, the Netherlands).

Nevertheless, article 16(2)(c) of the Treaty points to article 5 to define the expression "permanent establishment" in article 16(2)(c) of the Treaty. The fact that a PE exists for the sake of applying the Treaty may not be decisive for article 16(2)(c) of the Treaty.[18] The Supreme Court in *BNB* 2019/164 was of the view that the existence of a PE should be based on the tax treaty between the employee's resident state and his work state/the PE state, i.e. the Treaty. The Supreme Court, however, did not elaborate explicitly on its motivation in this respect. If there is a PE in the work state pursuant to the Treaty and the salary is borne by that PE, the object and purpose of article 16(2)(c) of that treaty would entail that the taxation right on the salary would be attributed to the work state/PE state.

The Supreme Court's approach, however, is in accordance with its decision in BNB 2002/125 (12 October 2001), concerning the application of article 15(2)(c) of the OECD Model to a fiscally transparent partnership (two partners residing in the Netherlands) maintaining a PE in the United Kingdom and the United States. The employee resided in the Netherlands and worked on behalf of the PEs in the United Kingdom and the United States. The Supreme Court in BNB 2002/125 presupposed that the general partnership (the employer) maintained the respective PEs. Strictly speaking (*see also* the second paragraph of this section), article 16(2)(c) of the Treaty and article 15(2)(c) of the former Netherlands-United Kingdom Income Tax Treaty (1980)[19] (both styled after article 15 of the OECD Model) require, for their non-fulfilment, that the PEs be maintained by an employer that is a resident of the employee's state of residence (in *BNB* 2002/125, the Netherlands).[20] Of course, the fiscally transparent partnership was not a resident of the Netherlands for purposes of article 4 of the respective tax treaties. The Supreme Court, in BNB 2002/125, placed strong emphasis on the object and purpose of article 15(2)(c) of the OECD Model. Therefore, it could be argued that the result reached in BNB 2002/125 is in line with the object and purpose of article 15(2)(c) of the OECD Model. The employee's salary was borne by the PEs in the United States and the United Kingdom where that salary lowered the tax base of these PEs in the respective states.[21] A grammatical interpretation of article 15(2)(c), however, could lead to the conclusion that the partners maintained the PE, while the general partnership was the employer. Although the salary lowers the PE's taxable base, the taxation right with respect to the salary is not allocated to the work state, which would not be in conformity with the object and purpose of article 15(2)(c) of the OECD Model.

3.3. Resolution of the Danish Ministry of Taxation

Initially, the Danish Ministry of Taxation, in its resolution of 8 June 1998,[22] was of the opinion – taking the starting point that all relevant tax treaties were styled after the OECD Model – that the tax treaty between the employer's residence state (State E) and the work state/PE state (Denmark in the case of the Danish resolution) is also decisive in defining "permanent establishment" in respect of the tax treaty between the employee's residence state (State R) and the work state (Denmark). Hence, if a PE is present according to the State E-Denmark tax treaty,

15. Authors' emphasis.
16. Art. 5(1) Treaty states the following: "For purposes of this Convention, the term 'permanent establishment' means a fixed place of business in which the business of the enterprise is wholly or partly carried on".
17. Compare van Weeghel, *supra* n. 14, at point 4.
18. This view was endorsed by the Belgian tax authorities in their Circular of 25 May 2005, No. AFZ 2005/0652 (AFZ 08/2005), point 4.3.1. This Circular was amended by the Circular of 11 Oct. 2005, No. AFZ/2005-0652 (AFZ 8/2005). *See also* Pötgens, *supra* n. 14, at p. 775. Compare the ruling of the Canada Revenue Agency, 20 July 2015, No. 2012-045767117, available at https://members.videotax.com/technical-interpretations/2012-045767117-treaty-triangulation-article-15 (accessed 3 Mar. 2020) for a similar view (*see also* Van Weeghel, *supra* n. 14, at point 4).
19. *Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains* (7 Nov. 1980) (as amended through 1989), Treaties & Models IBFD.
20. In order for art. 15(2)(c) *OECD Model* (2017) not to be fulfilled, it is required that the employer have a PE in the work state that bears the remuneration. Therefore, this provision establishes a connection with art. 7, which deals with the allocation of profits and expenses to a PE (compare also art. 7(3) of the pre-2010 version of the *OECD Model*). The connection with art. 7 could lead to the conclusion that the employer should be taxable in the work state. Art. 7(1) refers to the profits of an "enterprise of a Contracting State", which is defined as "an enterprise carried on by a *resident* of a Contracting State" (art. 3(1)(d) *OECD Model* (2017); emphasis added). From that perspective, a general partnership is not a resident (it is tax transparent and therefore not liable to tax in the Netherlands) and such a partnership could not maintain a PE. As a result, the taxation right would be assigned to the employee's residence state. Furthermore, it could be relevant in this respect (i) whether the general partnership carries on the enterprise but for the account of the partners or (ii) whether the partners carry on the enterprise. This is determined by domestic law and not by the tax treaty. *See also* Pötgens, *supra* n. 14, at p. 771.
21. Another example of a case where the Supreme Court relied on the object and purpose of a provision based on art. 15(2)(c) *OECD Model* (2017) is NL: *Hoge Raad* (HR), 23 Nov. 2007, No. 42 743, *BNB* 2008/29. *See*, for a discussion of this case, F.P.G. Pötgens, *The Netherlands Supreme Court and Remuneration Borne By a Permanent Establishment – Third Time Lucky!*, 48 Eur. Taxn. 12, p. 654 et seq. (2008), Journal Articles & Papers IBFD.
22. Discussed by P.S. Andersen, *Taxation of Employment Income under Tax Treaties in Triangular Cases*, 39 Eur. Taxn. 8, pp. 269 and 270 (1998), Journal Articles & Papers IBFD.

there is also a PE in the sense of article 15(2)(c) of the State R-Denmark tax treaty.[23] In other words, the PE definition in the State E-Denmark tax treaty affects the State R-Denmark tax treaty and influences whether the requirement of article 15(2)(c) of the State R-Denmark tax treaty has been met.[24]

The Ministry's interpretation may be appropriate when article 15(2)(c) is examined in isolation. Furthermore, it could be argued that the object and purpose of article 15(2)(c) of the State R-Denmark tax treaty, i.e. the salary costs lower the tax base in Denmark, which entitles this state to tax the employee's salary, means that Denmark should have the right to tax the employee's salary.[25] From that angle, it would be irrelevant whether a PE exists under the State R-Denmark Tax Treaty or the State E-Denmark Tax Treaty. What is important is that Denmark has to allow for a decrease in its tax base.[26] It is questionable, however, whether this interpretation is in accordance with the context and wording of a treaty similar to the OECD Model because the term "PE" is already defined in article 5(1), which contains this statement: "For the purpose of *this Convention*, the term permanent establishment means…". This provision establishes that the PE definition to be used for the purposes of the State R-Denmark Tax Treaty is that of that treaty (*see also* section 3.4.).[27] It could be argued, however, that similar wording is included in the State E-Denmark Tax Treaty.[28]

3.4. Danish High Court

The Danish High Court rejected the Danish Ministry of Taxation's approach; instead, it followed the view of the Netherlands Supreme Court in *BNB* 2019/164.[29] This means that the PE concept is determined pursuant to the tax treaties between the employee's residence states (Australia, Belgium, Croatia, India, Morocco, Spain and the United States) and the work state (Denmark).[30] Consequently, the PE concept of the tax treaty between the work state (Denmark) and the employer's residence state (Switzerland) is not decisive. The Court relied on the wording of article 5(1) of the tax treaties between the employee's residence states and Denmark (work state); *see also* section 3.3. The Court found additional support for this argumentation in the Commentary on the OECD Model.[31] Finally, the Court held that its interpretation and explanation was in line with the coherence and structure of the OECD Model and the use of the term PE in the tax treaties between the work state and the employee's residence states.[32]

3.5. Remaining PE issues

3.5.1. In general

After having concluded that the PE had to be determined based on the Treaty, the question that had to be answered was whether a PE was in fact present. The establishment of the facts by the Court of Appeal is not entirely clear in this respect. In its legal consideration No. 4.8, the Court of Appeal, for instance, stated that the conditions under which the employer/A Co was entitled to use B Co's office space in South Korea were unknown.

3.5.2. Fixed place of business PE (article 5(1) of the tax treaty at issue)

The Supreme Court derived from the legal considerations of the Court of Appeal that A Co did not maintain a fixed place of business PE within the meaning of article 5(1) of the Treaty. The Supreme Court based this decision mainly on the circumstances that were established by the Court of Appeal, i.e. (i) A Co did not have any turnover in South Korea[33] (and no profits were attributed to the activities

23. The view of the Danish Ministry of Taxation is supported by L. de Broe, *Article 15 – Income from Employment*, in *Klaus Vogel on Double Taxation Conventions* p. 1199, mn. 302 (E. Reimer & A. Rust eds., 4th ed., Wolters Kluwer 2015).
24. Compare also Pötgens, *supra* n. 14, at p. 776.
25. Id.
26. Id. Compare also De Broe, *supra* n. 23, at p. 1199, mn. 302.
27. Pötgens, *supra* n. 14, at p. 776; Andersen, *supra* n. 22, at pp. 269 and 270; the Belgian tax authorities in their Circular of 25 May 2005, No. AFZ 2005/0652 (AFZ 08/2005) point 4.3.1.; and B. Peeters, *Article 15 of the OECD Model Convention on "Income from Employment" and its Undefined Terms*, 44 Eur. Taxn. 2, p. 82 (2004), Journal Articles & Papers IBFD.
28. Pötgens, *supra* n. 14, at p. 776. In addition, De Broe, *supra* n. 23, at p. 1199, mn. 302, has pointed out that it is difficult to see how the tax treaty between the work state (in the example Denmark) and the employee's residence state (in the example State R) is relevant in determining whether a third state employer (in the example residing in State E) has a PE in the work state (in Denmark), as it follows from art. 1 of the tax treaty between the Work State (Denmark) and the employee's residence state (State R) that a third state resident (residing in State E) is not protected by the first treaty.
29. DK: High Court of Eastern Denmark (*Østre Landsret*), 2 May 2006, No. B 2581/05, *Poseidon Personnel Services S.A. v. the Ministry of Taxation*, Case Law IBFD, discussed by B. Møll Pedersen, *Triangular Cases: Art. 15 of the OECD Model, Income from Employment and the Definitions of Terms*, 47 Eur. Taxn. 2, pp. 90-92 (2007), Journal Articles & Papers IBFD. Compare also Fett, *supra* n. 12, at para. 12.2.2.3, footnote 1314 and De Broe, *supra* n. 23, at p. 1199, mn. 302.
30. The Danish Ministry of Taxation decided not to appeal the decision of the High Court to the Danish Supreme Court; *see also* Møll Pedersen, *supra* n. 29, at p. 92.
31. Para. 18 *OECD Model: Commentary on the Introduction* (2017) states that "[i]n Chapter II some terms used in more than one Article of the Convention are defined". *See also* Møll Pedersen, *supra* n. 29, at p. 91.
32. Compare Møll Pedersen, *supra* n. 29, at pp. 91 and 92.
33. The relevance of having turnover in South Korea in determining whether a PE exists in that state is questionable. What matters is that the activities of the enterprise be carried on wholly or partly via a PE located in South Korea. This may also be the case without having any turnover in South Korea. If the place of business is put at the enterprise's disposal with a certain permanency and its business is carried on through this fixed place of business, there is a PE in the sense of art. 5(1) Treaty unless one of the exceptions of art. 5(3) applies (for example, activities of a preparatory or auxiliary character). Compare also Van Weeghel, *supra* n. 14, at point 10. The attribution of profits is based on art. 7(2) Treaty (compare para. 14 *OECD Model: Commentary on Article 7* (pre-2010) and the separate enterprise principle included therein). Art. 7(2) *OECD Model* (post-2010) contains the Authorised OECD Approach. A taxpayer, however, can opt, under a tax treaty such as the Treaty, for either the pre-2010 version or the post-2010 version of the *OECD Model: Commentary on Article 7*; compare the resolution of the Netherlands State Secretary for Finance of 15 Jan. 2011, No. IFZ2010/457M, *BNB* 2011/91 and G.T.W. Janssen, *Cursus Belastingrecht (Internationaal Belastingrecht)* para. 3.4.2.A.a5 (K. van Raad & F.P.G. Pötgens eds., Wolters Kluwer online) (last updated Apr. 2019). In NL: HR, 3 June 2016, No. 14/05100, *BNB* 2016/171, Case Law IBFD, the *OECD Model: Commentary on Article 7* (1963) was applied to the *Convention between the Government of the Kingdom of the Netherlands and the Government of the State of Spain for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* art. 7 (16 June 1971), Treaties & Models

performed in South Korea), (ii) the supervisory activities performed by X were far away from the profit-generating drilling activities of A Co;[34] and (iii) X's activities did not form an essential or significant part of the activities of A Co as a whole.

Although the Supreme Court did not mention explicitly whether the activities were of a preparatory or auxiliary nature, the Supreme Court seemed to follow the decision of the Court of Appeal in this respect.[35] This decision further held that the supervisory activities were activities of a preparatory or auxiliary nature in accordance with article 5(3)(e) of the Treaty, which corresponds to article 5(4)(e) of the OECD Model. The Court of Appeal held – referring to the Commentary on the OECD Model – that the supervisory activities performed by X did not constitute an essential and significant part of A Co's business, i.e. drilling activities. As a result, according to the Court of Appeal, there was no fixed place of business PE (article 5(1) of the Treaty). In this respect, article 5(3) of that Treaty and article 5(4) of the OECD Model constituted an exception to article 5(1) of the Treaty in question and article 5(1) of the OECD Model.[36] The Court of Appeal based its view, remarkably, on certain extracts from the Draft Commentary on Article 5 of the OECD Model (2017).[37] It is striking that the Court of Appeal referred to the 2017 version of the Commentary even though the Treaty was based on the Draft OECD Model (1963);[38] the Commentary on Article 5 of the Draft OECD Model (1963) did not contain the extracts and paragraphs to which the Court of Appeal referred.[39]

According to the Commentary on Article 5 of the OECD Model, the decisive criterion for determining whether an activity has a preparatory or auxiliary character is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole.[40] In addition, according to the Commentary on the OECD Model, there are auxiliary or preparatory activities if a place of business – although it may well contribute to the productivity of the enterprise – performs services that are so remote from the actual realization of profits that it is difficult to allocate any profit to the fixed place of business in question.[41] These extracts seem to resonate in the decision of the Supreme Court.[42]

It could be argued that the Supreme Court could have reached the same result with a different motivation. It seems that A Co had a place of business at its disposal, i.e. the office space to which B Co offered access to A Co's employees.[43] In addition, this office space was at A Co's disposal.[44] However, one could argue that the period of approximately 9 months during which A Co had the disposal of the office space had an insufficient degree of permanency to it to conclude that there was a fixed place of business PE.[45] The Supreme Court did not opt for this line of argumentation but instead followed the approach of the Court of Appeal, including the finding that the activities were of a preparatory or auxiliary nature.

3.5.3. Construction or project PE (article 5(2)(h) of the Treaty)

The Supreme Court followed the Court of Appeal's finding that, in *BNB* 2019/164, a construction or project PE (article 5(2)(h) of the Treaty and article 5(3) of the OECD Model) was absent.[46] The question of whether a construction or project PE was available was answered without testing the requirements of a fixed place of business PE (article 5(1) of

IBFD, which was modelled after the *OECD Model* (1963). *BNB* 2016/171 involved an internal royalty payment between the head office (the Netherlands) and the PE (located in Spain) of which no account was taken in determining the profits that had to be attributed to the PE.

34. This seems, however, to neglect, to a certain extent, the fact that the construction of a drilling vessel and also the supervision thereof is an important element of A Co's drilling business.
35. Compare R.A. Bosman, *Annotation*, NLFiscaal 2019/1748.
36. This seems to be supported by para. 58 *OECD Model: Commentary on Article 5* (2017), which states the following: "This paragraph lists a number of business activities which are treated *as exceptions to the general definition laid down in paragraph 1* and which, when carried on through a fixed place of business are not sufficient for these places to constitute permanent establishments" (emphasis added). However, the wording of art. 5(4) *OECD Model* (2017) could give rise to the conclusion that the exception of that provision also applies to the construction or project PE of art. 5(3) *OECD Model* ("Notwithstanding the preceding provisions of this Article…") The same applies to art. 5(3) in relation to art. 5(2)(h) Treaty. Compare also Janssen, *supra* n. 33, at para. 3.2.4.C.d and Bosman, *supra* n. 35. B.J. Arnold, *Article 5: Permanent Establishment – Global Tax Treaties Commentaries* sec. 4.1.1.1., Global Topics IBFD (last updated 1 Oct. 2018). Sec. 4.1.1.1. seems to derive from the wording of art. 5(4) *OECD Model* (2017) to the effect that the exception for preparatory or auxiliary activities is restricted to art. 5(1).
37. Paras. 58 and 59 *OECD Model: Commentary on Article 5* (2017).
38. *OECD Draft Tax Convention on Income and on Capital* (30 July 1963), Treaties & Models IBFD.
39. *See also* van Weeghel, *supra* n. 14, at point 15 and Bosman, *supra* n. 35.
40. Para. 59 *OECD Model: Commentary on Article 5* (2017). *See further* A.A. Skaar, *Permanent Establishment* p. 196 et seq., Series on International Taxation, No. 13 (Kluwer Law International 1991).
41. Para. 58 *OECD Model: Commentary on Article 5* (2017).
42. In the same sense, *see* Bosman, *supra* n. 35.
43. Para. 10 *OECD Model: Commentary on Article 5* (2017).
44. Id., at para. 11.
45. In the same sense, *see* Bosman, *supra* n. 35 and Van Weeghel, *supra* n. 14, at point 11. Compare also paras. 6 and 28 *OECD Model: Commentary on Article 5* (2017). Para. 28 *OECD Model: Commentary on Article 5* (2017) stated that practice shows that there were many cases where a PE has been considered to exist where the place of business was maintained for a period longer than 6 months. According to the Netherlands Supreme Court, this 6-month period is only a rule of thumb and, in this context, each case has to be judged on its own merits. *See* NL: HR, 15 Jan. 2016, No. 14/03647, *BNB* 2016/114, as discussed by F.P.G. Pötgens, *Independent Professional Diver Residing in the Netherlands Did Not Have a Fixed Base in India: Decision of the Netherlands Supreme Court of 15 January 2016*, BNB 2016/114, 56 Eur. Taxn. 10 (2016), Journal Articles & Papers IBFD. E. Reimer, *Article 5 – Permanent Establishment*, in *Klaus Vogel on Double Taxation Conventions* p. 346, mn. 72 (E. Reimer & A. Rust eds., 4th ed., Wolters Kluwer 2015) argued, in contrast, that this 6-month period is regarded by states as a landmark and that they attach great relevance to this period. In addition to the time spent on performing the activities, it may also be relevant, according to the *Hoge Raad* in *BNB* 2016/114, whether the activities are only once off or are of a recurrent nature; compare para. 29 *OECD Model: Commentary on Article 5* (2017). If the activities are of a recurrent character, there may also be a PE, if they, for instance, do not exceed a period of 6 months. Paras. 29 and 30 of art. 5 *OECD Model* (2017) seem to underline the approach of the Netherlands Supreme Court in *BNB* 2016/114; *see also* R.A. Bosman, A.J.A. Stevens & C.W.M.M. Verkoijen, *V + L = PE? In hoeverre kan een schip een vaste inrichting vormen?*, MBB 4, p. 187 (2019) and Arnold, *supra* n. 36, at sec. 2.1.4.
46. *See*, for a discussion of art. 5(3) *OECD Model* (2017), G. Seitz, *The Construction Clause in Article 5(3) of the OECD Model*, 67 Bull. Intl. Taxn. 9 (2013), Journal Articles & Papers IBFD.

the Treaty and article 5(1) of the OECD Model). This was not altered by the circumstance that the construction or project PE was included in the examples in article 5(2) of the Treaty.[47] The Supreme Court had previously decided that the provision regarding construction or project PEs is to be regarded as a deeming provision.[48] This means that, according to the Supreme Court, a building site or construction or installation project always constitutes a PE if the requirements mentioned in the appropriate provision (article 5(2)(h) of the Treaty or article 5(3) of the OECD Model) are satisfied despite the fact that the general criteria of article 5(1) of the tax treaty at issue (or article 5(1) of the OECD Model) are not met.[49]

Furthermore, the Supreme Court seemed to adopt (again) the approach of the Court of Appeal in this respect. The Court of Appeal held that A Co did not maintain a PE in South Korea because A Co was only the principal whereas B Co built the ship in South Korea. According to the Court of Appeal, the mere supervision of the construction of the ship was thus insufficient to find that a PE existed on behalf of A Co. Apparently, the Court of Appeal, with this decision, presupposed that supervisory activities can only result in a construction or project PE if they concern supervisory or construction activities that are performed by the same enterprise, in this case A Co. Because the construction was done by B Co, supervision by A Co (or its employees) cannot lead to a PE within the meaning of article 5(2)(h) of the tax treaty in question.[50] The authors assume that the Supreme Court adopted the reasoning of the Court of Appeal, which would entail that the services rendered by X (the employee in question) by their very nature would not fall under the scope of article 5(2)(h) of the relevant treaty. Therefore, the reason for the non-applicability of this provision was seemingly not the fact that the duration of the activities did not extend beyond the threshold of 6 months that was provided for in article 5(2)(h).[51] Based on the facts, the supervisory activities of X only lasted for approximately 3 months. As a result, the question was left unanswered in *BNB* 2019/164 – at least to the extent that the required threshold of 6 months was exceeded – in terms of whether the construction of a ship by the enterprise itself (in this case A Co) would fall under a provision based on article 5(3) of the OECD Model and the extent to which supervisory activities would then be included therein.[52]

The Supreme Court and the Court of Appeal seemed to presuppose that the exception in article 5(3) of the Treaty (article 5(4) of the OECD Model), i.e. for preparatory and auxiliary activities, only applied to the fixed place of business PE (article 5(1) of the tax treaty in question and article 5(1) of the OECD Model) rather than to the construction or project PE. This can, at least, be derived from the circumstance that, after having concluded that the exception for auxiliary or preparatory activities applied to the fixed place of business PE, the Court of Appeal and the Supreme Court still examined whether a construction or project PE may be present in the case at issue. *See*, for further remarks on the interrelationship between article 5(2)(h) of the Treaty (article 5(3) of the OECD Model) and article 5(3) of the Treaty (article 5(4) of the OECD Model), section 2.5.2.

4. Conclusion

The Supreme Court rendered an interesting decision in *BNB* 2019/164 on a triangular case under article 15(2)(c) of the OECD Model (2017) (article 16(2)(c) of the Treaty). The Court held that, regarding whether the employer maintained a PE in the work state (South Korea), the tax treaty between the employee's residence state (the Netherlands) and the work state is decisive. In addition, the Supreme Court touched upon some principal PE issues.

47. In general, these examples have to satisfy the criteria included in art. 5(1) *OECD Model* (2017); compare para. 45 *OECD Model: Commentary* (2017) and NL: HR, 26 Jan. 2000, No. 33 434, *BNB* 2000/159 regarding the place of management example of art. 5(2)(a) *OECD Model* (2015). *See also*, Arnold, *supra* n. 36, at sec. 2.2.1.1.2 and Reimer, *supra* n. 45, at p. 361, mn. 157.
48. NL: HR, 9 Dec. 1998, No. 32 709, *BNB* 1999/267 regarding the former *Convention between the Federal Republic of Germany and the Kingdom of the Netherlands for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital and Various Other Taxes, and for the Regulation of Other Questions Relating to Taxation* [unofficial translation] (16 June 1959), Treaties & Models IBFD, wherein a construction PE was included in the examples of a PE (art. 2(a)(gg) of that treaty).
49. It is questionable whether this reading can be based upon the *OECD Model: Commentary on Article 5* (2017) (in particular, para. 49) and on the history of this provision (para. 8 *OECD Model: Commentary on Article 5* (1963)). The threshold of 12 months is a condition that applies in addition to art. 5(1) *OECD Model* (2017) and is intended to further explain the required duration. *See also* Janssen, *supra* n. 34, at para. 3.2.4.C.c. Compare further Skaar, *supra* n. 40, at pp. 343 and 344, and Arnold, *supra* n. 36, at sec. 2.3.1.
50. In the same sense, *see* Bosman, *supra* n. 35.
51. *See* Bosman, *supra* n. 35. It was not entirely clear whether the 6-month threshold of art. 5(2)(h) was exceeded; compare Van Weeghel, *supra* n. 14, at point 12.
52. Compare para. 50 *OECD Model: Commentary on Article 5* (2017) stating that the onsite planning and supervision of the erection of a building are covered by art. 5(3) *OECD Model* (2017). *See*, for the relationship between supervisory activities and art. 5(3) Seitz, *supra* n. 46, at para. 4.4; Skaar, *supra* n. 40, at p. 405 et seq.; Arnold, *supra* n. 36, at sec. 2.3.2.; J. Sasseville & A.A. Skaar, *General Report*, in *Is there a permanent establishment?* sec. 3.2. (IFA Cahier vol. 94A, IBFD 2009), Books IBFD and Reimer, *supra* n. 45, at p. 368, mn. 203.