3 DEFINITION OF 'PERMANENT ESTABLISHMENT'

3.1 Definition of Permanent Establishment According to Domestic Law: General Definition

As discussed above, the concept of a 'permanent establishment'[20] plays an important role in Dutch corporate income tax, Dutch personal income tax, Dutch wage **26**

20. In Dutch legal language the term 'permanent establishment' is translated as '*vaste inrichting*'.

tax, and in Value Added Tax. In this chapter we will focus on Dutch corporate income tax only and will not take a closer look at the concept of a permanent establishment in the other parts of domestic law. It should, however, be kept in mind that the scope of the definition is not substantially different in other areas of Dutch domestic law. The differences originate from the different nature and objectives of the various laws.

27 There is no definition of the term 'permanent establishment' in the Dutch corporate income tax act.[21] The term should therefore be defined on the basis of the case law of the Dutch courts. This case law shows that the definition of the term 'permanent establishment' in the OECD MC plays a guiding role for the interpretation of the term. In many cases the Dutch Supreme Court specifically refers to the Commentary to Article 5 of the OECD MC. Still, it is not clear to what extent both definitions are completely similar. More specifically, there is discussion in Dutch literature about the role of the exceptions for preparatory or auxiliary activities and the character of the building sites PE for the purposes of Dutch corporate income tax.

28 Contrary to the Dutch corporate income tax act, there is a definition of the term 'permanent establishment' in the Dutch Unilateral Decree for the Avoidance of Double Taxation.[22] It is defined as '*permanent place of business through which the business of an enterprise is wholly or partly carried on, including the seat of management of the enterprise, agricultural land, and projects that take more than twelve months to be constructed*'.[23] This definition is not exactly the same as the definition that is used in the OECD MC and the corresponding Commentary. It is, however, clarified in the parliamentary history of this provision that the definition of the OECD serves as a guideline for the interpretation of the concept in the Unilateral decree.[24]

29 In addition to the above, the term 'permanent establishment' can be found in the numerous DTCs that have been concluded by the Netherlands. Except for some older treaties, the definition in those DTCs is – roughly – the same as the definition that is used in the OECD MC. This can be concluded from the definition of a

21. Despite of the lack of a general definition, certain assets and activities (e.g., real estate situated in the Netherlands or activities that are performed in the capacity as a member of the board or directors of a company that is a resident of the Netherlands) of a non-resident taxpayer are deemed to be part of a Dutch enterprise and are considered to be a PE accordingly. Compare the Dutch corporate income tax act 1969, art. 17(a).
22. See the Unilateral Decree for the Avoidance of Double Taxation 2001, Art. 2(1).
23. This is an unofficial translation of the following definition in the Dutch language: *Een duurzame inrichting van een onderneming met behulp waarvan de werkzaamheden van die onderneming geheel of gedeeltelijk worden uitgeoefend, daaronder begrepen:*
a. de zetel van de leiding van de onderneming;
b. landbouwgronden; en
c. werken waarvan de uitvoering langer dan twaalf maanden duurt.
24. Explanatory Note to the Unilateral Decree for the Avoidance of Double Taxation 2001, Stb. 2000, 642, 31- 32, V-N 2001/5.5.

permanent establishment in the Dutch Standard Treaty.[25] It is also the official objective of the Dutch government to incorporate the definition of the OECD in the DTCs.[26] There are two notable exceptions to this general starting point. The first one is the definition in the treaties with some developing countries, since those countries often want a lower threshold to 'trigger' taxation for building sites, construction, and installation projects.[27] The second exception is the extension of the concept of a permanent establishment for offshore activities on the territory of the state. As a result, a permanent establishment is deemed to exist when such activities are carried on for more than thirty days on the continental shore.[28]

As the Dutch Supreme Court does not seem to use a different interpretation of the concept of 'permanent establishment' in the DTCs as compared to the interpretation for domestic law purposes, we will not separately deal with both interpretations. In the next paragraph we will take a closer look at the interpretation of the term 'permanent establishment' by the Dutch Supreme Court and the various lower courts. **30**

Characteristics (Article 5, paragraph 1 OECD MC) – A definition of the 'general permanent establishment' can be found in Article 5, paragraph 1 of the OECD MC. It is defined as 'a fixed place of business through which the business of an enterprise is wholly or partly carried on'. From the definition in the OECD MC the following characteristics of a 'general permanent establishment' can be distinguished: **31**

- the existence of a place of business;
- the place of business must be a fixed place (i.e., geographic stability);
- the place of business must have a certain degree of permanency (i.e., time requirement);
- the business must be carried on through this fixed place of business.

There is no specific case law in the Netherlands about the interpretation of a *place of business.* From the case law that is described below, it can, however, be concluded that a wide range of places may qualify as such. **32**

The Dutch Supreme Court gave guidance on the requirement of *geographic stability* in a case about a circus tent.[29] It can be concluded from this case that the place of business does not have to be fixed to the ground. Movable places of business may also constitute a fixed place within this context. Dutch case law shows that **33**

25. The Dutch Standard Treaty (*Nederlands standaardverdrag; NSV*) is the Dutch starting point for its treaty negotiations.
26. Memorandum of Dutch Tax Treaty Policy of 1998 (*Notitie 'Uitgangspunten van het beleid op het terrein van het internationaal fiscaal (verdragen)recht'*), as published in V-N 1998/22.3.
27. See n. 25 above.
28. See n. 25 above. An example can be found in Art. 27 of the DTC between the Netherlands and the United States.
29. Hoge Raad, 13 Oct. 1954, nr. 11 908 (BNB 1954/336).

even a yacht may therefore be qualified as a permanent establishment when the other requirements are met.[30] Such places of business should move within a certain territory of one jurisdiction.

34 Case law of the Dutch Supreme Court shows that the place of business must be of a permanent nature. The most famous Dutch example of this *time requirement* is the case about two salesmen of artificial eyes.[31] One of them rented different hotel rooms in the Netherlands to perform the business. The Dutch Supreme Court decided that the permanency test was not met in this case. One specific location should be at the disposal of the enterprise during a certain period of time. Different locations should not be added for these purposes. The minimum time requirement for the permanency test is not crystal clear. A period of a 'few' months (BNB 1992/51[32]) or six months (BNB 1975/66[33]) was not sufficient, whereas a period of 9.5 months (BNB 1976/121[34]) and 1.5 years (BNB 1956/123[35]) was.

35 In the interpretation of the Dutch Supreme Court, the requirement that the business must be carried on through this fixed place of business means that the fixed place of business must be 'at the disposal' of the enterprise.[36] This means that the enterprise either i) legally owns the place, ii) rents the place, or iii) de facto has the possibility to use it at its own discretion. In addition to this, it is required that the place of business is suitable for the exercise of the specific business.[37]

36 One interesting variation upon the theme is the Sonia case.[38] In this case, the taxpayer had a few places of business at its disposal, but none of these qualified as a permanent establishment as such. The Dutch Supreme Court decided that those different places of business should be taken together, which means that the combination of different factors may still constitute a permanent establishment. Please note that this case was decided for the purposes of the 1965 Unilateral decree for the avoidance of double taxation, which was different than the current Unilateral decree, not being based on the definition in the OECD MC.

37 *Examples (Article 5, paragraph 2 OECD MC)* – The various examples that are mentioned in Article 5, paragraph 2 OECD MC can also be found in most DTCs and are explicitly mentioned in the definition in the Dutch Standard Treaty. There is no specific case law about the meaning of the concepts 'branch'[39]

30. Compare Lower Court of Arnhem, MK, 31 May 2007, nr. AWB 06/3086 (V-N 2007/51.12).
31. Hoge Raad, 15 Jun. 1955, nr. 12 369 (BNB 1955/277).
32. Hof 's-Gravenhage, 10 Sep. 1990, nr. 4287/87-M-1 (BNB 1992/51).
33. Hoge Raad, 22 Jan. 1975, nr. 17 537 (BNB 1975/66).
34. Hoge Raad, 24 Mar. 1976, nr. 17 812 (BNB 1976/121).
35. Hoge Raad, 7 Mar. 1956, nr. 12 661 (BNB 1956/123).
36. An example can be found in Hoge Raad, 13 Mar. 1957, nr. 13 096 (BNB 1957/144).
37. Hoge Raad, 15 Jun. 1955, nr. 12 369 (BNB 1955/277).
38. Hoge Raad, 3 Apr. 1974, nr. 17 259 (BNB 1974/172).
39. In Dutch legal language the term 'branch' is translated as '*filiaal*'.

(sub b.), 'office'[40] (sub c.), 'factory'[41] (sub d.), 'workshop'[42] (sub e.) and 'a mine, an oil or gas well, a quarry or any other place of extraction of natural resources'[43] (sub f.).

The example of 'a place of management'[44] (sub a.) has been the subject of several cases in Dutch case law. This specific example shows that the interpretation of the concept of a permanent establishment in Dutch corporate income tax and Dutch DTCs is not completely the same as the interpretation of the concept in the Dutch Unilateral Decree for the Avoidance of Double Taxation. In the latter context, a place of management should be regarded as a permanent establishment by definition, while in the first context it should be seen as a mere example of the general permanent establishment. This means that for the purposes of Dutch corporate income tax and the Dutch DTCs, the requirements of a general permanent establishment should be met anyway in case of a place of management PE.[45] **38**

Exclusions (Article 5, paragraph 4 OECD MC) – The exclusions enumerated in Article 5, paragraph 4 OECD MC (i.e., preparatory or auxiliary activities) are also incorporated in the Dutch Standard Treaty and can, as such, be found in the Dutch DTCs. It is somewhat unclear to what extent these are part of the definition of a permanent establishment in Dutch domestic law. From case law of the Dutch Supreme Court, it can be concluded that the exclusions are in any case of importance for the purposes of a DTC.[46] The exclusions are not explicitly mentioned in the Dutch Unilateral Decree for the Avoidance of Double Taxation. **39**

3.2 National Double Tax Treaties

As discussed above in § 3.1, the definition of permanent establishment can also be found in the numerous DTCs concluded by the Netherlands. These definitions generally follow the definition used in the OECD MTC. The wording of Article 5 (permanent establishment) of the Dutch Standard Treaty, which counts as a starting point for Dutch treaty negotiations, and Article 5 of the OECD MC is practically identical. Also, according to the official Dutch tax treaty policy, it is **40**

40. In Dutch legal language the term 'office' is translated as '*kantoor*'.
41. In Dutch legal language the term 'factory' is translated as '*fabriek*'.
42. In Dutch legal language the term 'workshop' is translated as '*werkplaats*'.
43. In Dutch legal language the terms 'a mine, an oil or gas well, a quarry or any other place of extraction of natural resources' are translated as '*een mijn, een olie- of gasbron, een steengroeve of een andere plaats waar natuurlijke rijkdommen worden gewonnen*'.
44. In Dutch legal language the term 'a place of management' is translated as '*een plaats waar leiding wordt gegeven*'.
45. Compare Hoge Raad, 17 Dec. 1975, nr. 17 776 (BNB 1976/33) and 26 Jan. 2000, nr. 33 434 (BNB 2000/159).
46. Hoge Raad, 26 Jan. 2000, nr. 33 434 (BNB 2000/159).

one of the objectives to use the OECD MC definition as a starting point. There are just a few exceptions. With regard to building sites permanent establishments (Article 5(3) OECD MC), the policy states that the Netherlands in principle also uses a twelve-month minimum period. However, an exception may be made in situations of treaty negotiations with developing countries, in which it could be preferable to accept a shorter term. Therefore, deviating periods can be found in several bilateral Dutch tax treaties (see also § 3.1 above). Furthermore, the Dutch tax treaty policy contains an exception to the OECD MC definition with regard to offshore activities. Based on this, the Netherlands habitually includes a specific and separate provision in bilateral treaties with coastal states, extending the definition of permanent establishment with offshore activities on the continental shore when carried on for more than thirty days.

41 In addition to the exceptions mentioned above, which are based on the Dutch tax treaty policy, certain specific bilateral DTCs may deviate from the OECD MC due to the tax treaty policy of the other contracting state involved. An example can be found in Article 5(3)(b) of the tax treaty between the Netherlands and Portugal, in which, on the initiative of Portugal, the definition of a permanent establishment is extended (under conditions and with specific exceptions) with the furnishing of services.[47]

3.3 Special Cases

42 **Agents PE.** There is some amount of case law in the Netherlands about the agents PE. An agents PE is deemed to exist in the Netherlands when a person acts on behalf of the non-resident taxpayer (principal) and has the authority to conclude contracts on behalf of the enterprise of that taxpayer. This authority should be exercised on a habitual basis. In line with Article 5, paragraph 6 of the OECD MC, there is no agency PE when the agent is independent from the principal and is acting in the ordinary course of his/her business.[48]

43 As a result, the following criteria are relevant for the distinction between a dependent and an independent agent:

- authority to conclude contracts on behalf of the enterprise;
- habitual exercise of this authority;
- dependency;
- ordinary course of business.

47. The inclusion of a similar provision could be preferred by some other countries in the future, with reference to the amendments in the 2008 OECD Commentary to Art. 5 with regard to the optional services PE.
48. There is a specific definition in Art. 2 of the Unilateral decree for the avoidance of double taxation 2001.

The first criterion is the authority to conclude contracts on behalf of the enterprise. Such an authority must be general, meaning that it is a comprehensive authority.[49] It does not, however, necessarily have to be a formal power of attorney. Case law shows that the Dutch courts take a substance over form approach.[50] Accordingly, the mere factual behaviour of the representative is decisive rather than the legal form of the authority. In addition, the authority does not need to be general in the sense that it concerns the complete range of activities of the enterprise. It is sufficient when there is a formal or factual, but comprehensive, authority for certain activities during a certain period of time.[51] **44**

The second criterion is the habitual exercise of the authority to conclude contracts on behalf of the enterprise. There is not a lot of specific case law in this respect. It seems that the nature of the contracts and the business of the enterprise play an important role for these purposes. **45**

The third criterion is the dependency between the principal and the representative.[52] This dependency can be both legal and economic in nature. The representative is legally dependent on the principal when he/she is bound by detailed instructions and subject to supervision. Economic dependency depends on the entrepreneurial risk that is borne by the representative. For this matter, the Dutch Supreme Court regards the number of principals of the representative as a very relevant criterion.[53] **46**

When the representative is both legally and economically independent from the principal, there can be no agents PE, unless the representative does not act in the ordinary course of his/her own business. In Dutch case law, there is one specific example to illustrate this.[54] **47**

In relation to this final criterion, it is noteworthy that there is one case from which it can be derived that a person can be both an independent and a dependent agent in relation to the same principal.[55] In this case the Dutch Supreme Court clarified that a representative can act in the ordinary course of his/her own business in relation to the principal for certain activities, while the representative is dependent on the same principal for other activities. In the first case the principal does not have an agency PE, while there is such a PE in the second case. **48**

49. Hoge Raad, 17 May 1961, nr. 14 448 (BNB 1961/196).
50. Lower Court of Amsterdam, 20 Jun. 1978, nr. 1106/761 (BNB 1979/190) and Hoge Raad, 28 Mar. 2001, nr. 33 490 (BNB 2001/239). The conclusion of the Advocate General in the latter case is interesting in this respect.
51. Hoge Raad, 21 Apr. 1971, nr. 16 528 (BNB 1971/110) and Lower Court of Amsterdam, 20 Jun. 1978, nr. 1106/761 (BNB 1979/190) and Hoge Raad, 23 Jan. 1974, nr. 17 237 (BNB 1986/100).
52. Hoge Raad, 15 Jun. 1988, nr. 24 881 (BNB 1988/258).
53. Hoge Raad, 28 Jun. 1995, nr. 29 435 (BNB 1996/108).
54. Hoge Raad, 13 Jan. 1971, nr. 16 445 (BNB 1971/43).
55. Hoge Raad, 15 Jun. 1988, nr. 24 881 (BNB 1988/258).

49 **Affiliated companies as PEs.** Article 5, paragraph 7 of the OECD MC deals with the interrelationship of affiliated companies. It is established that the fact that a company controls or is controlled by a company that is a resident of the other state does not of itself lead to the conclusion that either company constitutes a permanent establishment of the other company. This does not even change when either company carries on business in the other state. Accordingly, the independence of the different legal entities is the starting point of the analysis. In theory, however, it would be possible that this independence is disregarded. Such situations are described in the OECD Commentary on Article 5.

50 Although a comparable provision can be found in Article 5, paragraph 7 of the Dutch Standard Treaty, there is – to our knowledge – no Dutch case law about a situation in which the independence is disregarded and an affiliated company is considered to be a permanent establishment.

51 **Building Sites PE.** In accordance with the OECD MC, the Dutch Standard Treaty has a specific provision for building sites, construction, and installation projects.[56] In the various Dutch tax treaties, a whole range of different periods can be found to set the minimum requirement. Minimum periods of 3 months, 6 months, 183 days, 9 months, 12 months, and 18 months are applicable in different DTCs.

52 The Dutch Supreme Court clarified that *for the purposes of a DTC* a building sites PE is a fictitious PE.[57] This interpretation is in accordance with the Commentary and it means that building sites, construction, and installation projects qualify as a PE when the minimum period in the DTC is met. In that case, it is irrelevant if the 'general' criteria of Article 5, paragraph 1 of the OECD MC are met.[58] It is not clear if the same line of reasoning is applicable to *Dutch corporate income tax*. There is no explicit reference to a building sites PE and there is no case law in this respect. Van Raad takes the view that there will only be a permanent establishment when the 'general' criteria are met.[59] This means that the site or project must qualify as a fixed place of business, etc.

53 There are no general rules in the Netherlands about the situation where the same taxpayer maintains two or more building sites, construction or installation projects in the same country, either consecutively or simultaneously. It is therefore not exactly clear under what circumstances such projects should be added for the purposes of the time threshold. The only indication in this respect can be found in the DTCs between the Netherlands and Belgium. In paragraph 6 of the Protocol

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56. In Dutch legal language the terms 'building sites, construction and installation projects' are translated as '*bouwwerk, constructie- en montagewerkzaamheden*'. A building site PE is normally referred to a '*uitvoering van werken*'.
57. Hoge Raad, 9 Dec. 1998, nr. 32 709 (BNB 1999/267). More precisely, this decision regarded a DTC based on the 1963 OECD MC.
58. The same is true for the definition in the Unilateral Decree for the Avoidance of Double Taxation.
59. Van Raad, annotation to Hoge Raad, 9 Dec. 1998, nr. 32 709, published in BNB 1999/267.

to this treaty, specific rules can be found for such activities at different places and at different points in time.

Other. In the Netherlands, there is no case law or other source of interpretation about a services PE or a server PE. The Netherlands did not make a reservation on the interpretation of the concepts in the Commentary. It would, therefore, be reasonable to assume that the scope of the Dutch concepts resemble the definitions of the OECD. **54**

3.4 Discrepancies between Local Law and Tax Treaties

As stated above (see § 2.1 and § 3.1), the corporate income tax act does not contain a definition of a permanent establishment. The only explicit definition of permanent establishment in a Dutch national context can be found in the 2001 Unilateral decree for double taxation. This definition is not exactly the same as the OECD MC definition; for instance, the exclusions of Article 5(4) OECD MC are not included in the Unilateral decree. However, the OECD MC definition does serve as a guideline for the interpretation of the notion of permanent establishment in the Unilateral decree, based upon its parliamentary history. **55**

Furthermore, it has been discussed that the definition of permanent establishment has been primarily developed in case law (ruled for the purpose of interpretation of either the Unilateral decree, or the domestic provisions, or the specific tax treaties). In case law, the Dutch tax courts have frequently referred to the OECD MC and Commentary as guidance for the interpretation of the definition of permanent establishment. It is currently not completely clear to what extent both definitions are in fact completely similar. However, the Dutch Supreme Court does not seem to use a different interpretation of the concept of permanent establishment in DTC situations as compared to domestic situations. **56**

3.5 Practical Approach

Based upon the Dutch ruling practice, it is possible to obtain certainty in advance with regard to the question of whether or not a non-resident corporation has a permanent establishment in the Netherlands through an advanced tax ruling (ATR). It is also possible to request an advanced agreement for certainty on the question of whether a Dutch resident corporation has a permanent establishment abroad, from a Dutch point of view. The Dutch ruling practice is discussed above in § 2.4. **57**