INTERNATIONAL:

Agents as Permanent Establishments under the OECD Model Tax Convention

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I. INTRODUCTION

The parts of the definition of permanent establishment dealing with the question whether an agent constitutes a permanent establishment of his principal are contained in Paragraphs 5 and 6 of Article 5 (hereinafter "Paragraph 5" and "Paragraph 6", respectively) of the 1992 OECD Model Tax Convention (hereinafter "the Model"). See below.

Paragraphs 1 to 4 of Article 5 provide that a permanent establishment exists where the foreign enterprise has a physical presence, such as an office or building site, in the other state. The agency provisions in Paragraphs 5 and 6 therefore only have effect if there is no physical presence

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1992 OECD Model: Article 5(5) and (6)

5. Notwithstanding the provisions of Paragraphs 1 and 2, where a person – other than an agent of an independent status to whom Paragraph 6 applies – is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in Paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that Paragraph.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

5. Nonobstant les dispositions des Paragraphes 1 et 2, lorsqu'une personne – autre qu'un agent jouissant d'un statut indépendant auquel s'applique le Paragraphe 6 – agit pour le compte d'une entreprise et dispose dans un Etat contractant de pouvoirs qu'elle y exerce habituellement lui permettant de conclure des contrats au nom de l'entreprise, cette entreprise est considérée comme ayent un établissement stable dans cet Etat pour toutes les activités que cette personne exerce pour l'entreprise, à moins que les activités de cette personne ne soient limitées à celles qui sont mentionnées au Paragraphe 4 et qui, si elles étaient exercées par l'intermédiaire d'une installation fixe d'affaires, ne permettraient pas de considérer cette installation comme un établissement stable selon les dispositions de ce Paragraphe.

6. Une entreprise n'est pas considérée comme ayant un établissement stable dans un Etat contractant du seul fait qu'elle y exerce son activité par l'entremise d'un courtier, d'un commissionnaire général ou de tout autre agent jouissant d'un statut indépendant, à condition que ces personnes agissent dans le cadre ordinaire de leur activité.

in the sense of the earlier paragraphs.[1] If there is a physical presence, but the activities are limited to those listed in Paragraph 4 of Article 5, for example a purchasing office, there is no permanent establishment. In such cases the existence of an employee with authority to conclude contracts relating to the excluded category of business is also ignored.[2] Where there is an agent,[3] the issue which the Model addresses is essentially whether the presence of the agent in the other state creates a permanent establishment of the foreign enterprise, or whether, assuming that the agent has a place of business in that state, which is not always the case, it is merely the place of business of the agent, which does not constitute a permanent establishment of the foreign enterprise.[4] While the agency provisions were introduced to deal with trading methods and expressions existing in the 1920s, which are not now common, they still have considerable importance today, particularly in the financial services field.

Both civil law lawyers and common law lawyers are likely to be confused by Paragraphs 5 and 6, although for different reasons: common lawyers may be puzzled about the significance of the agent "contracting in the name of the principal," and civil lawyers may wonder why it is necessary in Paragraph 6 to refer to brokers and commission agents since they do not contract in the name of the principal, are therefore not within Paragraph 5, and so do not need to be excluded from it. The issue which we shall address in this article is the interpretation of Paragraphs 5 and 6 from the point of view of both common and civil law, and in particular the difficult question of how the two paragraphs fit together, to which there is no wholly satisfactory answer. It may be helpful to the reader to state in advance the conclusions we hope to substantiate in this article, so that the relevance of what follows will be easier to understand. These conclusions are as follows:

1. the reference in Paragraph 5 to a person having an authority to conclude contracts in the name of an enterprise means that the agent has authority to con-

1. Unless there is such a physical presence unconnected with the agent's activities.

2. This is stated in Paragraph 5 itself, and see Article 5 of the Commentary to the Model (hereinafter "Commentary") Paragraph 28.

3. This expression is not used by the writers in this article in any technical sense and has the broad non-legal sense of *intermédiaire*, so that we shall not change the terminology if the context refers to a person who does not make binding contracts. Similar terminology is used in the title of the Hague Convention on the Law Applicable to Agency of 14 March 1978 which in French is *Convention sur la loi applicable aux contrats d'intermédiaires et à la représentation*, and see the reports by Michael Pelichet and I.G.F. Karsten in Vol. IV, *Acts and Documents of the Thirteenth Session* (1976), Hague Conference on Private International Law, Contracts of Intermediaries (1979), at 10, 11 and 405 for a discussion of the reason for adopting such expression. In Switzerland, for example, agent has a specific meaning in contract law (Article 418a of the Code of Obligations) and writers on tax usually use the term "*représentant/Vertreter*" (representative).

4. A similar approach is taken to determine whether the enterprise has sufficient presence to be sued in the other country, and this may have been the source of the OECD provisions. In English law the test used for the purpose of determining whether there is jurisdiction is the same as that used by the Model, namely whether the agent makes binding contracts on behalf of the principal. (See the proposition cited with approval by the Court of Appeal in *Adams v. Cape Industries* (1990) Ch 433, 527E: "A feature of these cases [where the foreign enterprise did not have any business premises in England] has been that the foreign company had a resident English agent who had authority to contract on behalf of and thereby to bind the principal.") If the agent does make binding contracts the second question is whether the agent is carrying on the foreign enterprise's business, or his own business. The Court of Appeal in the *Adams* case listed a number of relevant factors, including the economic relations between them and the degree of control which the principal has over the agent, all of which look to circumstances which are similar to those mentioned in Paragraph 6 of the Model. In the United States, see Brilmayer and Paisley, "Personal Jurisdiction and Substantive Legal Relations: Corporations, Conspiracies, and Agency", *California Law Review* 1986, Vol. 74, at 1.

clude contracts binding on his principal. Assuming that Paragraph 5 originated in French, the English is a literal translation of a civil law term of art that should have been translated differently;

2. Paragraph 6 operates as an exception to Paragraph 5, and excludes from the definition of permanent establishment independent agents where the principal is bound by contracts made by his agent, so long as the agent is acting in the ordinary course of his business;
3. it is only under the common law, and in the English language, that the reference to broker and general commission agent may be necessary for clarification with respect to those agents as they do bind their principal under common law. The French version's reference to *courtier* and *commissionnaire* [5] (the translation of broker and commission agent) is not a reference to the same kind of agent as broker and commission agent. These references originated from UK tax law and were originally in English;
4. cases where the principal is not bound by the agent's contracts, which arise with *courtiers* and *commissionnaires* under civil law, therefore fall outside both paragraphs and do not in any circumstances create a permanent establishment, whether or not the agents are acting in the ordinary course of their business; and
5. in civil law countries, Paragraph 5 concerns direct representation,[6] but Paragraph 6 does not concern indirect representation which, as mentioned under 4 above, falls outside both paragraphs. Paragraph 6 concerns independent agents while Paragraph 5 does not concern only dependent agents.[7] Accordingly, Paragraphs 5 and 6 do not represent a dichotomy between either dependent and independent agents,[8] or between direct and indirect representation.

It will be seen from the first three conclusions above that the critical factor for determining whether there is a permanent establishment is whether contracts made by an agent bind the principal. On this matter there is a fundamental difference between civil and common law in the legal result arising out of the same factual situation.[9] The difference is essentially that when an agent makes a contract in his own name, but on behalf of an undisclosed principal, as a general rule under common law, the principal is bound by the contract, whereas under civil law, again as a general rule, only the agent, and not the principal, is bound by such a contract. Two stockbrokers, for example, who make a contract on behalf of unnamed clients under civil law bind only each other, while under common law they bind their principals.[10] In short, civil law has an institution known as indirect representation, which is described in more detail below, under which a contract made by an agent in his own name, but for the account of a principal, does not bind the principal, so that the legal relations created are those between the third party and the agent, and, separately, those between the agent and the principal. Common law has no such institution, and indeed has developed the opposite rule, that a contract made by an agent for an undisclosed principal is enforceable by the third party against either the agent or the principal. As the question whether the *agent* is personally bound to the third party, either solely or jointly with the principal, is not relevant to the issue under discussion, we shall concentrate only on the question of whether the *principal* is bound by the agent's contract.

Although these differences between the two legal systems are fairly clear, the law of agency is so fundamental that at an international meeting a delegate does not think of explaining his own system to another delegate familiar with a different system of law, who may fail to understand that the difference exists. It seems that throughout the history of model conventions containing these provisions, starting, as we shall see, with the Fiscal Committee of the League of Nations in 1927, this fundamental difference has never been articulated, and these provisions have been incorporated in models without the differences in the underlying law being explained or noted. The problem is compounded because the references in Paragraph 6 to brokers and commission agents in common law have a meaning different from *commissionnaires* and *courtiers* in civil law. The consequence is that the present model, and particularly the Commentary, is not wholly satisfactory from the point of view of either legal system. We shall therefore start by assuming that the reader is unfamiliar with either legal system, and set out the principal differences between them that are relevant in considering this topic. Next we shall consider Paragraph 5 in the light of that discussion. Following that, we look at the historical development of Paragraph 6, which we believe is relevant to its interpretation. In Paragraph 6 we shall explain the difference in meaning of broker and commission agent in common law and civil law. Lastly, we shall endeavour to resolve these differences in Section VI.

II. THE LIABILITY OF PRINCIPALS UNDER CIVIL AND COMMON LAW OF AGENCY

A. *Civil law*

Civil law distinguishes between direct and indirect representation. In the former, the agent contracts *in the name of* the principal and binds the principal (but not the agent) to the third party.[11] In the latter, the agent acts in his own name and binds the agent (but not the principal) to the third party, so that the third party cannot enforce the con-

5. See Section II.A. and V.A.3.a. for the meaning of these expressions.
6. See Section II.A. for the meaning of direct and indirect representation.
7. Independent agents who bind their principals are within Paragraph 5 but are taken out by Paragraph 6 unless they are acting outside the ordinary course of their business. See the reference to "so-called dependent agents" (in the English, but not the French) in Article 5 Commentary Paragraph 32.
8. Although the 1963 OECD Commentary headings are "Dependent Agents and Employees", and "Independent Agents", Paragraph 19 of that Commentary shows that this is an over-simplification.
9. For an outline of the differences, see the Pelichet and Karsten reports (see *supra* note 3), and Bowstead on Agency (hereinafter "Bowstead"), 15th ed., (London: Sweet & Maxwell, 1985), at 13 in relation to indirect representation.
10. In civil law a stockbroker would be a *commissionnaire*, see in Japan Supreme Court judgment of 30 May 1957, *Minshu* Vol. 11, 854. For common law, see Bowstead (*supra* note 9), at 330-1. As we explain more fully, this difference should not affect the taxation of a dealer in securities carrying out transactions through a stockbroker in another state because in civil law the foreign principal is not within Paragraph 5, and in common law he is within Paragraph 5 but his agent is excluded from constituting a permanent establishment by Paragraph 6.
11. Article 1388 Italian, Article 1984 Belgian, Article 99 Japanese, Article 1984 French Commercial Codes, Article 164(1) German Civil Code (BGB), Article 32 Swiss Code of Obligations and Article 60(1) Book 3 Netherlands New Civil Code.

tract against the principal.[12] An example of a direct representative is the commercial agent,[13] who normally contracts in the name of the principal, and the usual example given of an indirect representative is that of the commission agent (*commissionnaire*),[14] who normally contracts in his own name.[15] This feature will be of importance in this article as *commissionnaire* is used in the French version of Paragraph 6. Although the French Civil Code[16] allows the existence of a *commissionnaire* acting in the name of, and therefore binding, the principal, a court decision of 1954[17] held that as a general rule a *commissionnaire* acts only in his own name: there are exceptions, such as the transport *commissionnaire*.[18]

There are exceptions in most civil law countries to the rule that the principal must be named in order to be bound: in Switzerland, the principal is bound by the agent's contract made in the agent's name if the agent, in fact, had power to bind the principal which power he did not use because he contracted in his own name, and the third party knew that the agent had that power.[19] In Germany, an undisclosed principal can be bound if the transaction is in cash and there is no credit risk, so it is immaterial to the third party who the other party is. In Belgium, a *commissionnaire* may contract in his own name for the account of a person to be named, and, having subsequently named the principal, only the principal is thereafter bound by the contract.[20] In Japan and Italy, an agent conducting commercial acts in the former,[21] and an *institore* (managing agent) in the latter,[22] contract in their own name but nevertheless bind the principal. The reason for this rule is that it would hamper commercial transactions if the agent had to disclose the principal in each transaction. Alternatively, the third party can require the agent to perform the contract, as is the case with an undisclosed principal in common law. In the Netherlands, contracting in the name of the principal is not understood in a formal way; what is decisive is whether, having regard to the facts and circumstances, the third party contracted with the agent or the principal.[23] In other words, it is possible for the agent to bind the principal even if the agent contracts in his own name if the third party must have known that he was contracting on behalf of the principal. In the civil law state of Louisiana, the courts have apparently adopted common law because an undisclosed principal of a *commissionnaire* is bound by his contracts.[24] The new Quebec Civil Code adopts the common law rule about undisclosed principals and does not contain any references to a *commissionnaire*.[25] In most civil law countries a person known by the third party to be an employee acting within the normal scope of his activities always binds his principal even though he does not disclose the identity of the principal.[26]

There are many other distinctions or questions in the categorization of a transaction between different civil law countries. For example, there is a question whether the *commissionnaire* must have a profession as such, or can enter into an isolated transaction as a *commissionnaire*; and there are questions of what type of transaction can be entered into by each type of agent. This article will not

12. Under Article 1119C of the French Civil Code a contract made in a person's name binds only that person. In common law terminology, the doctrine of undisclosed principal does not apply in civil law. In some systems, for example under Article 1166 of the French Civil Code, under Article 175 of the Italian Civil Code, and under Article 392(2) of the German Commercial Code, the principal may have a right against the third party, not as a result of any direct contract, but on behalf of the *commissionnaire*, on the basis that it does not matter to the third party who enforces the contract against him; but the converse does not apply and the third party does not have a right to sue the principal. The Belgian Supreme Court has not adopted this action, *Répertoire Pratique du Droit Belge*, 1969, Paragraph 271.

13. *Agent commercial* (France), see Commercial Code, Decree No. 58-1345 of 23 December 1958 and Law No. 91-593 of 25 June 1991; *agente* (Italy) see Article 1742 of the Civil Code who may be given power to conclude contracts, and Article 1752 of the Civil Code; *Handelsvertreter* (Germany), *représentant de commerce autonome* or *handelsagent* (Belgium), *handelsagent* (Netherlands), *représentant* (Switzerland), *dairisho* (Japan). See also the EC Council Directive of 18 December 1986 (86/653/EEC) on the coordination of the laws of the Member States relating to self-employed commercial agents which defines them as "a self-employed intermediary who has continuing authority to negotiate the sale or the purchase of goods on behalf of another person, hereinafter called 'the principal,' or to negotiate and conclude such transactions on behalf of and in the name of the principal." The exclusively civil law definition in the draft directive set out *infra* in note 62 caused problems in England.

14. *Commissionnaire* (Article 94 of the French Commercial Code, Articles 425 to 439 of the Swiss Code of Obligations, and Article 12 of Title VII of the Belgian Commercial Code), *commissionario* (Article 1731 of the Italian Civil Code, and Switzerland, see above), *Kommissionär* (Articles 383 to 406 of the German Commercial Code (HGB), and Switzerland, see above), *commissionair* (see above Belgium and formerly Articles 76 to 85a of the Netherlands Commercial Code (*Wetboek van Koophandel*) but no longer included in the new civil code from 1 January 1992 on simplification grounds since the issues are taken care of by the provisions dealing with authorization; this change is controversial and may be altered), *toiya* (Japan). Hereinafter we shall use the French term *commissionnaire* to indicate this type of agent. The Karsten report (see *supra* note 3) in Paragraph 24 also gives a forwarding agent (*expéditeur*) as an example of an indirect representative.

15. He would no longer be a *commissionnaire* if he acted in the name of the principal, see e.g. Article 1731 Italian Civil Code. In Germany, although he remains a *Kommissionär*, when acting in the name of his principal, the rules for commercial agents apply: Article 406(1) HGB, Küstner/v. Manteuffel, 2nd ed. 1992, annotation 82. Under Article 94(2) of the French Commercial Code a *commissionnaire* disclosing the identity of his client would become a *mandataire* (direct representative) (Com. 24 July 1852 d.P. 52.1.255).

16. See Article 94 of the Commercial Code and Title XIII of Book III of the Civil Code. Article 1736 of the former Quebec Civil Code was the same but the new code does not include any reference to *commissionnaire* as it adopts the common law doctrine of the undisclosed principal.

17. Cour de Cassation Commerciale de Novembre 1954, *Recueil Gazette du Palais* 55.15. Notwithstanding the decision, the Commercial Code is the dominant source of law in France.

18. Article 101 Commercial Code.

19. Article 32(2) Code of Obligations, see Oser/Schönenberger, *Kommentar zum Obligationenrecht*, Article 32, at 225.

20. *Répertoire Pratique du Droit Belge*; 1969, Paragraph 247. On the other hand, if the *commissionnaire* contracts in his own name the principal is not liable even if the third party knows the identity of the principal, or that this is disclosed after the contract, or even that the *commissionnaire* states that he is acting for the account of the principal, see Paragraph 7. In Italy, under Article 1705 Civil Code where the agent contracts in his own name the principal is not liable even if the third party knows his identity.

21. Article 504 Japanese Commercial Code. This type of agent is different from the commercial agent (*dairisho*) mentioned *supra* in note 13.

22. Article 2208 Italian Civil Code.

23. HR 3 December 1971 NJ 1972, 117 and HR 11 March 11 1977, NJ 1977, 521, referred to in A.R. Bloembergen, *Vertegenwoordiging* (Alphen aan den Rijn: Samsom H.D. Tjeenk Willink, 1988), at 14 and 37.

24. *Sentell v. Richardson* 211 La. 283 (1947) and 7 La.L.Rev. 409.

25. See *Report on the Contract of Mandate* (1971), at 4 and 8, Code Article 36 and the explanatory note which states: "the purpose of this provision, which is new law, is to give the undisclosed mandator a recourse against third persons.... This theory of the undisclosed principal is admitted in the Common Law."

26. In Japan, this would be an example of an agent conducting commercial acts within Article 504 of the Commercial Code because an employee is ordinarily authorized to act on behalf of his employer in conducting business for the employer. In Italy, see Article 2210 of the Civil Code; in practice this extends to anyone in charge of an office (*Corte di Cassazione*, 20 September 1979, No. 4832).

explore these distinctions between civil law countries as they are not material to the argument since what matters is the general classification of agency into direct and indirect representation that is accepted in all civil law countries represented. The significant point in civil law for this article is that a type of agency contract (indirect representation) exists under which the principal is not bound to the third party.

B. *Common law*

As has already been mentioned, the common law proceeds on the opposite basis, namely that there is only one contract, made between the principal (acting through the agent, rather than personally, but this makes no difference) and the third party. No distinctions are made in common law between direct or indirect representation; in civil law terminology, all common law agency contracts have the same effect as direct representation. Nor is there any distinction between dependent or independent agents,[27] or even between different types of agent. Under common law, virtually all contracts made by an agent bind the principal, even if the principal's existence is not disclosed. Such an undisclosed principal is bound by a contract made on his behalf by his agent within the agent's actual authority.[28] Evidence is admissible to show who is the principal. Under English law, the third party must decide whether to take action against the agent or the principal, but in the United States if the third party obtains judgment against the agent without knowledge of the principal the third party can subsequently take action against the principal.[29] An exception applies where the terms of the contract specifically exclude the liability of the undisclosed principal, and also in common law countries other than the United States[30] where the terms of the contract are inconsistent with the existence of the principal, such as the agent describing himself as the owner of a ship in the contract.[31]

During the 19th, and well into the 20th, century[32] at the time when the Fiscal Committee of the League of Nations was developing the definition of permanent establishment, the common law operated in a way that was closer to civil law in relation to contracts made by an agent on behalf of a *foreign* principal (which is the part of the law of agency with which we are concerned) that were not binding on the principal.[33] This occurred as the result of a strong presumption of fact,[34] so strong that the courts have said that they were justified in treating it as a matter of law.[35] This relationship seems identical to that of the civil law *commissionnaire*[36] but it suffered from the disadvantage of being only a presumption, so that there was no certainty that it would be applied in any particular case.[37] The common law has now abandoned this presumption[38] but it may have influenced the development of this area of tax law on the ground that it was abnormal for the agent to bind a foreign principal, and when he did so the principal had a considerable connection with the other state, justifying taxation of the principal on the ground of having a permanent establishment.[39] The only cases under common law in which the principal is now not bound, apart from those where the agent exceeds his authority, are first where the contract expressly so provides, which is uncommon, and secondly where the principal is undisclosed but the doctrine of undisclosed principal is inapplicable, as is the case where the agent declares that he is the owner.

C. *Conflict of laws*

There are two main problems that are likely to arise in the interaction of the two legal systems that we have described:

1. an indirect representative who has no power to bind his principal is appointed under civil law and makes a contract governed by common law under which the principal would normally be bound. An example would be a French *commissionnaire* making a contract

27. See Bowstead (*supra* note 9), at 18 that the distinction between an employee and an independent contractor has no relevance in agency. The Factors Act 1899, however, applied to independent contractors and not employees.
28. See, in the United States, Restatement of the Law of Agency 2nd, Section 186; in the United Kingdom, Bowstead (see *supra* note 9), Article 79, at 312. The doctrine of undisclosed principal does not apply to negotiable instruments.
29. In the United Kingdom, see Bowstead (*supra* note 9) Article 86, at 346. The US Restatement of the Law of Agency describes the US position as illogical but more equitable, Section 186.
30. Restatement of the Law of Agency 2nd, Section 189.
31. *Humble v Hunter* (1848) 12 QB 310.
32. Halsbury's Laws of England 3rd ed. (1952), Vol. 1, Section 496 included this presumption as a statement of the then existing law.
33. Such agent was often a factor (also called a commission agent), see Section V.A.3.a.
34. Bowstead (see *supra* note 9), at 435.
35. *Armstrong v. Stokes* (1872) LR 7 QB 598, at 605. Had the common law accepted the situation as a presumption of law, the concept of indirect agency might exist in common law today. See Blackburn J's dissenting judgment in *Robinson v Mollett* LR 7 HL 802, at 809–810 in favour of recognizing indirect representation. Hill, "The Commission Merchant at Common Law" (1968) 31 *Modern Law Review* 623 considers the common law precedents and concludes that common law has missed an opportunity of developing the law in the same way as civil law.
36. The only way to fit such a transaction into common law was to regard the commission agent as a principal in relation to the third party, and an agent in relation to his principal. In *Robinson v. Mollett* (1871) LR 7 HL 802, at 810, Blackburn J in a dissenting judgment records that it was the ordinary authority of a foreign commission merchant not to establish privity between the parties, on account of the great inconvenience which would result from establishing privity between the foreign producer and the home merchant. This lead to difficulties in assessing damages payable by a commission agent in similar circumstances for acquiring goods (opium) of inferior quality in *Cassaboglou v Gibb* (1883) 11 QB 797, and these were calculated on the actual loss suffered by the principal which is based on an agency relationship between them, rather than damages for the loss of profit on the goods which should have been purchased, which would have applied if the agent had been a principal acquiring the goods for resale. A related problem has arisen under civil law in a Belgian case in which a *commissionnaire* claimed damages from the third party carrier for damage to goods during transport which the *commissionnaire* had not personally suffered as the loss fell on his principal (Belgian Supreme Court, 25 October 1963, Pas, 1964, I, 204). The Court decided that only the *commissionnaire*, and not the principal, could sue and could claim damages suffered by his principal.
37. The relationship has been accepted in New Zealand in relation to a New Zealand third party acquiring goods from an English manufacturer through an English agent, see *Bolus v. Inglis* (1924) NZLR 175: "... the relation may be that of agency, whereby the English agent is authorised to purchase the goods in his own name and on his own responsibility from the New Zealand merchant, but is not authorised to make in the name of or on behalf of that principal any contract between him and the English manufacturer, or to impose on the principal any contractual liability towards the manufacturer."
38. *Teheran-Europe Co Ltd v. S.T. Belton (Tractors) Ltd.* (1968) 2 QB 545.
39. Although under UK internal law the fact that the foreign principal was not bound by contracts made by a commission merchant in his own name did not prevent taxation of the principal in *Watson v. Sandie & Hall* (1897) 3 TC 611 and *Weiss, Biheller and Brooks Ltd. v. Farmer* (1922) 8 TC 381, at 406, 407 on the grounds that the presumption was only between the parties to the contract and so did not prevent the real principal from being taxed (until the amendment made by the 1925 legislation, see *infra* note 92).

in England governed by English law.[40] An English case of this type arose in which a *commissionnaire* bound his principal by making a contract governed by common law although the Cuban principal (Cuba then being a Spanish colony) appointed the Cuban *commissionnaire* under a contract governed by Spanish law. The *commissionnaire* made a contract governed by English law in his own name (which under Spanish law would not have bound the principal) with an English third party.[41] The principal was, as an undisclosed principal, permitted by the English court to sue the third party, so that the third party was contractually bound to the principal.[42] If the principal is habitually bound he will be within Paragraph 5;[43] and

2. an agent appointed under common law, who would expect to bind his principal when making a contract in his own name, makes a contract in his own name governed by civil law that does not in fact bind the principal. An example of this problem is shown in another English case in which an English principal employed a commission agent in Mauritius (who would contract under French law) to purchase sugar.[44] The principal was not bound to the third party, although the reasoning in the case relied on the foreign principal exception.[45] If this situation occurred today, the principal would not be within Paragraph 5 and so there cannot be a permanent establishment.

This is not the place to go into the detail of this complex area of law[46] in the countries represented. The Rome Convention on the Law relating to Contractual Obligations[47] applicable between EC Member States excludes from the choice of law governing a contract "the question whether an agent is able to bind his principal",[48] thus leaving this to be determined by each state's law. In spite of the differences between civil and common law, and within civil law between direct and indirect representation, there is considerable similarity in the approach to this question, perhaps because the matter is looked at from the point of view of the third party. In most of the countries represented the question of whether the principal is bound is governed by the law relating to the contract between the agent and the third party, rather than whether in fact the agent had actual power to bind the principal under the contract between the principal and agent.[49] In most cases[50] the law relating to the contract between the agent and the third party is stated to be the law of the place where the contract is made, or sometimes of the place where the agent has his business establishment.[51] The rationale is that protection of the third

40. This implies that for the doctrine of undisclosed principal to apply it is not necessary for the principal to have authorized the agent to enter into a contract binding the principal, and that the principal's liability is superimposed by law irrespective of the intention of the parties. Whether this is correct is uncertain, see the discussion in Bowstead (see *supra* note 9), at 314–6.

41. *Maspons y Hermano v. Mildred, Goyeneche & Co* (1882) 9 QBD 530, affirmed on different grounds (1883) 8 App Cas 874. The exception to the doctrine of undisclosed principal relating to foreign principals mentioned in Section II.B. was held not to apply to a contract between a foreign agent and an English third party (although it did between an English principal and a foreign commission agent in *Ireland v. Livingstone*, see *infra* note 44). The *Maspons* case concerned a dispute about the insurance moneys for a lost cargo which the English third party was holding and wanted to set off against a debt owing by the *commissionnaire*, which the court did not permit, by allowing an action by the foreign principal against the English third party.

42. There are circumstances where this is permitted in civil law, see *supra* note 12, and the real test of the difference would have been whether the third party could sue the principal.

43. Whether the result is that he has a permanent establishment depends upon Paragraph 6 and in particular whether the agent is acting outside the ordinary course of his business; it is presumed that a *commissionnaire* is independent.

44. *Ireland v Livingstone* (1872) 5 HL 395.

45. See text *supra* at note 32.

46. In common law, as Fridman says "it can be said that the agency relationship in the conflict of laws is still the subject of considerable doubt". Fridman's *Law of Agency*, 6th ed. Butterworths, 1990, at 350.

47. 19 June 1980, with the Luxembourg Convention of 10 April 1984 and the Brussels protocol of 19 December 1988.

48. Article 1(2)(f). Article 37 No. 3 of the German Introductory Statute to the Civil Code (EGBGB) also excludes this question from the conflict rules applicable to contracts

49. See generally Hay and Müller-Freienfel's "Agency in the Conflict of Laws and the 1978 Hague Convention" 27 *American Journal of Comparative Law* (1979), at 1 and the Pelichet report (see *supra* note 3), at 19. German law and codes of other civil law countries deriving from it, such as Italy, make a distinction between the agent's mandate (the relationship between the principal and the agent) and the agent's authority or competence to bind the principal to the third party. The French code does not make this distinction but accepts a different legal system applying to the external relationship, by regarding the internal relationship as subsidiary to the external. Although common law regards the agent's contract as a single one between the principal and the third party, it sees no problem in the internal and external contracts being governed by different systems of law.

50. English law as explained in Dicey & Morris, *The Conflict of Laws*, 11th ed, Rule 201, at 1341 seems to be out of line in looking to the proper law of the contract between the agent and the third party, although this is often the same as the law of the place of contracting. *Ruby Steamship Corp. Ltd. v. Commercial Union* (1933) 46 Ll.L.R. 265 (in which a New York agent of a Canadian principal made an insurance contract in England which could not be cancelled by the agent for non-payment of the premium under English law but could under New York law, which was held to be validly cancelled by the agent, following New York law) is inconsistent with Dicey's Rule 201. A number of English cases where the agent was appointed under power of attorney are consistent with the rule that the law of the place of the agent's acting governs the question whether the principal is bound. This is a possible reading of *Chateny v. Brazilian Submarine Telegraph Co Ltd* (1882) 9 QBD 530 in which the Brazilian principal appointed an English broker by a Brazilian power of attorney to buy and sell shares in English companies. Under English law the agent did not have power to transfer the shares without further formalities, but under Brazilian law the principal would be bound. A transaction in shares entered into in England was upset on the basis that English law applied, although the law of the contract made by the agent would give the same result as the law of the place of performance. The court may have relied on the latter: "...it follows that the extent of the authority, in any particular country in which the authority is to be acted upon, is to be taken to be according to the law of the particular country where it is acted upon." *per* Lord Esher MR, at 84. It would follow from this that if the law of the place of performance gives greater power to bind the principal than the law of the appointment of the agent, the agent may have the greater authority. The revocability of an agency granted by a power of attorney in German form supplementing a contract between a German company and a German individual (the revocability of the contract was agreed to be governed by German law, at 677D) was held in *Sinfra AG v. Sinfra Ltd* (1939) 2 All ER 675 to be governed by English law as the law of the place it was intended to be used. In *Apt v. Apt* (1948) P 83 a marriage contracted by proxy in Argentina under a power of attorney made in England was held to be valid, although it would not have been if England had been the place of performance. And in *Bodley Head v. Flegon* (1972) 1 WLR 680 a contract made under a power of attorney granted by a Russian author (Solzhenitsyn) in Swiss form for use in Switzerland was held to be valid, although it gave authority to do something that was illegal in Russia as there was a state monopoly of foreign trade in Russia. All these cases concerned powers of attorney, which being unilateral acts might be subject to different rules. A power of attorney governed by civil law will mean that there is direct representation and there is less likely to be a conflict caused by differences between civil and common law.

51. In Switzerland, see the codification in Loi féderale sur le droit international privé of 18 December 1987: in order to protect the third party, Swiss conflict of law rules provide that in the absence of a place of business of the agent, or if that place is not evident to the third party, the applicable law is the law of the state in which the agent primarily acts in the particular case. In Germany, see Articles 27 to 37 of the Introductory Statute to the Civil Code (EGBGB) and the

party requires that he should know that the principal is bound. The solution adopted by the Hague Convention on the Law Applicable to Agency[52] is, unless the parties make a choice of law,[53] to apply the law of the place where the agent has his business establishment.[54] The law of the place where the agent acted[55] is, however, used in the following cases:

- if the principal has his business establishment there and the agent acted in his name;[56]
- if the third party has his business establishment (or habitual residence in the absence of a business establishment) there;
- if the agent acted at an exchange or auction; or
- if the agent has no business establishment.[57]

The law governing the external relationship is applicable to the relationship between the agent and the third party even where the agent has exceeded his authority,[58] and so potentially covers the first problem above. A practical distinction between civil and common law of agency concerns contracts made by officers of a company and partners. In many civil law countries such persons are not regarded as agents acting on behalf of the body, but as the body itself entering into the contract, whereas in common law they are regarded as agents making the contract on behalf of the body. Since this situation is excluded from the Hague Convention on the Law Applicable to Agency,[59] the question of which law applies may be uncertain. A common law country might look to the law of the place of contracting, whereas in a civil law country the contract might be governed by the law of the state of incorporation of the company.

If the Hague Convention is adopted generally, the two problems mentioned above are likely to arise only when the agent travels to the place of the third party's business establishment or the agent has no business establishment, because it is unlikely that a *commissionnaire* would have his business establishment in a common law country.

III. PARAGRAPH 5 OF ARTICLE 5

With that introduction, we turn to Paragraph 5 which, in referring to a person (whom we shall call the agent) acting on behalf of (*pour le compte de*)[60] an enterprise who has and habitually exercises an authority to conclude contracts in the name of (*au nom de*) the principal, describes the legal result of the exercise of the agent's authority (that the principal is legally bound to the third party), but does so in terms of the means of achieving the result in civil law (the agent exercising his authority to contract in the name of the principal). Any civil law reader would understand this to be a reference to direct representation. Unfortunately, the draftsmen did not appear to appreciate that common law[61] readers might not understand it in this way, and the Commentary does not clarify its meaning.[62] It is also confusing that a distinction was made in the United Kingdom between a broker and a factor (or commission agent) in that a broker contracts in the name of his principal, whereas a factor contracts either in his own name or that of his principal.[63] In the United Kingdom, the phrase "in the

commentary by Staudinger, 12th ed. In the United States see Restatement of Conflicts, Second Section 292. Where the agent and third party are in different states the principal will be bound if he is bound by the law of either state, see Section 292 comment e. It has been accepted in at least one case that the law which determines whether the principal is bound may be different from the law of the contract made by the agent (see Reporter's note). In Canada see Falconbridge, *Essays on the Conflict of Laws*, 2nd ed.(Canada Law Book, 1954), at 433. In Japan this question depends on the intention of the parties (Law Concerning the Application of Laws, Article 7); this is usually the law of the place where the agent contracts (Sugibayashi, *Horei Konmentaru* (1983) 59, cf. Orimo, *Kokusai Shiho (Kakuron)* (1972) 65; Tokyo District Court Judgment 25 February 1966 (*Kakyu minshu* Vol.7, 429). In the Netherlands, see L. Strikwerda, *Inleiding tot het Nederlandse Internationaal Privaatrecht* (Groningen: Wolters-Noordhoff, 1990). In Italy, see Article 25 Provisions of the Law in General and E. Vitta, *Diritto internazionale privato* (Turin: Utet, 1972-75), and *Diritto internazionale privato e processuale* (Turin: Utet, 1991) and G. Balladore Pallieri, *Diritto internazionale privato italiano*, in A. Cicu and F. Messineo, *Trattato di diritto civile e commerciale diretto* (1974), at 3 and 91. In France, see Battifol and Lagarde, *Droit International Privé*; and Paris, 1ère ch. urg., 31 October 1990, *Stabel c. Sté Pozzo*, DS 1991, inf. rap.6. For an article suggesting a different approach, see E. Goldfarb "Agency and the Conflict of Laws: A Critical Reassessment", *University of Toronto Faculty of Law Review*, Vol. 35 (1977), at 26. See also Hay and Müller-Freienfels (see *supra* note 49) for the approach in a number of countries.

52. 14 March 1978. This entered into force on 1 May 1992 following the ratification by Argentina, France and Portugal. The Netherlands ratified it on 1 October 1992. The convention applies to agents who act in their own name or in that of the principal. There is excluded by Article 3 the acts of an organ or officer of a company or a partner in the exercise of his functions by virtue of an authority conferred by law or by its constitution.

53. Article 14 which requires a written specification by the principal or agent and its express acceptance by the third party.

54. If he (or, if the exceptions apply, another party) has more than one, it is the establishment with which the relevant acts of the agent are most closely connected.

55. Article 13 provides that where an agent makes a contract in one state with a third party in another by telephone etc., he is deemed to have acted at the place of his business establishment.

56. This, like Paragraph 5, is an unfortunate example of the use of civil law terminology in a convention intended for use by common law countries as well.

57. Article 11.

58. Article 15.

59. Article 3(a).

60. These words exclude a person acting as a principal. As is indicated by the use of both expressions, a distinction is made in civil law between acting "for the account of another", and acting "in the name of another", so that a *commissionnaire* may act for the account of an identified principal but still be solely liable on the contract (*Répertoire Pratique du Droit Belge*, 1969, Para. 246); see *supra* note 20. In common law, contracting "on account of" another person normally means that the party is contracting as agent and does not intend to be bound himself, *Gadd v. Houghton* (1876) 1 Ex.D. 357, but this is a rule of construction only, and see *Punjab National Bank v. de Boinville* (1992) 1 WLR 1138 for an example of its not applying because of the context.

61. Surprisingly, the United States has used the expression "in the name of" in its internal tax law in Internal Revenue Code (hereinafter "IRC") Section 864(c)(5), stating that an agent's office is not attributed to the foreign principal "unless the agent has and regularly exercises an authority to negotiate [this was the word used in the former US–UK treaty (1945) and other earlier US treaties] and conclude contracts *in the name of*" the principal. The United States appears to have copied from the Model perhaps without understanding the significance of these words.

62. See text *infra* at note 70 for the Commentary. For an example of misunderstandings in England caused by the use of civil law terminology of contracting in the name of the principal, which naturally tends to be interpreted in a descriptive or literal sense in England, see the Report on the Proposed EEC Directive on the Law Relating to Commercial Agency (1977) Cmnd 6948. At the time of that report the definition in the draft directive read: "commercial agent means a self-employed intermediary who has continuing authority for a fixed or indeterminate period to negotiate and/or to conclude an unlimited number of commercial transactions in the name and for the account of another person." The draft directive was subsequently altered, see *infra* note 198 for the final wording. For a further example of misunderstandings caused by the use of civil law expressions, see text *infra* at note 66 in relation to the UK observation in the 1992 Model.

63. See *infra* note 144.

name of" if understood in a descriptive sense does not affect the liability of the principal, as the principal is always bound except where the exception for foreign principals applied.[64] A so-called observation[65] by the United Kingdom[66] added to the Commentary to the 1992 Model suggests that the meaning of the expression "contracting in the name of" has not been understood in the United Kingdom. The observation states that:

> The United Kingdom considers that an agent who is not an agent of independent status within Paragraph 6 of this Article and who has the characteristics described in Paragraphs 32 and 33 above[67] will represent a permanent establishment of an enterprise if he has the authority to conclude contracts on behalf of that enterprise whether in his own name or that of the enterprise.

It is understood that a body of appeal commissioners in the United Kingdom (who do not report their decisions) has decided a case by applying a literal interpretation of the expression "contracting in the name of", so that a UK agent who did not reveal the principal's name but did bind the principal did not constitute a permanent establishment, and the UK representative on the OECD Committee on Fiscal Affairs wanted to prevent this from happening again. However, it would have been much more satisfactory if the Commentary to Paragraph 5 had been changed to clarify the meaning of the expression contracting in the name of (or better still avoiding its use in the English text), rather than one country making an observation which suggests that it does not understand Paragraph 5 and implying that other common law countries accept that the expression is to be taken literally.

By using a term of art derived from civil law in the Model there can be no doubt that it was intended to have the civil law meaning, as there is no sense in making the liability of the principal to tax turn on a purely descriptive, rather than a legal, difference. It is unfortunate that use of a purely civil law term of art occurs in a model that was intended for use by common law states as well,[68] particularly as the earlier League of Nations drafts had avoided it.[69] In order to avoid confusion, we shall therefore use the expression "contracting in the name of the principal" to indicate the civil law categorization of the transaction. That categorization is irrelevant in common law since the result (that the principal is bound) is the same in whosoever's name the transaction is effected, unless the contract specifically or by implication provides that only the agent is bound. When we refer to the *result* of the categorization of the transaction we shall state *whether the principal is bound by the contract*, without referring to the means by which this happened, which will differ according to the legal system involved.

Paragraph 5 thus states a general rule: that the agent can only constitute a permanent establishment of the principal if the agent has, and habitually exercises, an authority to conclude contracts binding on the principal (stated, in the obviously civil law terminology of the Model, as contracting in the name of the principal, referring to direct representation). This interpretation of Paragraph 5 is supported, although not as clearly as one would wish, by the Commentary which says: "in such a case [where the agent has authority to conclude contracts] the person has sufficient authority to *bind* the enterprise's participation in the business activity in the State concerned."[70]

64. See text *supra* at note 32.

65. An observation is a disagreement with the Commentary, rather than the Model, see the Introduction to the 1992 Model Paragraph 30. Since this statement disagrees with the wording of the Model it should have been a reservation (Paragraph 31), rather than an observation.

66. Article 5 Commentary Paragraph 45.

67. These are the commentary on Paragraph 5 and relate to the authority to conclude contracts relating to the business proper of the enterprise.

68. The same problem also occurs in European legislation and the United Kingdom has generally avoided using the expression "contracting in the name of" in its internal law giving effect to it. Article 9(2)(e) of the EC Sixth Directive on VAT reads "the services of agents who act in the name and for the account of another ...;" the UK VAT Act 1983, Sched 3. item 7 avoids the reference to contracting in the name of the principal by saying: "the services rendered by one person to another ..." Article 15(14) of the Directive says "services supplied by brokers and other intermediaries, acting in the name and for account of another person. .;" the UK VAT Act 1983, Sched. 5 Group 9 item 11 changes this to "the supply of services in procuring for another person ..." By avoiding references in internal law to contracting "in the name of" the principal, the United Kingdom had adopted the correct equivalent effect to the civil law terminology of the Directive. In Article 26 the Directive refers to travel agents (including tour operators) dealing with customers in their own name and not acting only as intermediaries who account for VAT on expenses paid out in the name and for the account of a principal; the UK VAT Act 1983, s 37A(3) translates this as a travel agent (or tour operator) acting as a principal. The UK VAT Tribunal in *Aer Lingus v. Customs and Excise Comrs*, LON/90/1747X and LON/92/1140X, has held this to be in accordance with the Directive, but is the Directive referring to indirect representatives rather than to agents acting as principals? (Article 28(3)(g) of the Directive also allows a transitional derogation for travel agents which also applies to travel agents acting in the name and on account of the traveller, which does not have any application to the United Kingdom). The United Kingdom uses a derogation in Article 28(3)(e) to avoid complying with Article 6(4) of the Directive: "Where a taxable person acting in his own name but on behalf of another takes part in a supply of services, he shall be considered to have received and supplied those services himself." There is a proposal for a directive to remove this derogation (OJ 92/C205 of 13 August 1992, COM(92)215 Final) which the Economic and Social Committee has recommended postponing (OJ 92/C332 of 16 December 1992, 92/C332/17). It is possible that the UK VAT Act 1983, s.32(4), under which if goods or services are supplied through an agent who acts in his own name, Customs and Excise may treat the supply as one to and by the agent, is intended to comply permissively with the above articles of the Directive, in which case it has a different meaning to the civil law meaning of the Directive (that such contracts by the agent in his own name do not bind the principal). These provisions were considered by the UK VAT Tribunal in *Metropolitan Borough of Wirral v. Customs and Excise Comrs*, MAN/91/725. The English version of Article 5(4)(c) of the Directive treats as supplies of goods: "the transfer of goods pursuant to a contract under which commission is payable on purchase or sale," the meaning of which is obscure. It seems that this is a mistranslation of the French *la transmission d'un bien effectuée en vertu d'un contrat de commission à l'achat au à la vente* (or the Dutch *in commissie*, Italian *contratto di commissione* or the German *über eine Einkaufs- oder Verkaufskommission*), which is referring to a transaction carried out by a *commissionnaire*, in which the commission is the task given to the agent and not the method of payment, see text *infra* at note 163. Treating transactions by *commissionaires* as a sale and purchase by the *commissionnaire* avoids problems about the principal and the third party not knowing each other's identity. Article 11(3)(c) of the Directive excludes from the taxable amount "the amounts received by a taxable person from his purchaser as repayment for expenses paid out in the name and for the account of the latter...;" there are no special provisions of UK VAT law dealing with this. Article 5(4)(a) of the Directive applies to "the transfer, by order made by or in the name of public authority ...of the ownership of property;" and Article 6(1) to the supply of services in pursuance of an order made by or in the name of a public authority ..." There do not appear to be any corresponding provisions in UK internal law.

69. See text *infra* at note 103 and generally Section IV. The expression "contracting in the name of" was first used in the OEEC first report of 1958, see *infra* note 127.

70. Article 5 Commentary Paragraph 32. The significance of binding the enterprise will be more obvious to a civil law reader who is familiar with the concept of some agents not binding the principal. See also the UN Model commentary: "... the agent had legal authority to bind the enterprise for business purposes..." (Article 5 Commentary to Paragraph 5).

Vogel[71] makes the same point about the meaning of "in the name of" when he refers to cases where the principal is *bound* by the agent's statements. It is interesting that one common law country, Australia, has avoided using civil law terminology in any of its treaties[72] and has stated the meaning explicitly in four of its treaties by using the expression "authority to conclude contracts *binding* the enterprise".[73] It is suggested that it would be advantageous for this wording to be adopted in the Model, avoiding what is essentially the mistake of translating literally into English a French term of art. Other common law countries frequently use "on behalf of" in treaties instead of "in the name of", so that "on behalf of" is used twice in Paragraph 5.[74] The earlier drafts of the UN Model Double Taxation Convention Between Developed and Developing Countries originally used "on behalf of"[75] instead of "in the name of" in the equivalent provision, probably reflecting its common law background with Professor Stanley Surrey as special advisor to the Rapporteur of the Group of Experts. This was changed in the Eighth Report[76] to correspond with the OECD Model.[77] If the former wording had been used it would have resulted in a different meaning in a civil law country because a *commissionnaire* does conclude contracts on behalf of (*pour le compte de*) his principal, so from the civil law point of view it is fortunate that the change was made.[78] The common law reader may be unfamiliar with the terminology "in the name of", but, once it is understood that it is derived from civil law, the meaning is clear: that there can be a permanent establishment only if the principal is bound by the agent's contract.[79] The logic of using the test based on whether the principal is bound by contracts is, in the words of the OECD Commentary, that the enterprise "involves the agent to a particular extent in the state concerned" and is "participating in the economic life of that other state."[80] If, as in the case of an indirect representative in civil law, the principal could not be sued for the agent's acts, it can be said that the principal is not involved at all in a sale made by the agent in the agent's state.[81]

The OECD Commentary states that the authority to conclude contracts must cover contracts which constitute the business proper of the enterprise, and that it would be irrelevant if the person had authority to engage employees for the enterprise, or if the contracts related to internal operations only.[82] The Commentary also states that "a person who is authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority "in that State", even if the contract is signed by another person in the State in which the enterprise is situated".[83] This suggests that one is to look at the position as a matter of substance rather than mere form, so that this is counted as a case in which the agent effectively had power to bind the enterprise.[84] We shall assume throughout this article that the contracts entered into by the agent are not limited to the matters mentioned in Paragraph 4 of Article 5.[85]

Where contracts are habitually concluded that bind the enterprise there is a permanent establishment in respect of *any* activities which the agent undertakes, not merely in

71. Klaus Vogel, *Double Taxation Conventions* (Deventer: Kluwer, 1990) (hereinafter "Vogel"), Article 5, marginal note 139.

72. At least in the English language version, which uses "on behalf of" instead of "in the name of". In Italy-Australia (1982) the English text says "on behalf of" while the Italian has the equivalent of "in the name of"; in Netherlands-Australia (1976) the English text has "on behalf of" and the Dutch *namens* ("in the name of"). The same occurs in the former Italy-UK treaty (1960).

73. Australian treaties with Germany (1972), Finland (1984), Korea (1982) and Spain (1992).

74. Canadian treaties with: Australia (1980), Bangladesh (1982), Denmark (1983), Finland (1959, but not 1990), India (1985), Korea (1978), New Zealand (1980), Pakistan (1976), Papua New Guinea (1987), Philippines (1976), Thailand (1984), Zambia (1984); US treaties with: Australia (1982), Austria (1956), Bangladesh (1980), Barbados (1984), Bermuda (1986, insurance companies only), former Denmark (1948, not 1980), Greece (1950), India (1989), Indonesia (1988), Ireland (1949), former Italy (1955, not 1984), Jamaica (1980), former Netherlands Antilles (1948), Pakistan (1957), Switzerland (1951); UK treaties with: Antigua (1947), Australia (1967), Bangladesh (1979), Belize (1947), British Solomon Islands (1950), Brunei (1950), Burma (1950), Dominica (1949), Faroe Islands (1950), Ghana (1947), Greece (1953), Grenada (1949), Guernsey (1952), Isle of Man (1955), former Italy (1960, not 1988), Ivory Coast (1985), Jersey (1952), Kiribati (1950, Lesotho (1949), Malawi (1955), Montserrat (1947), former Norway (1951, not 1969), former Pakistan (1961, not 1986), Papua New Guinea (1991), Sierra Leone (1947), St Christopher (1947), former Switzerland (1954, not 1977), Thailand (1981), Tuvalu (1950), Uganda (1952). These and other treaty references are taken from the International Bureau of Fiscal Documentation's Tax Treaties Database on CD-ROM, 1992, release 2.

75. See the UN First Report on Tax Treaties Between Developed and Developing Countries Paragraph 53 for the origin of this suggestion from members from developing countries, and Paragraph 35 of the second report for the adoption of the suggestion. The latter at Paragraph 37 records a difference of opinion about whether using the expression "on behalf of" meant that the contracts bound the principal, and whether contracting "in the name of" meant naming the principal. This is a further example of misunderstandings between common and civil law countries. This was the version used in the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries, UN 1979, at 47. The commentary (at 51) explains that it "means that the agent has legal authority to bind the enterprise for business purposes...."

76. UN 1980. No reason is given for the change in the report.

77. In his article "UN Group of Experts and the Guidelines for Tax Treaties Between Developed and Developing Countries", 19 *Harvard International Law Journal* 1 (1978), at 13-14, Professor Surrey describes the change as probably not significant.

78. See *supra* note 60. If the commentary to the Manual (see *supra* note 75) had remained, the intended meaning would have been clear.

79. Even if he is so bound, Paragraph 6 may prevent there being a permanent establishment.

80. Article 5 Commentary Paragraph 31. This is no doubt why it is similar to the test for jurisdiction over the enterprise by the courts in the other state, see *supra* note 4.

81. Hence the similarity to the test for jurisdiction, see *supra* note 4. The principal is, of course, involved in the relationship between the principal and the agent but this does not involve a sale to the third party unless the agent contracts with the third party.

82. Article 5 Commentary Paragraph 33. US regulations (Section 509.104(b)(5)(iii)) under the Swiss treaty (1951) exclude an agent having power to contract at fixed prices on conditions determined by the principal.

83. Article 5 Commentary Paragraph 33.

84. Vogel (see *supra* note 71) Article 5 marginal note 140 refers to this as a factual test so that an agent who negotiated a contract, but had it signed by the principal might have an actual authority to bind the principal. The Germany–Malaysia (1977) protocol makes a similar point: "It is understood that the conditions of Paragraph 4 (5 of the Model) of Article 5 are equally complied with, if contracts concluded by a person within the meaning of this provision in the name of the enterprise are subject to final approval by the enterprise."

85. Paragraph 4 deals with such matters as storage, display, delivery, processing, purchasing, collecting information and other activities of a preparatory or auxiliary nature. Article 5 Commentary Paragraph 21 says that the common feature of these activities is that they are, in general, preparatory or auxiliary. As is stated in Article 5 Commentary Paragraph 33: "Since, by virtue of Paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either." In the equivalent to Paragraph 5 in the 1963 Draft only the purchase of goods or merchandise was excluded.

respect of those which do bind the enterprise.[86] In relation to partnerships, there are a number of examples in common law countries which show that a partner, who in law is an agent for the other partners,[87] is a permanent establishment because of his automatic ability, as an agent, to bind his partners when acting within the scope of his express or implied authority.[88]

IV. THE ORIGIN OF PARAGRAPH 6 OF ARTICLE 5

Before turning to Paragraph 6 we shall look at the historical development of that paragraph which we shall use later as an aid to its interpretation. The earliest League of Nations draft convention was in 1927 and it seems probable that the agency provisions in it were strongly influenced by UK legislation that had been passed in 1925, which in turn had been influenced by discussions in the League of Nations committee. In support of this proposition, we can cite Mitchell B. Carroll:[89]

> As London was the center for the entrepôt trade in raw materials of all kinds, the heads of the tax administrations of the European countries who attended in the early 1920s the meetings of the League [of Nations] Committee of Technical Experts sought to prevail upon the British member to restore the exemption of nonresidents selling such materials through *bona fide* commission agents or brokers in London or other British trading centers. This lead to amending the United Kingdom income tax act to exempt such transactions under certain conditions.

More importantly, a League of Nations paper published in 1932 written by a UK Revenue official, after quoting the 1925 UK law, stated:[90]

> This provision is reflected in the corresponding provision in the draft Conventions contained in the Report by the government experts on *Double Taxation and Tax Evasion* at Geneva in 1928.

The history of the UK legislation taxing foreign principals doing business through agents in the United Kingdom is described in the Appendix to this article so that the context of the 1925 provision can be understood. Briefly, a non-resident is chargeable to tax in the name of a branch or agent[91] carrying on the regular agency of the principal. The UK 1925 legislation added a proviso as follows:[92]

> Provided that where sales or transactions are carried out on behalf of a non-resident person through a broker in the ordinary course of his business as such and the broker–
>
> (a) is a person carrying on bona fide the business of a broker in the UK, and
>
> (b) receives in respect of the business of the non-resident person which is transacted through him remuneration at a rate not less than that customary in the class of business in question,
>
> then, notwithstanding that the broker is a person who acts regularly for the non-resident person as such broker, the non-resident person shall not be chargeable in the name of that broker in respect of profits or gains arising from those sales or transactions.
>
> In this subsection "broker" includes a general commission agent.[93]

86. Article 5 Commentary Paragraph 34. This provision was new in the 1977 Model.

87. In the United Kingdom see Partnership Act 1890, s.5: "Every partner is an agent of the firm and his other partners for the purposes of the business of the partnership...." The Partnerships Act (Ontario) and the Partnership Acts in the Australian states (e.g. the New South Wales Partnership Act, s.5) are to the same effect. In the United States the Uniform Partnership Act provides in Section 9 that: "Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority."

88. In the United States see *Donroy v. USA* Court of Appeals 9th Circuit 301 F.2d 200 in which a Canadian limited partner in a US partnership was held to have a permanent establishment in the United States. There is a letter ruling to the same effect in relation to a Netherlands limited partner in a US partnership: Letter Ruling 83-16-109. The same result was reached in Canada in *Arbed v The Queen* (1982) DTC 6099 but on the grounds that the US resident partner in a Canadian partnership was not an enterprise of the United States and so did not have any treaty protection. There is one Belgian decision to the effect that a partner constituted a permanent establishment under the former Belgium–Netherlands treaty (1933) but this did not contain the equivalent of Paragraph 5 (*L'arrêt S.A. de droit néerlandais Fabriek van Elektrische Apparaten*, Bruxelles, 17 January 1963) and another decision to the contrary (*L'arrêt S.A. Sogetra*, Bruxelles, 21 February 1973 and *Cassation*, 27 June 1974), and also an internal law decision to the effect that a partner did constitute a permanent establishment (*L'arrêt Empresa Commercial A.F. Cobrita*, Bruxelles, 7 November 1955) but internal law also does not require power to conclude contracts.

89. Mitchell B. Carroll, "International Tax Law", 2 *International Lawyer* 692 (1968). He recorded that in the early 1920s the United Kingdom started to tax brokers and commission agents on behalf of foreign principals where the business was more than casual. This was as a result of the 1915 UK legislation described in the Appendix below. It appears from his article and from the League of Nations reports that the first visit that Mitchell Carroll made to the League of Nations was in June 1926 which means that he must have received this information second hand, but there is no reason to doubt it. The report to the League of Nations Fiscal Committee in 1930 of a clause in the UK Finance Bill which became Finance Act 1930, s.17 enabling the United Kingdom to make treaties "for the avoidance of double taxation resulting from divergent definitions of the term 'autonomous agent'" should also be mentioned. The League of Nations material is conveniently collected in Vol.4 of Legislative History of United States Tax Conventions, US Government Printing Office, 1962 (hereinafter "LHUSTC") to which page references are given here (see LHUSTC at (4206)). The Committee noted that "The British clause would appear of a nature greatly to facilitate the conclusion of international agreements on the basis of the recommendations adopted by the Fiscal Committee." The real reason for the clause was somewhat different, see text *infra* at note 282.

90. E.W. Verity, Principal, Board of Inland Revenue, "Tax Systems and Allocation Methods in the United Kingdom", published by the League of Nations in 1932 in Vol. 1 *Taxation of Foreign and National Enterprises*, document No. C. 73. M. 33. 1932. II. A, 15 February 1932. The original 1927 draft is similar to the 1928 one to which he refers. The United Kingdom was represented at the League of Nations Fiscal Committee meetings from the beginning.

91. Defined to include any factorship, agency, receivership, branch or management. Note the reference to a factor, which has been held to mean a factor in the legal sense of an agent who has possession of the goods of his principal, see *Grainger v. Gough* 3 TC 311, at 318 *per* Lord Esher MR.

92. This quotation is from Taxes Management Act 1970 (hereinafter "TMA 1970"), s.82, which is essentially the same as Finance Act 1925, s.17 with some drafting changes which make it easier to read. The effect of this legislation was that cases such as *Watson v. Sandie & Hull* (1897) 3 TC 611 and *Macpherson v Moore* (1912) 6 TC 107 would in future be decided differently.

93. As will be explained in Section V.A.3.a., two expressions then comprised the majority of sales agents in U.K. mercantile law. The distinction between them was that a broker did not have possession of the goods that he was selling and (in the descriptive sense) sold in the name of his principal, while a commission agent (or factor) had possession of the goods he was selling and sold (again in a descriptive sense) in his own name. Since these distinctions had no relevance for tax purposes, it was not surprising that one was defined to include the other.

This legislation should be compared to the earliest League of Nations draft model convention two years later in 1927 that included a provision (hereinafter "the 1927 provision") drafted on lines similar in substance to Paragraph 6 but in form worded as a negative part of the definition of permanent establishment:

> The fact that an undertaking has business dealings with a foreign country through a *bona-fide* agent of independent status (broker, commission agent, etc.) shall not be held to mean that the undertaking in question has a permanent establishment in that country.[94]

The Commentary[95] explained that "the words '*bona-fide* agent of independent status' were intended to imply absolute independence, both from the legal and economic points of view.[96] The agent's remuneration must not be below what would be regarded as a normal remuneration." The logic of the requirement for the normal rate of remuneration was stated in Mitchell Carroll's later paper of 1933 to be that the agent's commission represented the measure of the amount on which a branch carrying on the same activities as a commission agent should be taxed.[97] If the only activity in a state was carried on through a commission agent there would be no further profit to be taxed and therefore no point in treating the commission agent as a permanent establishment. The League of Nations also published an additional paper on this subject in 1933 that set out in detail what was described as the commission method of determining the profits of a permanent establishment.[98]

Common to both the 1925 UK legislation and the 1927 provision and commentary are: the expressions "broker", "commission agent" (but not "general" which was then only in the UK legislation), "bona fide", and the requirement for normal remuneration. The main difference is that the UK provision does not refer to independent agents apart from brokers and general commission agents,[99] and requires the transactions to be carried out in the ordinary course of business, a requirement which only later became comprised in the Model.[100] The Inland Revenue's briefing to Ministers in connection with the UK Finance Act 1925 said that non-residents used general commission agents for selling produce or raw materials, rather than manufactured goods.[101]

In 1929 a League of Nations committee of experts examined the situation from first principles and found that four methods or criteria were used in internal law in various countries for defining an "autonomous agent"[102] who was not treated as a permanent establishment: first, that only agents dependent on an enterprise had sufficient powers to conclude contracts binding[103] on the enterprise, so that an autonomous agent did not have such powers,[104] which they said was an admissible criterion but not applicable to every case; secondly, that there was no permanent establishment unless the agent had a fixed depot, to which they considered there were exceptions, such as insurance agents and buying agents; thirdly, that only non-autonomous agents were in receipt of fixed emoluments, which they did not think was a necessary factor; and fourthly, the continuity of relations between the agent and the enterprise, which they said was not an absolute criterion.[105] From these, they produced a definition of permanent establishment[106] which stated a fundamental principle that "when a foreign enterprise regularly has business relations in another country through an agent established there, who is authorized to act on its behalf, it shall be deemed to have a permanent establishment in that country." There then followed a list of cases in which a permanent establishment was presumed to exist, one of which was that of a duly accredited agent (*fondé de pouvoir*)[107] having business headquarters in the source country who habitually enters into contracts on behalf of the enterprise for which he works. Two exceptions (hereinafter "the 1929 exceptions") were then listed:

> A broker who places his services at the disposal of an enterprise in order to bring it into touch with customers does not, in his own person, constitute a permanent establishment of the enterprise, even if his work for the enterprise is continuous or carried on at regular periods.
>
> Similarly, a commission agent (*commissionnaire*) who acts in his own name for any number of undertakings and receives the normal rate of commission does not constitute a permanent establishment of any of the undertakings he represents.[108]

94. Double Taxation and Tax Evasion, 1927, see LHUSTC at (4125). This wording was repeated in each of the 1928 draft model conventions. See LHUSTC at (4162), (4170), (4173).
95. 1927 Report LHUSTC at (4129), 1928 Report at (6166).
96. This statement is still to be found in the 1992 Model Commentary: Article 5 Commentary Paragraph 37(a).
97. "Methods of Allocating Taxable Income", in Vol.IV of *Taxation of Foreign and National Enterprises*, at 193.
98. See Ralph C. Jones, "Allocation Accounting for Taxable Income of Industrial Enterprises", Chapter IV in *Taxation of Foreign and National Enterprises*, Vol. V, Doc. No. C. 415(c). M. 217(c) 933. II. A. The commission method, which Mitchell Carroll (see *supra* note 97) called the independent commission or fee basis (see his Paragraph 683), is used in distinction to the separate enterprise method of assuming a notional sale of the goods to the permanent establishment, which he called the independent dealer price basis (see Paragraph 685). See also Protocol Article VI.1.C to the London and Mexico drafts for a statement that if the activities of the permanent establishment are those of a commission agent or broker the income should be determined on the basis of the customary commission for such services (LHUSTC at (4400)).
99. Although these two comprised the two main classes of sales agents, see text *infra* at note 140.
100. Inclusion of the UK concepts of "ordinary course of business" and the "general commission agent" in a model did not occur until the OEEC first report of 1958. Ordinary course of business has been used in this area of the law in the United Kingdom since the Factors Act 1899. Coincidentally, UK tax law also uses the expression "in the name of" but in a completely different sense, that of the agent being assessed in the principal's name (e.g. an assessment on X as agent for Y).
101. Public Record Office Document IR 61, 112, at 204.
102. This is the same as independent agent.
103. It is interesting that "binding" was the expression originally used, and only much later in the OEEC first report of 1958 was the civil law terminology of contracting "in the name of" used in what is now Paragraph 5 to convey the same meaning.
104. This is indicative of the civil law approach.
105. 1929 Report, LHUSTC at (4197).
106. LHUSTC at (4198). Note the similarity between these four criteria and Paragraph 5. The criteria are, however, wider in that they apply in cases where there was no power to contract, since the existence of such a power was a case where a permanent establishment was presumed to exist (see the text immediately following) and therefore it could exist in the absence of a power to conclude contracts.
107. This is the same as *mandataire*, i.e. a direct representative, and is used in the French Civil Code Article 1995 in connection with agent's responsibilities. See the London-Mexico (unofficial) commentary (LHUSTC at (4396–7)): "power of the local agent to bind the enterprise."
108. LHUSTC at (4918).

The commentary emphasized the difference between a *commissionnaire*, who acted in his own name,[109] and a so-called commission agent (*agent à la commission*) who had a stock of goods and who usually sold the goods under a contract of sale or invoice bearing the name of the foreign enterprise and signed on behalf of the enterprise. One can detect a strong civil law influence here, using civil law terminology such as the reference to the *commissionnaire* contracting in his own name, while the *agent à la commission* contracts in the name of the principal, and to a broker in the sense of *courtier* who merely brings the parties together.[110] Effectively, these exceptions stated that civil law agents who did not conclude contracts binding the principal were not included as permanent establishments. There was no mention of the 1927 provision of common law origin for independent agents,[111] and the 1929 draft did not therefore exclude independent agents who did bind their principals from constituting a permanent establishment.[112] These provisions were effectively repeated in 1930.[113] However, in 1931 common law had obviously reasserted its influence and the original 1927 provision relating to agents of genuinely independent status (broker, commission agent, etc.) was included again, in place of the 1929 exceptions.[114]

Finally, by the time of the 1933 draft convention relating to the allocation of business income[115] Mitchell Carroll's report on the allocation of profits in 27 countries had been tabled[116] and three volumes of National Reports had been published, so there was by then a better understanding of the position. There was included in the protocol to the draft convention both the original 1927 provision, of common law origin, for agents of genuinely independent status (broker, commission agent, etc.), in the first paragraph of the quotation below, and the 1929 exceptions of civil law origin for brokers and *commissionnaires* in the last paragraph below.[117] This suggested that it was realized that they each had different scope, and both served some purpose; certainly common lawyers would not regard the 1929 exceptions as sufficient, and the language of the 1927 provision was no doubt unfamiliar to civil lawyers. This 1933 version read as follows:

> The fact that an enterprise with its fiscal domicile in one of the contracting States has business dealings in another contracting State through an agent of genuinely independent status (broker, commission agent, etc,) shall not be held to mean that it has a permanent establishment in that State.
>
> A permanent establishment shall therefore be deemed to exist when the agent established in the State:
> (1) Is a duly accredited agent (*fondé de pouvoir*) who habitually enters into contracts for the enterprise for which he works; or
> (2) Is bound by an employment contract and habitually transacts commercial business on behalf of the enterprise in return for remuneration from the enterprise; or
> (3) Is habitually in possession, for the purpose of sale, of a depot or stock of goods belonging to the enterprise.
> ...[118]
>
> A broker who places his services at the disposal of an enterprise in order to bring it into touch with customers does not in his own person constitute a permanent establishment of the enterprise, even if his work for the enterprise is to a certain extent continuous or is carried on at regular periods. Similarly, a commission agent (*commissionnaire*), who acts in his own name for one or more enterprises and receives a normal rate of commission, does not constitute a permanent establishment of any such enterprise.

One has the impression of failure to agree, resulting in an inelegant compromise, without either group ever having fully understood the other, but knowing that the other's draft did not solve the problem. We draw the conclusion from the separate history of the 1927 provision and the 1929 exceptions that the reference to a commission agent in the first paragraph of the 1933 provision (not, it should be noted, translated as *commissionnaire*)[119] is to a common

109. The Commentary stated "It is important to distinguish the agent who constitutes a permanent establishment from the commission agent (*commissionnaire*) who acts in his own name and not in that of the party for whose account he acts. The commission agent is, under the law of many countries, an independent person in business for himself and is responsible to persons buying from him the products which the real vendor has shipped to him to sell." LHUSTC at (4198). This is a clear reference to indirect representation in civil law.

110. See *infra* note 157.

111. See text *supra* at note 94.

112. It is also recorded in the 1931 Report in LHUSTC at (4231) that the International Chamber of Commerce was concerned about the definition and a subcommittee was formed composed of representatives from Italy and the Netherlands, but not including the United Kingdom (the only common law country then represented on the fiscal committee) to consider the matter. The committee decided not to modify the previous definition, but the draft plurilateral conventions of 1931 did contain the 1927 provision.

113. 1930 Report, LHUSTC at (4206).

114. 1931 Report, Draft Plurilateral Convention A, Article 4, LHUSTC at (4238), and draft B, Article 4 at (4240).

115. 1933 Report, LHUSTC at (4246).

116. LHUSTC at (4241). It is interesting to see what the internal law of the states surveyed by Mitchell Carroll said about dealings by brokers and commission agents, which one presumes was interpreted by civil law states to refer to *courtiers* and *commissionaires*. In general, civil law states did not tax the principal who had dealings through a broker or commission agent: this applied to France (describing them as traders acting on their own behalf and not as representatives or agents of their principal – we interpret this as a description of acting in their own name, Vol.I, at 78), Spain ("if the agent is truly autonomous not only from the strictly legal point of view, but also from the point of view of economic realities" – the same test of independence as the League of Nations adopted, Vol. I, at 139), Belgium ("if he simply takes orders and passes them on to the foreign firm, without intervening in any way in the transactions between the firm and its customers (delivery of goods, payment of invoices, judicial disputes, etc.)") and if he does not mention the firm he represents on his stationery or name plate – the part in quotation marks seems contrary to the usual understanding of what a *commissionnaire* normally does, Vol.II, at 72), Italy ("because such agent works in his own name and cannot be regarded as directly forming part of the foreign enterprise" – a clear description of an indirect representative, Vol.II, at 265-6), the Netherlands (Vol.II, at 259), and Switzerland (unless the conditions under which he works make him a permanent representative, Vol.II, at 435). On the other hand, Germany would regard a *Kommissionär*, but not a broker, as a permanent agent (*ständiger Vertreter*, see *infra* note 226) and tax the principal, and, as mentioned, this could also occur in Switzerland. In the common law states, the United States and Canada did tax the principal on the ground of contracts being made there, although interestingly the United States stated that normally such agents did not conclude contracts, and the United Kingdom had legislation (the Finance Act 1925 quoted above) which prevented taxation in these circumstances.

117. Note the change from *commissionaires* acting *for any number of undertakings* in the 1929 exceptions to the present *for one or more enterprises* which was made in the 1930 draft.

118. The part omitted deals with the evidence of the existence of an employment contract for the purposes of item (2).

119. That this difference is intentional is demonstrated by the fact that in the 1935 draft and the Mexico and London draft conventions of 1943 and 1946 the expression is still translated in one place and not in the other. This point cannot be made in the French text which uses *commissionnaire* in the first and last paragraph, but it is suggested that the difference in the English version is significant. The commentary to the 1929 exceptions clearly states that a *commissionnaire* was intended, but this cannot be the case with the 1927 provision of common law origin. The commentary to the OECD 1963 draft cross-refers to the Protocol to the London and Mexico drafts Article V(3) (the (5) in the English, but not in the French, version is a misprint) which corresponds to the first paragraph of the quotation.

law agent, who is not the same as his civil law counterpart (translated as *commissionnaire*) in the last paragraph.[120] The requirement for the agent to receive the normal rate of remuneration, deriving from UK law, had become attached to the civil law *commissionnaire*.[121]

The 1933 form of the article quoted above remained substantially the same up to and including the Mexico and London draft conventions of 1943 and 1946.[122] The unofficial commentary to the London and Mexico drafts suggests that an agent who has power to make contracts binding the principal is not independent, and so the only exception for independent agents was that covered by the equivalent of the last paragraph in the quotation above.[123] We suggest this is contrary to the historical evolution of the two provisions, although it was true of the 1929 provision which became the last paragraph of the 1933 draft quoted above.[124] The commentary was not official.[125] The foreword stated, "[The commentary] has been prepared by the Secretariat and should not be taken as a statement in all its parts of the views of the Committee."[126] The authors of the commentary may not have appreciated the different origins of the two statements relating to independent agents.

The OEEC first report of 1958, which was copied in the OECD 1963 Draft, modified in the 1977 Model, and which remains unchanged in the 1992 Model, moved away from the earlier approach and adopted essentially its present form with what finally became Paragraph 6 operating as an exception to Paragraph 5. This is indicated by the words in what finally became Paragraph 5 "other than an agent of an independent status to whom Paragraph 6 applies". The OEEC draft read as follows:

> 4. A person acting in a Contracting State on behalf of an enterprise of the other Contracting State – other than an agent of an independent status to whom Paragraph 5 applies – shall be deemed to be a permanent establishment in the first-mentioned State if he has, and habitually exercises in that State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise.
>
> 5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business.[127]

The OEEC and later drafts all adopted, in what is now Paragraph 5, the criterion of the agent habitually concluding contracts, but unfortunately used the expression concluding contracts "in the name of", a concept well known only to civil law, which the League of Nations had rightly avoided.[128] This was coupled with an exception in what is now Paragraph 6 on lines similar to the original 1927 draft, but with further changes in the direction of UK law, by referring to carrying on business, by referring to a *general* commission agent,[129] and by adding the proviso that the independent agents must be acting in the ordinary course of their business. In the end, therefore, Paragraph 6 became almost identical to the 1925 UK legislation.[130] The 1929 exceptions for civil law brokers and *commissionnaires* were dropped. Presumably, civil lawyers considered that they were unnecessary when what is now Paragraph 5 required that the agent conclude contracts in the name of the enterprise before there could be a permanent establishment, whereas under the 1927 League of Nations draft this was merely a case where a permanent establishment was deemed not to exist.

We conclude from this historical survey that Paragraph 6 is the direct descendent of the 1927 provision which, in turn, derived from UK law. We shall use this historical development as part of the context of Paragraph 6 to interpret the expressions "broker" and "general commission agent" in Paragraph 6.

120. Austria-France (1959) attaches the requirement of the independent agent acting in his own name to a provision on the lines of the first paragraph, which seems to be a mixing of the civil and common law provisions which might be expected in a treaty between two civil law countries. This is coupled with a provision stating that an agent without authority to conclude contracts in the name of and on behalf of the principal was not a permanent establishment.

121. Normal remuneration was a requirement for common law agents in the 1927 provision, now the first paragraph of the quotation, because of the words "bona fide agent of independent status," see text *supra* following note 96. It is odd that the requirement should be taken from the commentary and attached to a different part of the article.

122. Apart from some drafting changes. In the London and Mexico drafts in the equivalent of the last paragraph of the draft quoted above it is stated that the same rule applies even if the goods sold have been temporarily placed in a warehouse, thus dealing with the conflict with (3) in the 1933 draft.

123. London and Mexico Model Tax Conventions, League of Nations, 1946, at 16, LHUSTC, at (4336).

124. Compare the statement about some countries' internal law in the League of Nations 1929 Report (see text *supra* at note 103) that the criterion of concluding contracts was admissible but not applicable to every case, LHUSTC at (4197).

125. 1946 at 16, LHUSTC at (4336). The unofficial nature of these commentaries was referred to again by the OECD Fiscal Committee in its *General Remarks and Brief Analysis* of the 1963 Draft in Paragraph 34 at 18: "As these Commentaries have been drafted and agreed upon unanimously by the experts appointed to the Fiscal Committee by the governments of the member countries, they are of special importance in the elaboration of international fiscal law. They are, therefore, a great improvement as compared to the Commentaries on the Mexico and London Model Conventions which were merely a working instrument, prepared by the Secretariat of the League of Nations, which did not commit the Fiscal Committee of that organization."

126. See Foreword, at 6-7, LHUSTC at (4326–7).

127. LHUSTC at (4445).

128. It is odd that this happened at the same time that the predecessor to Paragraph 6 was changed to correspond even more closely to UK internal law than the League of Nations drafts, and so the United Kingdom must have influenced that part of the draft. Possibly the UK representative was familiar with the terminology of contracting in the name of the principal (see the definitions in Jowitt's Dictionary *infra* notes 141, 144) but did not recognize the different significance of the expression in civil law.

129. It is odd that there is no explanation of this in the OEEC commentary.

130. The only differences were that the reference to bona fide was dropped from the text, and the reference to normal remuneration was dropped from the commentary. The expression "ordinary course of business" was used in this context in the United Kingdom – in the Factors Act 1899, s.1(2): "acting in the ordinary course of business of a mercantile agent." As pointed out below in Section V.A.3.c., the UK tax provision says "in the ordinary course of his business as such", which appears to have a meaning different from the Model. The UK tax provision looks at what is ordinary for brokers, etc. generally, whereas the Model looks at what is ordinary for the actual broker, etc. US internal law is similar: "in the ordinary course of his business in that capacity", Reg. Section 1.864-7(d)(3). All Australian treaties (except those with China (1988) and Thailand (1989)) add "...ordinary course of the person's business as such a broker or agent", or, in the case of those with Japan (1969), New Zealand (1972), Singapore (1969), United Kingdom (1967) and United States (1982), "...as a broker, general commission agent or other agent of independent status", which seem to have the same meaning as US and UK law.

V. PARAGRAPH 6 OF ARTICLE 5

A. *Detail of Paragraph 6*

For the exception in Paragraph 6 to apply, the following requirements need to be met:

1. Paragraph 5 must be satisfied

By virtue of Paragraph 5, to which Paragraph 6 is an exception, the agent must have and habitually exercise an authority to conclude contracts binding on the principal. If he does not, there is no permanent establishment even though the requirements of Paragraph 6 are not satisfied, because he does not fall within Paragraph 5.

2. The principal must carry on business (*exerce son activité*) in the other state through the agent

It may be argued that this is not a separate condition as it is inherent in Paragraph 5 that this condition is satisfied since the agent must exercise in the Contracting State an authority to conclude contracts. Until the London and Mexico draft League of Nations conventions, the wording was that the enterprise had business dealings or business relations in the other country.[131] The change to the present wording made in the First OEEC Report of 1958[132] may also have been as a result of UK influence. The United Kingdom makes a distinction between a non-resident person trading in the United Kingdom, who is taxable, and trading with the United Kingdom, who is not.[133] Originally, for a person to be trading in the United Kingdom, contracts for sale had to be concluded in the country by the agent,[134] although by the 1920s the courts were moving away from saying that this was the only test.[135] UK law has to some extent been followed in Canada (although by statute[136] a different test now applies to carrying on business in Canada, but not outside Canada), and to the extent that the concept is relevant in Australia, the UK authorities would be persuasive. There does not appear to be any significance to the place where the contracts are made in the other countries represented in this article.

Carrying on business requires continuity in many countries.[137] In the Netherlands, the normal treaty wording is different from that used in Article 7(1) ("unless the enterprise carries on business in the other Contracting State through a permanent establishment"), although there may be no intended difference.[138]

3. The agent must be one of the following types:

a. *Broker and general commission agent*

Establishing the meaning of these two expressions is one of the most difficult problems of interpretation of the Model. In this section we start by explaining separately the meanings which they have in common and civil law, respectively. The resolution of those different meanings will be left until Section VI.

Common law

In order to understand the meaning in common law[139] of broker and commission agent, which are not expressions in current use in their original sense, it is necessary to look at their meaning in 19th century mercantile law. The following is a quotation from Smith's Mercantile Law: "There are two extensive classes of mercantile agents, namely, factors who are entrusted with the possession as well as the disposition of property, and brokers, who are employed without being put into possession of the goods."[140]

Factors were also called commission agents or commission merchants, although these expressions were frequently used in practice for purchasing agents.[141] Another distinction between factors and brokers that has a superficial similarity to civil law was that the factor (or commission agent) normally sold in his own name[142] without disclosing

131. See text *supra* at notes 94, 118.
132. See text *supra* at note 127.
133. See the references in UK tax law to: *trade carried on in the United Kingdom* or *trade exercised within the UK* (Taxes Act 1988, hereinafter "TA 1988", s.18) and *carries on a trade in the United Kingdom through a branch or agency* (TA 1988, s.11).
134. See e.g. *Maclaine v. Eccott* 10 TC 481. The place of conclusion of the contracts was determined by domestic law as the place at which the acceptance is communicated, so that an acceptance posted in the United Kingdom by the agent would mean that the contract was concluded in the United Kingdom.
135. The test is now "where do the operations take place from which the profits in substance arise" *F.L. Smidth v. Greenwood* (1922) 8 TC 193 at 204, and see *Maclaine v. Eccott* (1926) 10 TC 481, *Balfour v. Mace* (1928) 13 TC 537, *Firestone Tyre & Rubber Co. Ltd. v. Llewellin* (1955) 37 TC 111.
136. Income Tax Act (hereinafter "ITA") s.253.
137. E.g. Canada ITA s.2(2) as interpreted by Revenue Canada in Interpretation Bulletin IT 459, presumably relying on a statement by the President of the Exchequer Court of Canada made "with great doubt about the correctness of the conclusion" in *Tara Exploration Co. Ltd. v. M.N.R.*, 70 DTC 6370, 6376. The correctness of this view has been doubted in respect of isolated transactions that constitute a "business" as that term is defined which includes an adventure in the nature of trade: Canada ITA s.248(1). See Ward's Tax Law and Planning (Toronto: Carswell, looseleaf) at Section 40.1(d). In Australia the expression is used in corporation law as well as income tax law and generally requires a degree of regularity as Australia in its income tax law uses the expression "carried out" in relation to a single adventure in the nature of trade, see *Thiel v. Comr. of Taxation* 90 ATC 4717. In Italy under Article 2082 of the Civil Code an entrepreneur is a person who engages professionally in an economic activity, which requires more than occasional activity.
138. Paragraph 6 says *"zaken doen"*, while Article 7(1) says *"bedrijf uitoefenen"*. The former is ordinary language, while the latter is legal language, which makes it difficult to establish the precise meaning of the former.
139. The expressions were first used in UK tax law in 1915 (see Appendix) which must have been nearly the end of their use in commercial law. See the Karsten report (*supra* note 3) Paragraphs 26, 27 on the differences between common law and civil law brokers.
140. Cited in *Re Henley, exp. Dixon* (1876) 4 Ch.D. 133 at 137; the then current edition of J.W. Smith's Compendium of Mercantile Law was the 8th ed. of 1871. And see *Baring v. Corrie* (1818) 2 B & Ald 137 in relation to factors, and *Fowler v. Hollins* (1872) LR 7 QB 616, at 623 in relation to brokers. See also Bowstead (*supra* note 9), at 23.
141. Jowitt's Dictionary of English Law 2nd ed., (London: Sweet & Maxwell, 1977) under the heading Agency states: "agents employed for the sale of goods or merchandise are called mercantile agents, and are of two principal classes – brokers and factors. A factor is sometimes called a commission agent, or commission merchant; but in practice the latter terms seem to be frequently used to denote an agent who purchases goods for his principal, while 'factor' generally means an agent for sale." In this context the commission refers to the method of payment, cf. the *commissionnaire*, where it refers to the task entrusted to him, see *infra* note 163. For an example of a purchasing commission agent, see *Ireland v. Livingstone*, *supra* note 44). In the context of the Model a sales agent is more likely to be the relevant meaning. See also *supra* note 33 in connection with factors. A report preparatory to the new Quebec Civil Code, makes the point that commission merchants or consignment merchants most closely resemble the former factors but since they had adopted the doctrine of the undisclosed principal in the new code no special provisions were necessary to deal with such agents: Report on the Contract of Mandate (1971), at 8.
142. Here we use the expressions "selling in the name of the principal" or "in his own name" in a descriptive sense which does not affect the liability of the principal.

the existence of his principal, although there was nothing to prevent him from disclosing his principal,[143] whereas a broker sold the goods in the name of his principal.[144] Because the factor (or commission agent) normally sold in his own name and had possession of the goods, legislation was necessary to protect the third party in cases where the factor did not have power to sell. The Factors Act 1899 gave the third party a good title to the goods when the sale was made by the factor "acting in the ordinary course of business of a mercantile agent".[145] This reference to ordinary course of business may have influenced UK internal tax law and, as we have seen, consequently Paragraph 6. No such protection was necessary in the case of a broker because he did not have possession of the goods and could not therefore pretend that they were his own. If a broker sold in his own name, the principal would not be bound because he would be acting outside the scope of his authority.[146] Unfortunately, the stockbroker, the most common type of broker today who sells in his own name, was an exception to these rules.[147] Another relevant meaning of broker was that "...that expression...is used in reference to a class of persons, by the custom of certain markets, [who] are entitled and recognised as being entitled, to act for both purchaser and seller...."[148] The United States also uses the terms in its internal law without any clear meaning,[149] probably because they are copied from the Model.[150] Canada and Australia might come to the same conclusion as the United Kingdom, not by the application of Article 3(2) because the terms are not used in their internal tax law, but as a matter of the ordinary meaning of the terms determined by following UK, Canadian and Australian cases explaining their meaning.

The odd composite expression "general commission agent" derives, as mentioned above, from UK tax law, and first appeared in a Model in the OEEC First Report of 1958.[151] Although the expression is not in use today, it must once have been more commonly used in the United Kingdom. As was said in a case: "I think [the agents] were doing something clearly outside the scope of general commission agents: and, if it is said that at Liverpool people, who are there called commission agents, do this work, I am afraid the only result of it is that I must hold that what is understood by 'general commission agents' by those people is not what the Act of Parliament means...."[152] The aspect which was outside the ordinary scope of a general commission agent was that in this case they accepted bills so that the principal was paid in advance.[153] The word "general" has been interpreted in a later case in the United Kingdom in relation to the internal law provision to mean that the agent works for clients generally, in the manner of a broker.[154] The Revenue argued in that case that the expression covered those who would be brokers if there were a recognized market, and those who deal in a broker-like way with several commodities but because of the generality of their dealings are not described as brokers. It was held that the general commission agent must have broker-like qualities and hold himself out to work for clients generally. The Revenue's argument makes sense in relation to the definition in UK tax law which states that broker includes a general commission agent, but does not give effect to a commission agent being a recognized type of selling agent.[155]

Civil law

Normally a civil law broker (*courtier*)[156] does not enter into contracts at all but merely brings the parties together.[157] But there are examples of cases in civil law where the

143. *Stevens v. Biller* (1883) 25 Ch.D. 31. For tax cases in which the commission agent disclosed his principal, see *Crookston Bros. v. Furtado* (1910) 5 TC 602, 604 (principal named), and *Macpherson v. Moore* (1912) 6 TC 107, 109 (principal's initials on the invoice).

144. Jowitt's Dictionary of English Law (see *supra* note 141) under the heading Broker states: "A broker differs from a factor (and thus from a commission agent) in the following respects: – he generally contracts in the name of his principal, while a factor may buy and sell either in his own name or in that of his principal; he is merely a negotiator between the parties, and is therefore not entrusted with the possession or control of the goods, while a factor is. Stockbrokers are an exception to these rules." See also *Fairlie v. Fenton* (1870) LR 5 Ex.Ch 169, at 172 where Cleasby B. said that "Properly speaking, a broker is a mere negotiator between the other parties and he never acts in his own name, but in the names of those who employ him. When he is employed to buy or sell goods, he is not entrusted with the custody or possession of them, and is not authorised to buy or sell them in his own name. For an example of a broker who, under a trade custom unknown to his principal, acted in his own name in purchasing for several principals and the principal was not bound, see *Robinson v. Mollett*, *supra* note 44. Brokers also dealt in transactions not involving goods, such as stockbrokers and insurance brokers.

145. S.1(2).

146. See *Baring v. Corrie* (1818) 2 B & Ald 137, 148 *per* Holroyd J.

147. See *supra* note 144. Also see e.g., in Manitoba *Re Stoble-Furlong-Matthews Ltd.* (1931) 3 DLR 170, which contrasts the position of a stockbroker with an ordinary broker who is a mere negotiator.

148. *Wilcox v. Pinto* 9 TC 111, 129-30.

149. There are two US Revenue Rulings illustrating the exemption for a commission agent where the treaty wording was "bona fide commission agent or broker": Rev. Rul. 55-617, 1955-2 CB 774 on the former Belgian treaty (1954), and Rev Rul. 56-594, 1956-2 CB 1126 on the former UK treaty (1945). There is also a US case on the same wording in the Swiss treaty (1951) where an independent real estate agent managed property for the Swiss owner who was held not to have a permanent establishment: *Amodio v. C I R.* 299 F.2d 623.

150. See IRC Section 864(c)(5)(A) which is drafted more clearly than the Model with the equivalent of Paragraphs 5 and 6 in the same provision: "...an office or other fixed place of business of an agent shall be disregarded unless such agent (i) has the authority to negotiate and conclude contracts in the name of the non-resident alien individual or foreign corporation and regularly exercises that authority..., and (ii) is not a general commission agent, broker, or other agent of independent status acting in the ordinary course of his business." Independent agents are also referred to in Section 864(b) in relation to trading in securities and commodities: "...through a resident broker, commission agent, custodian, or other independent agent."

151. See text *supra* at note 127.

152. *Boyd v. Stephen* 10 TC 698 at 746, *per* Rowlatt J. The Act referred to was the Finance Act 1915 (then consolidated as rule 10 of the General Rules, ITA 1918), see the Appendix below.

153. See the case in the previous note: "But it does seem to me that this fact of their accepting a bill by which these people were entitled to get their money, in advance, differentiates them entirely, and must differentiate them, from the position of a general commission agent." (*per* Rowlatt J., at 746.)

154. *Fleming v. London Produce* (1968) 44 TC 582. As set out in the text *supra* at note 92, the term broker is defined in the UK TMA 1970, s.82 to include a general commission agent. The only differences between them were whether they contracted in their own name or that of the principal (in a descriptive sense) and whether they had possession of the goods.

155. By 1968 the expression commission agent was no longer in general commercial use.

156. *Makler* (German), *mediatore* (Italian). It is interesting that, according to the Oxford English Dictionary, broker is itself derived from the old French *broceur* or *brocour*, a person who breaks something into small pieces, implying selling a large parcel of a commodity in small parts. A related word *brocanteur* is used in modern French in relation to second-hand goods.

157. E.g. Article 1754 Italian Civil Code: a person who places two or more persons in contact for the purpose of bringing about a transaction, without being connected with either of such parties by way of collaboration, employment or representation, is a broker. It will be seen from this definition that a broker does not have power to conclude contracts (representation). In Germany, see Article 652 of the Civil Code, and in commercial law *Handelsmakler* is used in Article 93 et seq. HGB. In France, see Article 74 of the Commercial Code (and see Rip-

broker contracts in the name of,[158] and therefore binds, the principal, such as the Dutch *makelaar*,[159] the Belgian transport broker and, in practice other brokers.[160]

The meaning of *commissionnaire*, which is the official translation of commission agent, has been dealt with in Section II.[161] It will be recalled that a *commissionnaire* is an agent who normally contracts in his own name and, accordingly, does not bind his principal to the third party, although there are some civil law *commissionnaires* who do contract in the name of, and therefore bind their principals, such as the French and Dutch transport *commissionnaire*.[162] It should be noted that in civil law the commission refers not to the method of payment, as it does in common law, but to the task entrusted to the agent.[163]

We shall postpone until Section VI. the resolution of the problems caused by this substantial difference in meaning of these terms in common and civil law.

b. *Any other agent of an independent status*

Independence is used here in a sense similar to that of an independent contractor in tort in common law.[164] The term "independent" is also used in civil law states. In both it basically means that the person is not an employee, although the criteria are not exactly the same.[165] However, this meaning has not been adopted by the Model because the Commentary[166] explains that it means first that the agent is legally independent, that he is not subject to detailed instructions or to comprehensive control by the principal (which is normally the case for an employee),[167] and secondly, that the agent is economically independent, an important criterion for determining this being whether the agent rather than the principal bears the entrepreneurial risk relating to the agent's activities.[168] This seems to relate to the question whether the agent is running his own business and paying his own expenses, or whether he is in a position similar to an employee having his expenses paid by the principal.[169] It can be assumed from the use of the word "other agent" that brokers and *commissionnaires* are

pert, *Traité de droit commercial*, No. 2394); in Switzerland Article 412 Code of Obligations; in Japan *nakadachinin*, Article 543 of the Commercial Code, which defines a broker by providing that a *nakadachinin* (broker) is a person whose business is to act as an intermediary in commercial acts between other parties. No provisions about brokers are contained in the new Quebec Civil Code on the ground that they merely put the parties in contact with each other: *Report on the Contract of Mandate*, at 8. There are no legal provisions about brokers in the Belgian code, but the accepted meaning is the same as in other civil law countries: a broker is an independent intermediary who is in charge, on a business basis, of bringing together two or more persons in order to allow them to conclude among themselves legal relations to which he is not a party (Van Ryn and Heenen, *Principes de droit commercial*, (hereinafter "Van Ryn"), Vol. IV, 2nd ed, 1988, No. 156, at 117. In practice in Belgium brokers are given power to conclude contracts binding on their principals, in which case the brokerage contract coexists with the *mandat*. In some cases, see *infra* note 160, the contract may become a mixed one of brokerage and *mandat*, or even that the *mandat* becomes the predominant element. See also the Karsten report (*supra* note 3) Paragraph 26.

158. See also the reference in the EC Sixth Directive on VAT in Article 15(14): services supplied by brokers and other intermediaries, acting in the name and for the account of another person.... This implies that there are brokers who bind their principals in civil law countries (see *infra* note 159).

159. Defined as a person who makes his business arranging and concluding contracts by order of and in the name of persons to whom he is not in a fixed relation (Commercial Code Article 62). An example of a real estate broker whose work was so extensive that he did not fall within Paragraph 6 is given in the *Hoge Raad* decision of 21 April 1971 *Beslissingen in Belastingzaken Nederlandse Belastingrechtspraak* (hereinafter "BNB") 1971/110 in which the broker managed a building on behalf of a German owner. The court held that the broker did not act as a broker but as a permanent agent.

160. See the Act of 26 June 1957 relating to the status of auxiliaries in the transportation of goods, Article 1(2). For example, a broker concerned with river-boat chartering habitually has authority to conclude contracts binding on his principal. See *supra* note 157 in relation to other brokers.

161. See *The Conflict of Laws* by Ernst Rebel, 2nd ed. (Ann Arbor: University of Michigan Press), Vol. 3, at 140 where he makes the point that the common law terms agent, factor, broker and commission agent are not identical with any nomenclature of a civil law country.

162. Dalloz, *Nouveau Répertoire de Droit*, at 762; Article 101 Code de Commerce, and see the definition of *commissionnaire* in *supra* note 16. Dutch law is similar, see Article 90 Commercial Code. In Belgium, as in the case of a broker (see *supra* note 157), a transport *commissionnaire* also binds the principal but in doing so is not regarded as acting as a *commissionnaire*, see Van Ryn *supra* note 157, at 16. In the Commentary to the OEEC First Report (Paragraph 19 of Annex B) and to the 1963 OECD Draft (Article 5 Commentary Paragraph 20), but not the 1977 or 1992 Model, forwarding agents (*commissionnaire-expéditeur* in the French) are mentioned as an example of an other independent agent within what is now Paragraph 6 (Article 5(5) of the 1963 Draft). Forwarding agents are also mentioned in the Karsten report (see *supra* note 3) in Paragraph 24 as an example of an indirect representative.

163. See the Karsten report (*supra* note 3) Paragraph 24. This is used in the same sense as a commission in the army, or as in Special Commissioner of Income Tax in the United Kingdom.

164. Basically, the distinction is that an employer is liable for torts connected with the employee's duties, whereas a person who engages an independent contractor is only liable for torts committed in the performance of his contractual duty.

165. The word is used in the same sense in the headings to Articles 14 and 15 of the Model: Independent Personal Services and Dependent Personal Services, respectively. See also the definition of "independently" in the EC Sixth Directive on VAT, Article 4(4) to mean otherwise than under a contract of employment or other legal ties creating the relationship of employer and employee as regards working conditions, remuneration and the employer's liability. An example in some countries of a person who is not an employee but who is not independent is a doctor employed by a health authority. Originally in England they were treated as independent contractors in tort but now they are regarded as employees: Clerk & Lindsell on Torts, 16th ed. (London: Sweet & Maxwell, 1989), Sections 3-12. See, in Netherlands cases where a non-employee is not independent: HR 12 January 1971 BNB 1971/43 (insurance agent), HR 21 April 1971 BNB 1971/110 (real estate broker managing a building), Court of Appeals (*Gerechtshof*) of The Hague 28 March 1983 BNB 1984/279 (sole shareholder of company as agent for the company). In France, the chairmen and directors of SAs are neither independent nor employees (Law No. 66-537 of 24 July 1966, Articles 93 and 107), although for tax purposes they are often treated as employees. In Germany (see Article 84(2) HGB which states that a commercial agent who is not independent is deemed to be an employee) and Italy and Belgium, dependency and employment are synonymous, but see *infra* note 197 for the difficulty of determining the distinction in Belgium in relation to agents. See also in Germany, a decision of the Tax Court of Hanover of 4 July 1991, RIW 1991, 1055 in which key employees of Swiss management consultants working independently as project leaders to head teams of independent specialists contracted for the particular job in the premises of the Swiss corporation. The court held that the project leaders, despite being also employees of the Swiss corporation, qualified as independent agents under the equivalent to Paragraph 6 in the Germany–Switzerland treaty (1971).

166. Article 5 Commentary Paragraphs 37(a), 38.

167. The Commentary is similar to Swiss law and to the approach of Italian authors and courts in deciding whether a person is an employee, and see in France *Jurisclasseur, Droit International*, Vol. 4, fasc. 353-C, Conventions, Définition de l'Etablissement Stable 8, 1983, Paragraph 49. Vogel (*supra* note 71) at Article 5 marginal note 138 and marginal note 169 refers to being personally dependent, meaning accepting instructions of a general nature, as in the case of an employee. It is not clear whether under the Model there can be a category of agent who is self-employed under internal law but still legally dependent.

168. Article 5 Commentary Paragraph 38.

169. See the 1930 League of Nations draft convention for a similar approach: "as evidence of an employment contract...may be taken, moreover, the fact that the administrative expenses of the agent, in particular the rent of premises, are paid by the enterprise." This statement was included in the Protocol to the London and Mexico drafts Article V(5).

always independent.[170] Legal and economic independence has been used in this connection since the 1927 League of Nations Report.[171] An agent of independent status who is relevant for the purposes of Paragraph 6[172] can exist in civil law systems apart from the *courtier* and *commissionnaire* because there is nothing to prevent an independent agent binding his principal,[173] and so falling within Paragraph 5, except possibly in Belgium.[174] A good example of such an independent agent in civil law is given by the German *Bundesfinanzhof* decision[175] in which an insurance broker was presumably independent as it acted for fourteen insurance companies. It concluded contracts binding one of its principals, a Dutch insurance company, by issuing policies, collecting premiums and representing it in court and generally. The court held that the Dutch insurance company did not have a permanent establishment as the agent fell within the exception in Paragraph 6. In the Dutch *Cargadoor* case[176] where a shipping agent concluded contracts binding on the principal, the *Hoge Raad* said that there was nothing to prevent an independent shipping agent binding his principal and still falling within the exception of Paragraph 6, because also included in Paragraph 6 is a broker who did the same, being defined as "a person whose activity is characterized, *inter alia*, by the circumstance that he usually acts in the name of his principal...". The agent did not therefore constitute a permanent establishment of the principal under the Netherlands–Singapore treaty (1971) which followed the Model.

It should be noted that although Paragraph 6 concerns independent agents, Paragraph 5 is not limited to dependent agents. Paragraph 5 also includes independent agents acting outside the ordinary course of their business if they bind their principal. The Commentary confirms this by stating that persons covered by Paragraph 5 are "persons, whether employees or not, who are not independent agents *falling under Paragraph 6*".[177] Both dependent and independent agents who do not have power to bind their principals fall outside Paragraph 5. From the italicized words one can infer that, as Paragraph 6 applies only to independent agents acting in the ordinary course of their business, independent agents binding their principal but acting outside the ordinary course of their business can still form a permanent establishment for the principal if they do this habitually.

Insurance agents

The OECD Commentary mentions that agencies of foreign insurance companies are sometimes outside Paragraph 5[178] and that states may wish to include a specific provision to treat them as permanent establishments. Such a provision was not appropriate to the Model. It was, however, included in the UN Model, which the Commentary to that Model states was required by developing countries because the principal with an independent agent could not be taxed under a treaty following the OECD Model[179] (although, in fact, these are still excluded from the UN Model provision, but the Commentary says that this aspect should be left to negotiations).[180] The UN Commentary also states that dependent insurance agents normally do not have power to conclude contracts,[181] and so are excluded from Paragraph 5, with the result that their principal's business could not be taxed in the host country. The UN

170. The 1963 OECD Draft Article 5 Commentary Paragraph 20 states: "In the Mexico and London drafts and in (numerous other conventions) brokers and commission agents are stated to be agents of an independent status." Note the reference to an agent of independent status in Paragraph 5 which must include brokers and general commission agents. See also the reference to independent agents in Article 7 Commentary Paragraphs 6 and 7. It is suggested that the *genus* is independent agents. Although the *ejusdem generis* rule is not mentioned in the Vienna Convention, Sinclair, *The Vienna Convention on the Law of Treaties*, (2nd ed), at 153 suggests that it can be used in interpreting a treaty. It was not used as an aid to interpretation by the majority of the UK House of Lords in *Buchanan v. Babco* (1978) AC 141, at 160, although Lord Edmund-Davies dissenting at 167 said that there was nothing wrong in applying the rule in interpreting a treaty since he had no reason to believe that it was peculiar to English law.

171. "...absolute independence, both from the legal and economic point of view." Commentary to Article 5, LHUSTC at (4129). The 1963 Draft Article 5 Commentary Paragraph 15 cross-refers to the same passage in the 1928 League of Nations report (LHUSTC at (4166)).

172. See *supra* note 13 for the types of agent concerned.

173. See, for example, Article 1752 of the Italian Civil Code under which a legally and economically independent agent (*agente con rappresentanza*) can conclude contracts in the name of his principal (see Ghezzi, *Contratto di agenzia in Commentario del codice civile, Scialoja e Branca* (Bologna: Zanichelli, 1970), at 16; the French *agent commercial*, see instruction to the Service of 1 December 1985; Japanese insurance and sea transportation commercial agents (Article 46 Commercial Code); and in Germany, see Article 84(1) HGB which defines a commercial agent as an independent entrepreneur who has contracted for an indefinite or definite period of time to solicit business or to conclude contracts in the name of another entrepreneur. EC Directive 86/653 of 18 December 1986. See also the statement of the Swiss tax administration in a case of 23 November 1961: "The question of independent agent with power to act in the name of the foreign enterprise has not yet been decided with respect to the Swiss–German treaty. In principle an independent agent has to act in his own name. Article II, Paragraph 4 of the proposal of the Tax Committee of the OECD [1963] could however have a different meaning." The possibility of an independent agent binding his principal while acting in the ordinary course of his business is noted in the UN First Report on Tax Treaties between Developed and Developing Countries Paragraph 52 where it is stated that this result might not always be satisfactory.

174. See Section V.A.3.b.

175. 30 April 1975, BStBl 1975 II 262.

176. 15 June 1988, BNB 1988/258.

177. Article 5 Commentary Paragraph 32.

178. Article 5 Commentary Paragraph 39. The French version refers more clearly than the English to agencies of a single insurance company and suggests that they might be treated as independent. There is case law in Switzerland to this effect.

179. For an example of this, see text *infra* at note 220.

180. UN Model, Article 5(6) and Commentary. Independent agents were excluded on the basis that developed countries wanted all independent agents to be treated in the same way, and drew attention to the problems which would be caused if an insurance company did business in a state through a number of independent agents. See also UN Second Report on Tax Treaties between Developed and Developing Countries Paragraph 48.

181. See also UN First Report on Tax Treaties between Developed and Developing Countries Paragraph 48. The practice in this respect may have changed: the EC Directive on insurance agents (13 December 1976, EEC/77/92) defines them to include persons who act in the name and on behalf of, or solely on behalf of, their principals, and this seems to be the case in many EC countries apart from the Directive, for example in France they are *mandataires* (Article 1984 Civil Code, see *supra* note 3); in Italy they are *agenti in gestione libera* governed by the general rules on agency in Articles 1742 to 1753 of the Civil Code and the Law of 7 February 1979, No 48 and Decree of 16 January 1981, No. 45, Article 10; in Germany, as normal commercial agents they can conclude contracts in the name of the insurance company, Article 92(1) HGB. In Belgium neither insurance agents (see RPDB, Comp. IV, *Assurances terrestres (contrat en général)* No. 479) nor insurance brokers (Van Ryn, *supra* note 157, No. 159, at 119) have power to conclude contracts. In non-EC countries, including Japan, Switzerland (general agency principles in Articles 418a to 418v of the Code of Obligations), Canada, Australia and the United States insurance agents do have power to conclude contracts (although there may be restrictions in the case of life insurance policies and in the United States an insurance broker does not have such power).

provision deems an enterprise to have a permanent establishment if it collects premiums in the other state or insures risks situated in the other state through an insurance agent other than an independent agent.[182] In other words, this provision has the effect of creating a permanent establishment even though the agent does not have power to conclude contracts binding the principal.

France and Belgium often include specific provisions about insurance agents in their treaties. A number of Belgian treaties exclude insurance agents from the scope of Paragraph 6 either by way of a specific exclusion for them,[183] or by including a provision on the lines of Article 5(6) of the UN Model,[184] which treats an insurance agent who collects premiums or insures risks as a permanent establishment, unless he is independent. However, Belgium varies this to include as a permanent establishment an independent insurance agent contracting in the name of the principal. This seems to be a case of Belgium retaining its internal law charging provision, and hence its treaty interpretation,[185] but only so far as insurance agents are concerned. As a result of this treaty provision, a US Treasury Report states that the United States might treat Lloyd's agents of Belgian residents differently from Lloyd's agents with principals in other states.[186] However, the document states that there is a reasonable argument for treating all Lloyd's agents in the United States as not being independent.

Agents with only one principal

An agent with only one principal is less likely to be economically independent in the sense used in the Commentary,[187] and, in addition, may effectively be an employee and not legally independent.[188] However, the 1933 League of Nations provision quoted above[189] referred to a *commissionnaire* who acts in his own name for *one or more enterprises*, which suggests that a *commissionnaire* might have only one principal; there was at that time the same reference to being economically independent. In the United States, under internal law, an agent acting for one principal but otherwise independent may, depending on the facts and circumstances, still be treated as independent.[190] The same is true in Switzerland where it is accepted that an insurance agent can be independent if he acts for only one insurance company. In the United Kingdom a person will not qualify under internal law as a general commission agent or broker if he has only one principal,[191] but this does not determine whether this is a requirement for any other agent of independent status under the Model. Under German internal law,[192] the definition of commercial agent presupposes that an independent agent can act for one principal only.[193] In the other countries represented the issue is unresolved.

The UN Model deals specifically with this situation by adding a sentence to Paragraph 6: "However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, he will not be considered an agent of an independent status within the meaning of this Paragraph."[194] The reason for this addition was stated in the UN Commentary to be that members from developing countries wanted to broaden the scope of the defini-

182. Examples contained in treaties with countries represented by the writers are: French treaties with: Algeria (1982), Austria (1959), Belgium (1964), Benin (1975), Brazil (1975), Burkina Faso (1965), Cameroon (1976), Central African Republic (1969), Comoro Islands (1970, Congo (1967), Denmark (1957), Finland (1970), Gabon (1966), Germany (1959), Indonesia (1979), Israel (1963), Italy (1958), Ivory Coast (1966), Japan (1964), Lebanon (1962), Luxembourg (1958), Madagascar (1983), Mali (1972), Malta (1977), Mauritania (1967), Morocco (1970), Netherlands (1973), Niger (1965), Norway (1980), Philippines (1976), Portugal (1971), Senegal (1974), Sri Lanka (1981), Switzerland (1966), Spain (death duties) (1963), Togo (1971), Tunisia (1973), United Kingdom (1968), United States (1967); Canadian treaties with: Barbados (1980), Brazil (1984), Indonesia (1979), Ivory Coast (1983), Jamaica (1978), Kenya (1983), Philippines (1976), Tunisia (1982), Zambia (1984); German treaties with: Argentina (1978), Brazil (1975). Egypt (1987), France (1959), Indonesia (1977), Ivory Coast (1979), Jamaica (1974), Kenya (1977), Luxembourg (1958), Philippines (1983), Tunisia (1975); Swiss treaties with: Egypt (1987), France (1966), Indonesia (1988), Ivory Coast (1987); Italian treaties with: Brazil (1978), France (1958), Indonesia (1990), Ivory Coast (1982); Netherlands treaties with: Brazil (1990), France (1973), Indonesia (1973), Philippines (1989), Sri Lanka (1982), Surinam (1975), and within the Kingdom of the Netherlands (1964); Japanese treaties with: France (1964), Indonesia (1982), Philippines (1980); UK treaties with: Belgium (1987), France (1968), Indonesia (1974), Ivory Coast (1985), Jamaica (1973), Kenya (1973), Philippines (1976), Tunisia (1982); US treaties with: France (1967), Indonesia (1988), Sri Lanka (1985), Tunisia (1985); Belgian treaties with: Austria (1971), Brazil (1972), Denmark (1969), Finland (1976), France (1964), Indonesia (1973), Ireland (1970), Israel (1972), Ivory Coast (1977), Korea (1977), Philippines (1976), Sweden (1965), Thailand (1978), Tunisia (1975), United Kingdom (1987). It is not used in any Australian treaties.

183. The exclusion is on the basis that the independent insurance agent concludes contracts in the name of the principal, see Belgian treaties with: Germany (1967), Luxembourg (1970), Morocco (1972), Netherlands (1970), Norway (1988), Spain (1970), Switzerland (1978), United States (1970).

184. Following the suggestion in OECD Article 5 Commentary Paragraph 39. For a list see *supra* note 182.

185. See Section V.A.3.b. The Belgian official commentary on its tax treaties at 5/505 considers that even in the absence of specific provisions in the treaty an insurance agent with power to conclude contracts binding on the principal is a permanent establishment on the basis that he is acting outside the ordinary course of his business.

186. Treasury Report to Congress on the taxation of income earned by members of insurance or reinsurance syndicates of Lloyd's of London, *Daily Treasury Documents*, 24 February 1989.

187. See *supra* note 166.

188. Vogel (see *supra* note 71), Article 5 marginal note 170. Vogel regards an agent with only one principal as automatically economically dependent. In German internal law, under Article 92(a) HGB a commercial agent who is either prohibited from acting for other principals, or where acting for other principals is not possible in the circumstances, is still regarded as independent and not an employee, although he enjoys certain protection, such as minimum remuneration rules. In Italy an agent with one principal may be treated as an employee, see Baldi, *Il contratto di agenzia* (1987), at 69. In the United Kingdom it was accepted that a factor could act for only one principal in *Lowther v. Harris* (1927) 1 KB 393.

189. See text *supra* at note 118.

190. Reg.1.864-7(d)(3)(iii).

191. *Fleming v. London Produce* 44 TC 582, at 597.

192. Article 84(1) HGB.

193. The German *Bundesfinanzhof* (30 April 1975, BStBl 1975 II 262) stated that a German insurance agent acting for a Netherlands insurance company and 13 other domestic and foreign insurance companies was demonstrably independent, which suggests that the number of principals was considered relevant.

194. A number of treaties with developing countries therefore include such a provision, e.g. (limited to countries represented by the authors): Australian treaties with: China (1988), Philippines (1979), Thailand (1989); Belgian treaties with: China (1985), Indonesia (1973), Ivory Coast (1977), Pakistan (1980), Philippines (1976), Sri Lanka (1983), Thailand (1978) (this treaty also covers the case where the agent's activities are limited to acting on behalf of the enterprise and other enterprises controlled by or controlling it); Canadian treaties with: China (1986), Egypt (1983), India (1985), Indonesia (1979) Ivory Coast (1983), Kenya (1983), Papua New Guinea (1987), Zambia (1984); French treaties with: China (1984), Indonesia (1979), Trinidad (1987); treaties between Germany and: Kuwait (1987); Italian treaties with: China (1986), Indonesia (1990), Kenya (1979), Pakistan (1984), Philippines (1980) (which limits this

tion of permanent establishment.[195] Although this change cannot be used to interpret the OECD Model, it does suggest that the members from developed countries were not convinced that the same result would arise under the OECD Model.

Can an independent agent concluding contracts binding the principal exist in Belgium?

Belgian internal tax law does not accept that it is possible for an agent to be both independent and make contracts binding on the principal,[196] although there is nothing to prevent this in Belgian civil law, as is shown by the existence of the *représentant de commerce autonome* [197] and confirmed by the EC Directive on commercial agents which defines commercial agent to include self-employed (*indépendant* in the French text) intermediaries who negotiate and conclude transactions for the sale and purchase of goods on behalf of, and in the name of, the principal.[198] The tax law jurisprudence dates from before the creation of the *représentant de commerce autonome*. The same interpretation as is given to internal tax law seems to be given by the Belgian tax authority to Paragraph 6 in its treaties,[199] presumably by applying Article 3(2) of the Model so that independent agent has the same meaning as it has under internal tax law. Paragraph 6 therefore has no effect in Belgium since none of the agents that the Belgian tax administration considers to be covered by Paragraph 6 bind their principals and so they would not fall within Paragraph 5. In connection with insurance agents, the Belgian commentary on its tax treaties[200] states that if the agent binds the principal, he is no longer independent (presumably this is a shorthand way of saying that he is no longer excepted by Paragraph 6, since this has nothing to do with independence as explained by the Commentary) as he is acting outside the ordinary course of his business as an independent agent.[201] This remark implies that it is no part of the ordinary course of business of an independent agent to make contracts binding on the principal,[202] which is understandable from the point of view of Belgian internal tax law under which this does not occur, but it is not clear why this should be so generally under the Model. The tax authority's view has been criticized by Hinnekens[203] in cases where the independent agent acts for numerous principals, which is likely to be the situation in practice. It is therefore considered that there may be no reason why a Belgian independent agent who has authority to conclude contracts binding on his principal should not be excluded by Paragraph 6.

c. *The agents must be acting in the ordinary course of their business (agissent dans le cadre ordinaire de leur activité)*

We have already referred to an historical use of a similar phrase "acting in the ordinary course of business of a mercantile agent" in the Factors Act 1899[204] in the United Kingdom.[205] This expression meant the ordinary course of business of a mercantile agent in general, not of a mercantile agent in the trade in question and looked at the question whether he was "acting in such a way as a mercantile agent acting would act: that is to say, within business hours, at a proper place of business, and in other respects in the ordinary way in which a mercantile agent would

rule to cases where the transactions between the principal and agent are not made on arm's length conditions); Japanese treaties with: Indonesia (1982), Thailand (1990) (this treaty also covers the case where the agent's activities are limited to acting on behalf of the enterprise and other enterprises controlled by or controlling it); Netherlands treaties with: China (1987), India (1988), Nigeria (1991), Pakistan (1982) (this treaty also covers the case where the agent's activities are limited to acting on behalf of the enterprise and other enterprises controlled by or controlling it); Swiss treaties with: China (1990), Indonesia (1988), Sri Lanka (1983), Trinidad (1973); UK treaties with: China (1984), Ghana (1977), Indonesia (1974), Jamaica (1973), Kenya (1973), Pakistan (1986), Philippines (1976), Trinidad (1982); US treaties (all if the conditions are not at arm's length) with: China (1984), India (1989), Jamaica (1980), Philippines (1976), Sri Lanka (1985).

195. UN Commentary to Article 5, Paragraph 7. See also UN First Report on Tax Treaties between Developed and Developing Countries Paragraph 51 from which it is clear that the point arose out of discussion of the OECD Model. It is recorded that some members from developing countries agreed that it was unsatisfactory that exclusive agents did not constitute a permanent establishment. And see UN Second Report Paragraph 40.

196. Article 140 Section 3 CIR excludes independent agents acting in their own names and at their own risk without intervention from the foreign enterprise from constituting a Belgian permanent establishment.

197. An independent agent who for remuneration is in charge of negotiating and, possibly, concluding an indefinite number of commercial contracts in the name and for the account of a business enterprise of which he is not an employee (Van Ryn, *supra* note 157, No. 168, at 126). This is very similar to the definition in the EC Directive (see *supra* note 198). It is not easy to distinguish such an agent from an employee who is a sales representative (Article 87, Act of 3 July 1978), the definition of which excludes a commercial agent who does not act under the authority (*sous l'autorité de*) of his principal (Article 4, third paragraph), particularly as an agent who concludes contracts in the name of his principal is deemed to act under an employment contract until the contrary is proved (which requires evidence that he does not work under the authority of the principal) (Articles 4, Paragraphs 1 and 2). Several decisions treat an agent who had power to conclude contracts as having a *mandat* and therefore not independent (Anvers, 13-2-1980; RDC, 1983, 351). P. Foriers considers that the importance of the acts done by the agent should exclude this classification (*Le droit commun des intermédiaires commerciaux, courtiers, commissionaires, agents* in *Les intermédiaires commerciaux* (Paris: Ed. du Jeune Barreau, 1990, at 122). Van Ryn considers that the agency contract has an original character which does not fit into one of the categories of civil law (Van Ryn, *supra* note 157, No. 171, at 128).

198. 18 December 1986, EC/86/653. This is not yet in force in Belgium, although it should have been since 1 January 1990. It does not come into force in the United Kingdom until 1 January 1 1994 and so one cannot yet tell how this will be legislated in English law. The full definition of commercial agent is: "a self-employed intermediary who has continuing authority to negotiate the sale or the purchase of goods on behalf of another person, hereinafter called the 'principal', or to negotiate and conclude such transactions on behalf of and in the name of that principal."

199. Paragraph 5/502.

200. Paragraph 5/505.

201. One could argue that Belgium, in changing a number of its treaties (see *supra* note 183) to exclude from Paragraph 6 an insurance agent who has an authority to conclude contracts in the name of the principal, is accepting that agents with such an authority are within Paragraph 6. Belgium would presumably argue that the addition is a statement of what they see as being the position anyway, but it is odd that only Belgium makes this change.

202. The Belgian official commentary on its treaties states at Paragraph 5/503 that an agent is acting outside the ordinary course of his business if he performs a complete cycle of operations for the account of the enterprise, processes or converts goods, discloses the name of the enterprise, or is an employee or under the control of the enterprise, all of which derive from internal law.

203. "De hervorming van de niet verblijfhoudersbelasting" ("The Reform of the Non-residents' Tax"), AFT 1990, at 80-81, and see M. Hürner, "Tax Liabilities of a Foreign Seller of Goods Using Commercial Intermediaries in Belgium", 23 *European Taxation* 1982, at 347.

204. See *supra* note 100. Factors Act 1899, s.1(2). Note that the Act does not refer to *his* business. It is likely that the use of this expression in the context of agents influenced the UK tax law provision which in turn influenced Paragraph 6.

205. Although the Factors Act did not extend to Scotland there was a similar Act in Scotland, the Factors (Scotland) Act 1890.

act....."[206] The test therefore looked at what was normal in the broadest sense. The UK 1925 tax law quoted above,[207] which we have argued was the ultimate source of Paragraph 6, referred to transactions carried out "through a broker [or general commission agent][208] in the ordinary course of his business as such."[209] The addition of "as such" suggests that it means in the ordinary course of a normal broker's or general commission agent's business, and this interpretation is supported by case law:

> I think they were doing something clearly outside the scope of general commission agents: and, if it is said that at Liverpool people, who are there called commission agents, do this work, I am afraid the only result of it is that I must hold that what is understood by "general commission agents" by those people is not what the Act of Parliament means.....[210]

US internal law is similar: "in the ordinary course of his business *in that capacity*".[211] Many Australian treaties make an amendment to the Model with similar effect.[212] These examples look at the norm for brokers and commission agents in general, which is narrower than the Factors Act, but is still unrelated to the attributes of the agent's own business. One can see the logic of this. So long as the broker or general commission agent is acting for the principal in the ordinary way, the principal has insufficient penetration into the other state to warrant taxing him; the only business carried on in the other state is that of the broker or general commission agent, rather than the principal, and is no different from the business done by the agent for other residents of that state.[213] But when the broker or general commission agent goes outside the norm for such an agent, at least when he does something extra,[214] the principal then has a greater connection with the other state which justifies taxing him as a person doing business in that state. One can argue that as a test it is not perfect because if brokers of type A normally do certain transactions that brokers of type B never do, the principal will not be taxed if he uses a type A broker for such a transaction, because the transaction is ordinary for such a broker, but, if he uses a type B broker, he will be taxed, because the transaction is outside the ordinary course of business of a type B broker. However, this is unlikely to cause problems in practice, and the principal has no cause to use the wrong type of broker. It can also be argued that the test inhibits change because when one broker performs a new transaction or adopts a new practice this will result in the principal having a permanent establishment, until it becomes normal for other brokers to perform the same transaction or use the same practice.

These precedents have not been followed by the OECD[215] which changed the wording to refer to the ordinary course of the broker's own business, rather than the business of a normal broker. Paragraph 6 says "provided that such persons [broker, general commission agent and any other agent of an independent status] are acting in the ordinary course of *their business*," which is ambiguous, but the Commentary clarifies the point by referring to *his* business.[216] The Commentary explains this as follows:

> Persons cannot be said to act in the ordinary course of their own business if, in place of the enterprise, such persons perform activities which, economically, belong to the sphere of the enterprise rather than to that of their own business operations.[217]

The German *Bundesfinanzhof*[218] has supported this approach, pointing out the reference to *his* business, so long as the transaction was within the scope of activities normally performed in the industry concerned, rather than whether it was customary for similar agents in the industry to perform that transaction. In the particular case, a German shipping agent leased containers on behalf of (and concluded contracts binding on) a US principal, which was not at that time common for shipping agents to do. Nevertheless, they were acting in the ordinary course of their own business.[219] In other words, leasing containers was related to the shipping industry even though it was not normal at that time for shipping agents to be involved with this. In another German case, an agent who acted for fourteen insurance companies was held to be acting in the ordinary course of his business in concluding transport insurance contracts.[220] Against this interpretation is a Dutch decision[221] in which the *Hoge Raad* said, without giving reasons, that the question was not whether the activities fell within the normal pattern of activities of the particular broker, but whether the activities fell within the normal activities of insurance brokers in general (which selling insurance policies in standard form in the name of a US company at the airport did not). A South African case also looked at what was normal for stockbrokers in general,

206. *Oppenheimer v. Attenborough* (1908) 1 KB 221, at 230, *per* Buckley LJ. In that case a diamond merchant gave a diamond broker diamonds to show to potential purchasers. The broker pledged them, which was not within the usual authority of a diamond broker, but nevertheless the pledgee obtained a good title. See Bowstead (*supra* note 9), at 370.
207. See text *supra* at note 92.
208. Broker is defined to include a general commission agent, see text *supra* at note 93.
209. TMA 1970, s.82(1). There are other similar references in UK tax law, such as interest may be paid gross by a bank carrying on a bona fide banking business in the United Kingdom in the ordinary course of that business in TA 1988, s.349(3)(*b*), which, in Statement of Practice SP 12/91, the Revenue interprets as meaning in the ordinary course of that business, having regard to UK banking practice generally.
210. *Boyd v. Stephen* 10 TC 698, at 746 *per* Rowlatt J.
211. Reg. Section 1.864-7(d)(3).
212. All Australian treaties (except those with China (1988) and Thailand (1989)) add "...ordinary course of the person's business as such a broker or agent," or, in the case of those with Japan (1969), New Zealand (1972), Singapore (1969), United Kingdom (1967) and United States (1982), "...business as a broker, general commission agent or other agent of independent status," which seem to be the same as US and UK law.
213. The UK provision quoted above also requires payment of the normal rate of remuneration.
214. If he does less than the norm, everything which he does is within the ordinary course of a normal agent's business.
215. The expression "ordinary course of his business" was first used in the OEEC First Report of 1958. None of the League of Nations drafts had used it.
216. Article 5 Commentary Paragraphs 36, 37.
217. Article 5 Commentary Paragraph 38. See also the reference to an enterprise with a permanent establishment participating in the economic life of the other state in Article 7 Commentary Paragraph 30. The Commentary seems to limit the concept of acting outside the ordinary course to doing something extra for the principal.
218. 23 September 1983, BStBl 1984 II 94.
219. Vogel, Article 5 marginal note 172 refers to the normal custom in the case in issue, rather than an abstract vocational profile; but this is not normally governed by the agent's arrangements with other principals; nor need the custom be universal in the trade, such as hiring containers when containerization was being introduced.
220. BFH BStBl II 626 (1975).
221. 13 January 1971, BNB 1971/43.

rather than the activities of the particular stockbroker.[222] In spite of these differences in approach it will often not make any difference to the result since the agent's acts will also be normal for other agents in the industry concerned. In civil law countries where the business of each type of agent is laid down in the commercial code, it is easier to determine whether he is acting in the ordinary course of his business.

One reason for the OECD's reference to the agent's own business may be that the expression "ordinary course of his business" includes the requirement that the agent should be earning the right commission for the work which he performs, rather than for the services which others perform.[223] According to one view, as long as the agent is independent and properly remunerated there is no point in trying to tax the principal because the agent's remuneration represents the whole profit which should be taxed in the agent's state even if the agent constituted a permanent establishment of the principal in that state.[224] This argument would not apply to the UK tax provision[225] as it refers both to ordinary course of business as such and to customary remuneration, implying that it is possible for an agent to be acting in the ordinary course of business and still receive less than the customary remuneration.

The Commentary goes on to give an example, which illustrates a different point, of a commission agent (clearly referring to a *commissionnaire*) who not only sells goods in his own name, which is normal for a *commissionnaire* and means that the transaction cannot be within Paragraph 5, but also habitually acts as a permanent agent[226] having an authority to conclude contracts [by implication binding the principal] which brings him within Paragraph 5.[227] By acting as a permanent agent[228] and concluding contracts that bind the principal,[229] (something which a normal *commissionnaire* never does) he is acting outside the ordinary course of his business as a *commissionnaire*. He is thus not excepted by Paragraph 6, and he thus creates a permanent establishment for his principal. The Dutch Lower Court in the *Cargadoor* case was reversed because it had applied this statement in the Commentary about *commissionnaires* to other independent agents (in that case shipping agents).[230] This example illustrates that a comparison of the transaction in question with the agent's own business (a *commissionnaire* in the Commentary) still creates problems when the wrong type of agent is used by the principal. If the principal had not used a *commissionnaire* but another type of independent agent who normally did bind his principal the transaction would have been in the ordinary course of that agent's own business and the principal would not have had a permanent establishment.

But there are many more problems to this test. For example, a transaction may, when the first one of its type is carried out by the agent and used for a particular principal, be abnormal for the agent in question and thus create a permanent establishment for that principal, and gradually become one in the ordinary course of his business for the agent concerned when he does the same transaction for all his principals, after which there is no longer a permanent establishment.[231] On the other hand, normality from the point of view of the agent's own business can be said to determine more accurately whether the transactions belong economically to the sphere of the enterprise rather than to that of the agent's own business operations, which is the test the Commentary set out to apply.[232] All transactions which are normal to the agent's own business belong naturally to the sphere of the agent's business, rather than that of the principal, however abnormal they may be from the point of view of agents generally. There is also the practical point that, if the agent is independent and properly remunerated, it could be argued that there is no point in taxing the principal as the amount of profit would be nil; but on this basis one would have expected the test to be based on proper remuneration, rather than ordinary course of business. The problem of this analysis is that it does not measure the degree of penetration of the principal's business operations into the agent's state, which is the logic and purpose of the UK law, and which seems to us to have more validity in determining whether there is a permanent establishment.

If the agent is acting outside the ordinary course of his business, so that the condition for the application of Paragraph 6 is not satisfied, one needs to go back to the begin-

222. *Secretary of Inland Revenue v. Downing* (1975) 37 SA Tax Cases 249.

223. The commentary to the original League of Nations 1927 provision (see *supra* note 96) and the text of the 1929 exceptions (see *supra* note 108, 111) referred to the normal rate of commission in connection with a *commissionnaire*, but ordinary course of business was not used in a Model treaty until the 1958 OEEC draft (see *supra* note 127).

224. See *supra* note 98. For an example of the contrary view, see United Kingdom – Australia (1967) Article 5(4) which provides for sales profit on goods manufactured in the other state to be determined on the basis of a wholesaler's profit less expenses of transport and sale.

225. See text *supra* at note 92.

226. Permanent agent is a defined term in tax law in Germany and Austria (*ständiger Vertreter*) and is also used, but not defined in the Netherlands (*vaste vertegenwoordiger*, Article 49 Individual Income Tax Act) tax law, and Switzerland (Article 6 Federal Direct Tax Act: *représentations permanentes, Ständige Vertretungen, rappresentanze permanenti*, and it is used in the *Circulaire de l'Administration fédérale des contributions du 29 juin 1959*). In Germany it means an agent who consistently conducts business transactions on behalf of an enterprise and is committed to abide by the instructions of the enterprise. We surmise that this part of the Commentary was originally drafted by a German (or Dutch or Swiss) author and approved by the Fiscal Committee without realizing that permanent agent was a term of art. The expression is used in the Switzerland – Netherlands treaty (1951) Article 4(2) and was also used in the former Germany -Italy (1925) and Germany – Switzerland treaties (1931) (see Vogel (*supra* note 71) Article 5 marginal note 160). There is an early use of *permanent representative* (which is presumably the same expression) in the League of Nations 1925 Report, LHUSTC at (4091), and in the commentary to the original 1927 draft convention, LHUSTC at(4129).

227. Article 5 Commentary Paragraph 38. This example originated in Paragraph 19 of the commentary to the permanent establishment article in the OEEC First Report of 1958.

228. This also suggests that he is not independent, see *supra* note 226.

229. Note that it is because he concludes contracts in the name of, and accordingly binds, the principal, and not merely because the *commissionnaire* is acting outside the ordinary course of his business that he is within Paragraph 5 and constitutes a permanent establishment.

230. See text *supra* at note 176. The Netherlands Supreme Court stated that brokers can act in the name of the principal and brokers were given as an example of an independent agent in Paragraph 6, so there was no reason why another independent agent should not do so.

231. The point can be made that the first example of a business practice which is subsequently continued can be treated as part of the ordinary course of business. However, a practice may start by being exceptional and only later become normal, in which case it is harder to say that the exceptional practice is part of the later normal course of business.

232. Article 5 Commentary Paragraph 38, see text *supra* at note 217. If the agent does something extra for a principal he is carrying out that aspect of the principal's business, which is not part of his own business.

ning and ask whether the agent habitually concludes contracts binding on his principal, as only if he does so can there be a permanent establishment within the meaning of Paragraph 5.[233] Thus, there will be a permanent establishment if he habitually contracts in the name of the principal but not if he contracts in his own name under civil law, but there will be in all cases in common law. In this respect the Model does not achieve the same result under each system.[234]

B. *Parent and subsidiary*

Although not part of Paragraph 6 it is convenient to mention here Article 5(7) of the Model (see below).

In cases where the subsidiary is not acting as an agent of the parent (or vice versa) but as a principal, this provision will not apply. Where it does apply, however, the Commentary explains that the same test is used as for an independent party to determine whether the subsidiary creates a permanent establishment for the parent: the subsidiary must not be independent and must have and habitually exercise an authority to conclude contracts binding the parent.[235] Thus there can be cases in which the subsidiary is sufficiently independent of the parent to constitute an independent agent.[236] Presumably this arises where the parent is but one of many principals and, in these circumstances, the fact that the parent can, in the last resort, dictate to the subsidiary does not affect the particular agency business since the subsidiary can be economically independent when carrying on the agency business. This provision may have been inserted to prevent the German theory which considers a subsidiary to be dependent on its parent from applying.[237]

1992 OECD Model: Article 5(7)

The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.	Le fait qu'une société qui est un résident d'un Etat contractant contrôle ou est contrôlée par une société qui est un résident de l'autre Etat contractant ou qui y exerce son activité (que ce soit par l'intermédiaire d'un établissement stable ou non) ne suffit pas, en lui-même, à faire de l'une quelconque de ces sociétés un établissement stable de l'autre.

VI. THE INTERACTION BETWEEN PARAGRAPHS 5 AND 6 OF ARTICLE 5

A. *Interpretation derived from Article 3(2) of the Model*

We have seen that in both civil and common law states, with the possible exception of Belgium,[238] independent agents do exist who make contracts binding on their principals.[239] In both legal systems the effect of Paragraph 6 is to except such agents from constituting permanent establishments under Paragraph 5; on this basis the interaction between Paragraphs 5 and 6 does not give rise to any problem. For similar reasons, in common law countries the inclusion in Paragraph 6 of brokers and general commission agents, so long as these are understood in the sense of English law, has the same effect. The problem arises in civil law states from *courtiers* and *commissionnaires* being included in Paragraph 6 in the company of other independent agents, because neither *courtiers* nor *commissionnaires* make contracts binding on their principals and so do not need to be excluded from Paragraph 5.[240]

We must now endeavour to resolve the differences in meaning between broker and general commission agent and their civil law equivalents[241] as a matter of the proper interpretation of the Model, or rather of a treaty in the same form as the Model in English and French. The differences are important and go to the root of how Paragraphs 5 and 6 fit together, and they will have a considerable effect if countries apply Article 3(2) of the Model,[242] under which, unless the context otherwise requires, undefined terms have the meaning that they have in internal tax law, to determine the meaning of the terms "broker" and "general commission agent" in a treaty following the Model. We discuss three possible interpretations derived from the application of Article 3(2), as follows.

1. Common law

In the United Kingdom, brokers and commission agents, who at the time the League of Nations first introduced these provisions comprised the two main classes of sales agents, to which are added other independent agents, all fall within Paragraph 5 as they bind their principals, but are by Paragraph 6 prevented from constituting a permanent establishment. The effect of the application of Article 3(2) in the United States, which also uses these expressions in its internal tax law, is less clear, and Canada and Australia do not use the expressions in their internal tax law.

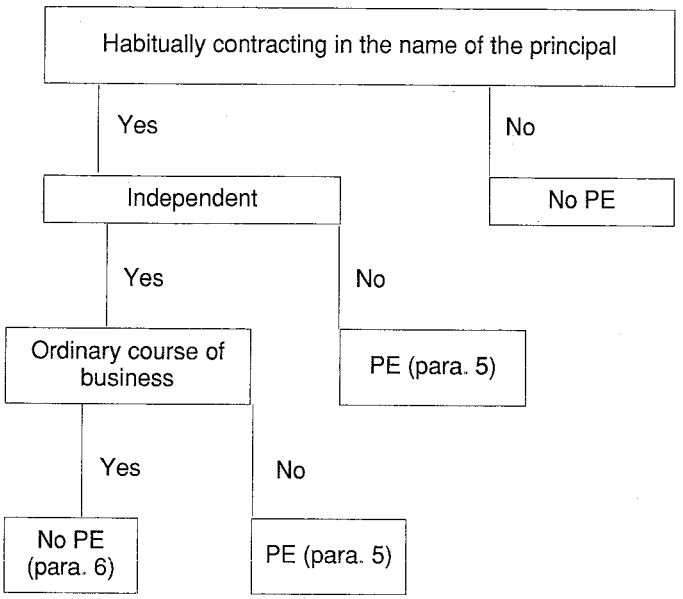
2. Civil law

If one applies Article 3(2) in civil law countries, such as France,[243] Belgium[244] or Italy,[245] which use the terms

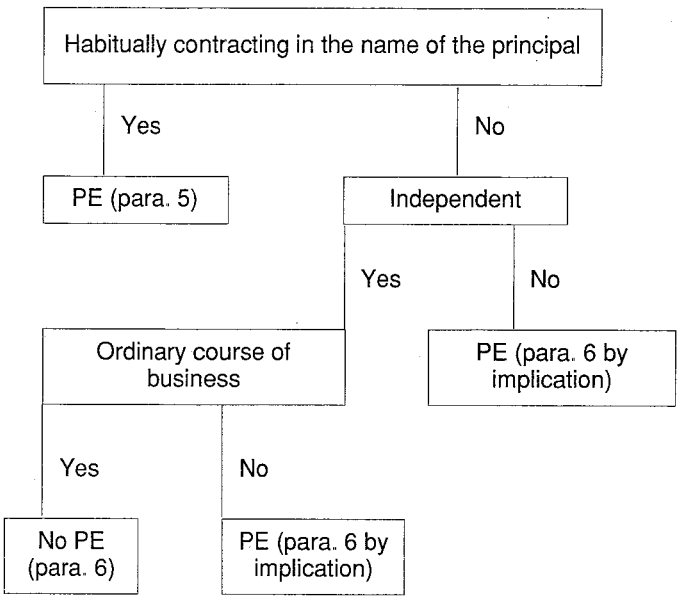
233. This point is also made by Vogel (see *supra* note 71) Article 5 marginal note 174.
234. We consider and reject an alternative interpretation in the text *infra* at note 248, that an independent agent who is acting outside the ordinary course of his business but not binding the principal impliedly constitutes a permanent establishment.
235. Article 5 Commentary Paragraph 41.
236. Article 5 Commentary Paragraph 38 states that the fact of ownership of the capital of the subsidiary does not make it dependent.
237. See the General Report of Professor Bühler in 1954 IFA Cahiers, and Vogel (*supra* note 71) Article 5 marginal note 191.
238. See Section V.A.3.b.
239. See Section V.A.3.b.
240. Apart from the exceptions already noted, see *supra* notes 159, 162.
241. See Section V.A.3.a. and Section II.
242. See the authors' "*The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the Model*", 1984 *British Tax Review*, at 14 and 90.
243. *Courtier* is used in the French Tax Code in Articles 261 C(2), 1002, 1003, 867-IV, 876 and Annex II Article 310 HC. *Commissionnaire* is used in Annex II Article 310 HC. The expressions are not used in relation to a tax normally covered by its tax treaties in the Netherlands. In Germany they are used in Section 222(1) of the Income Tax Regulations.
244. Article 140(3) Code Impôts sur les Revenus (hereinafter "CIR"); Article 229(2) CIR 1992.
245. Article 25 *bis* of Presidential Decree of 29 September 1973, No. 600.

DIAGRAM

Nos. 1 and 2: common law and civil law



No. 3: alternative civil law



courtier and *commissionnaire* in their internal tax law in relation to a tax covered by tax treaties, one might wonder why these terms were included in Paragraph 6 at all, since neither of them are permanent establishments within Paragraph 5 because they do not make contracts binding on their principals. Therefore, there is no need for them to be excluded from Paragraph 5.[246] However, "other independent agents" as we have seen, with the possible exception of Belgium, do bind their principals and fall within Paragraph 5 and therefore need to be excluded by Paragraph 6 from being permanent establishments. The result of this interpretation is therefore the same as under common law except that the references to *courtiers* and *commissionnaires* are redundant. This might possibly be explained by the fact that they were included for common law reasons.

3. Alternative civil law

The third possibility is that the inclusion of *courtiers* and *commissionnaires* in the company of other independent agents might lead readers from civil law countries to conclude that the other independent agents in Paragraph 6 should share one of the qualities as *courtiers* and *commissionnaires*, other than the quality of independence,[247] namely that they do not conclude contracts binding on their principals.[248] This results in a very different interpretation of Paragraph 6, namely that it is not an exception to Paragraph 5 at all but an independent provision stating who does not constitute a permanent establishment and by implication, who does.[249]

Diagrammatically the main differences between these three interpretations can be shown in the diagram above.

B. *Resolution of the two civil law interpretations*

We first consider which of the two civil law alternatives shown in the diagram is to be preferred, and we shall then consider the difference between the interpretation of Nos. 1 and 2. This analysis will also be applicable to those countries that do not use the expressions "broker" or "general commission agent" in their internal tax law, so that Article 3(2) is not applicable. Under Article 31 of the Vienna Convention on the Law of Treaties (hereinafter "Vienna Convention"), a treaty is to be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. If one looks at the context of the wording of the Model, Paragraph 6 is, because of the words in Paragraph 5 "other than an agent of an independent status to whom Paragraph 6 applies," stated to be an exception to Paragraph 5, which is the case with interpretations Nos. 1 (in relation to all three types of agent) and 2 (in relation to independent agents only), but not the case in relation to any of the agents in 3. On the other hand, the OECD Commentary states:

> Although it stands to reason that such an agent [broker, general commission agent or any other agent of an independent status], representing a separate enterprise, cannot constitute a permanent establishment of the foreign enterprise, Para-

246. See Austria – Germany (1954) protocol Article 10(c) for an example of a treaty which covers this case by providing that a commission agent, broker or other independent representative acting outside the ordinary course of his business is a permanent establishment.

247. On the basis of the maxim *noscitur a sociis*.

248. This interpretation may have applied to the League of Nations drafts, see the 1929 report about various states' internal law (*supra* note 103), the 1929 exceptions (see text *supra* at notes 108, 111) and the unofficial commentary to the London and Mexico drafts (*supra* note 123).

249. For an example of this approach, see the Belgian official commentary on its treaties at Paragraph 5/502 states that Paragraph 6 confirms their internal tax law (Article 140(3) CIR) under which *courtiers* and *commissionaires* acting in their own name and at their own risk do not normally constitute a permanent establishment of their principals when acting in the ordinary course of their business.

> graph 6 has been inserted in the article for the sake of clarity and emphasis.[250]

This suggests a less significant role for Paragraph 6, corresponding to interpretation No. 3 on the right hand side of the diagram. The question is then how much weight should be given to the Commentary? One possibility is that it might be regarded as an instrument made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty which under the Vienna Convention is treated as part of the context of the Model.[251] If this is right, there are two conflicting aspects of the context which appear to be irreconcilable. Perhaps the Commentary is really saying that it stands to reason that an independent agent, because he is operating his own business, should not constitute a permanent establishment, with which we entirely agree, and one should not place too much emphasis on the last words which suggest that Paragraph 6 is unnecessary. Another possibility is that the Commentary might be regarded as a supplementary means of interpretation. If so, under Article 32 of the Vienna Convention, the Commentary cannot be used to contradict the meaning derived from applying Article 31 except where this meaning is ambiguous or obscure, or leads to a manifestly absurd or unreasonable result. We do not consider that application of Article 31 leaves the meaning ambiguous or obscure even though in civil law the references to *courtier* and *commissionnaire* appear to be redundant. The result of applying interpretations Nos. 1 and 2 is not manifestly absurd or unreasonable; it fits Paragraph 5 and 6 together in a way that is consistent with the words in Paragraph 5 referring to Paragraph 6. While it might be said to be a serious matter to suggest departing from the meaning of the Commentary which has been approved by all the members of the Fiscal Committee, including those from common law countries (even though the meaning derived from the Commentary may be implied rather than stated specifically), the Commentary is also a commentary to the English text and it is difficult to see how the statement, if it really means that Paragraph 6 is unnecessary, can possibly be true either in common law countries, in relation to any agents, or civil law countries, in relation to independent agents who do make contracts binding their principals. For these reasons we favour the interpretation on the left hand side of the diagram in spite of the Commentary.

C. *Resolution of the interpretation between common and civil law*

We next consider which one of interpretations Nos. 1 (common law) and 2 (civil law) is to be preferred. For the reasons already given, interpretation No. 1 is more in accordance with the context since three types of agent are named, all of whom need to be excluded by Paragraph 6, while under interpretation No. 2 only independent agents are excluded and the references to *courtier* and *commissionnaire* are redundant. In resolving this question we have the added difficulty that the two languages of the Model do not have the same meaning. In the official French version of the Model the expressions used (*courtier* and *commissionnaire*) clearly refer to the civil law meaning; and in the English, broker and commission agent probably have the meaning derived from common law, or at least English law. If a treaty is made between a civil law country and a common law country in English and French corresponding to the two official versions of the Model, recourse must be made to Article 33(4) of the Vienna Convention which states that:

> ...when a comparison of the authentic texts discloses a difference of meaning which the application of Articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.

The meaning derived from the application of Articles 31 and 32 of the Vienna Convention supports the common law meaning, which is the meaning derived from the English language text, since it gives full effect to the inclusion of broker and general commission agent. Under the French, the references to *courtier* or *commissionnaire* are redundant because such persons do not fall within Paragraph 5, which gives no effect to the ordinary meaning of those terms. It is therefore considered that the English text is to be preferred under Articles 31 and 32. If this is wrong, it is difficult to see which meaning best reconciles the texts, having regard to the object and purpose of the treaty, since after ignoring the redundant words, there is nothing to reconcile as the result is the same in both languages.

The way to avoid the redundant references to *courtier* and *commissionnaire* is to say that the internal tax law meaning of those expressions should not be used in a civil law country pursuant to Article 3(2) because the context otherwise requires.[252] In making this point we are not restricted to the meaning of context as defined in the Vienna Convention.[253] We can include in the context for this purpose the difference in meaning between the English and French versions. More importantly, we can also include the historical evolution of the Model and the derivation of Paragraph 6 originally from UK tax law and from this the League of Nations 1927 provision,[254] rather than the 1929 exceptions.[255] This is why we considered the history in detail in Section IV. as this is part of the external context, particularly in view of the cross-reference from the 1963 OECD Draft to the League of Nations London and Mexico Drafts.[256] If the expressions originally had the meaning

250. Article 5 Commentary Paragraph 36. These words were originally used in the commentary to the OEEC First Report, Paragraph 20 of Annex B. Further support for this interpretation is given by the unofficial commentary to the London and Mexico Drafts, see *supra* note 123. The commentary to the 1963 OECD Draft says of what is now Paragraph 6 that "Corresponding provisions are included in the Mexico and London Drafts (Article V, Paragraph [3] (the 5 is a misprint as can be seen from the French version), of the Protocol)..." thus linking this to the Model. This reference corresponds to what we have described as the 1927 provision and corresponds to the first paragraph of the 1933 draft (see text *supra* around note 118).

251. Article 31(2)(b), see van Raad "Interpretatie van belastingverdragen" ("Interpretation of Tax Conventions") *Maandblad Belasting Beschouwingen* 1978 No.2/3 Paragraph 20. In *Thiel v. FCT* 90 ATC 4717 in the Australian High Court Dawson J said that he could not see why this provision did not apply to the OECD Commentary but, as with the other judges, went on to consider the position of the Commentary as a supplementary means of interpretation.

252. See Article 3 Commentary Paragraph 12 (added in 1992) which says that the meaning of a term in the other state is part of the context.

253. See Article 3 Commentary Paragraph 12 for an explanation of the meaning of context here and see also *supra* note 242, at 90.

254. See *supra* note 94.

255. See *supra* notes 108, 111.

256. The terms internal and external context are taken from Elmer A. Dreidger, *The Construction of Statutes* 2nd ed. (Toronto: Butterworths, 1983), at 107 et seq. See in relation to the meaning of context *supra* note 242, at 90. For the cross-reference to the London and Mexico Drafts, see *supra* note 250.

which they had in English law, they should not have been translated into French as *courtier* and *commissionnaire*. We therefore consider that the references to *courtier* and *commissionnaire* in the French text should not be interpreted in accordance with internal law in those countries that use the expression in their internal tax law. Something on the lines of the meaning of those expressions in English law should be used to interpret a treaty on the lines of the Model. Fortunately, this difference has little effect in practice because any agent making contracts binding on his principal who is independent and acting in the ordinary course of his business is excluded in a civil law country by the reference to "other agent of an independent status". If this is accepted, the main difference between the result in civil law and common law is that in civil law there are more agents (most of whom would be independent in any event) who do not bind their principals and who are therefore outside Paragraph 5 whether or not they are acting in the ordinary course of their business, but in both systems independent agents who bind their principals and act in the ordinary course of business would not constitute permanent establishments. Comparable common law agents will bind their principals and therefore have to comply with Paragraph 6 in order to avoid creating a permanent establishment, by qualifying as independent and acting in the ordinary course of their business.

In any particular case in practice the whole of this analysis may not be applicable. Either the expressions "broker" and "general commission agent" may not be used in internal tax law, or the treaty may not be in both English and French (or another language corresponding to the French). Unless one is able to conclude that the treaty in question is based on the Model and that the interpretation we have outlined of the Model can be said to reflect the intention of the two contracting states, the meaning derived from the particular language or languages of the treaty may differ from what we have described in relation to the Model.

VII. CONCLUSION

We can now set out again, and comment on, the following conclusions which at the beginning of this article we stated we hoped to substantiate.

1. The reference in Paragraph 5 to a person having an authority to conclude contracts in the name of an enterprise means that the agent has authority to conclude contracts binding on his principal. Assuming that Paragraph 5 originated in French, the English is a literal translation of a civil law term of art that should have been translated differently.

We have dealt with this issue under Section III. and it is clear that the Model is using the meaning in civil law of the expression "concluding contracts in the name of the principal". By using a term of art of civil law the meaning must be the same in common law even though the same expression is often used merely in a descriptive sense in common law. It is unfortunate that a term of art of one system of law should be used in a Model, particularly when the League of Nations drafts avoided doing so. The Commentary assumes that the meaning of contracting in the name of a principal is clear and does not explain it.

2. Paragraph 6 operates as an exception to Paragraph 5, and excludes from the definition of permanent establishment independent agents where the principal is bound by contracts made by his agent, so long as the agent is acting in the ordinary course of his business.

3. It is only under the common law and in the English language that the reference to broker and general commission agent may be necessary for clarification with respect to those agents as they do bind their principal under common law. The French version's reference to *courtier* and *commissionnaire* (the translation of broker and commission agent) is not a reference to the same kind of agents as broker and commission agent. These references originated from UK tax law and were originally in English.

These are the conclusions we reached in Section VI., which we acknowledge are difficult to fit in with the OECD Commentary. However, they give full effect to the words in Paragraph 5 "other than an agent of independent status to whom Paragraph 6 applies;" and the purpose of Paragraph 6 to operate as an exception to Paragraph 5. We have described in connection with Paragraph 6 the former meaning of broker and commission agent in UK commercial law, and we have demonstrated in Section IV. the derivation of Paragraph 6 from UK tax law. The French terms *courtier* and *commissionnaire* do not have anything like the same meaning as the English terms, and indeed are otiose in Paragraph 6. We consider that the context, particularly the wording of Paragraph 5, the historical evolution of Paragraph 6 and the difference in meaning between the English and French versions of the Model, require that the civil law meaning of those words not be used.

4. Cases where the principal is not bound by the agent's contracts, which arise with *courtiers* and *commissionnaires* under civil law, therefore fall outside both paragraphs and do not in any circumstances create a permanent establishment, whether or not the agents are acting in the ordinary course of their business.

5. In civil law countries, Paragraph 5 concerns direct representation, but Paragraph 6 does not concern indirect representation which, as mentioned in 4 above, falls outside both paragraphs. Paragraph 6 concerns independent agents while Paragraph 5 does not concern only dependent agents. Accordingly, Paragraphs 5 and 6 do not represent a dichotomy between either dependent and independent agents, or between direct and indirect representation.

Following from No. 3 above, a *commissionnaire* is not usually within Paragraph 5[257] and does not need to rely on Paragraph 6, whereas a common law agent acting in his own name in a similar way does need to rely on Paragraph 6 because he still binds his principal. Indeed, a *commissionnaire* usually does not constitute a permanent establishment for the principal even if he acts outside the ordinary course of his business, and so it does not matter whether his business is within Paragraph 6 or not, so long as in acting outside the ordinary course of his business he does not habitually conclude contracts binding on the principal. Even if he did conclude contracts, he would still be excluded by Paragraph 6 even if he did it habitually so long as he remained independent and acted in the ordinary

257. See Section II. for exceptions to this rule.

course of his business, although this possibility may be more theoretical than real.

We should add that what is important to the application of Paragraph 6 is whether the agent has been properly remunerated for his services. This test originally applied in the League of Nations drafts and is still found in UK internal law. So long as there is proper remuneration this is the measure of profit on which a branch carrying on the same activities should be taxed. This seems a much more important requirement than the requirement that the agent is acting in the ordinary course of his business. It is therefore odd that the original reference to normal remuneration was dropped in favour of acting in the ordinary course of his business.

We are left with the suspicion that many of the problems of interpretation are caused more by a failure to translate terms which were well understood in one legal system into terms that would have the same meaning in the other system. Paragraph 5, with its civil law terminology, was presumably originally written from a civil law perspective and the term of art "contracting in the name of" was translated literally into English without its being realized that it was a term of art. On the other hand, Paragraph 6 was originally derived from UK tax law, and the commercial terms "broker" and "commission agent" were also translated literally into superficially similar French words having a totally different meaning in a civil law system. Neither side seems to have realized that a serious translation error was being made. The confusion is compounded, we suspect, by the Commentary to Paragraph 6 being originally[258] drafted by a civil lawyer who understood Paragraph 6 in accordance with its civil law (or French) meaning, as a result of which the Commentary is misleading from the common law point of view; and common lawyer members failed to amend it to deal with the situation from their point of view.

Our recommendation for improving the Model would consist of changing the English language version of Paragraph 5 to refer to the agent having an authority to conclude contracts binding on the principal. In Paragraph 6 we suggest that the references to brokers and general commission agents should be dropped as the expressions are no longer in commercial use in common law countries and have been mistranslated into French. Paragraph 6 would then refer generally to independent agents. At the same time, the commentary should be rewritten to explain that in common law countries Paragraph 6 has the effect of excluding a large number of agents from creating a permanent establishment. As it is not true that Paragraph 6 is included merely for the sake of clarity and emphasis this statement should be dropped.

APPENDIX

History of the UK taxation provisions on agents

In order to show the context and relevance of the UK provision that formed the origin of Paragraph 6, this Appendix outlines the development of the UK position on taxing non-residents carrying on business through agents in the United Kingdom. If the non-resident principal was trading in, as opposed to with, the United Kingdom (which originally meant that the contracts for sale were made in the United Kingdom),[259] he was taxable in the name of an agent (or factor[260] or receiver[261]) having the receipt of the profits.[262] It was not necessary that there should be privity of contract between the foreign seller and the UK buyer.[263]

In 1915[264] the necessity for the agent to receive the profits before the non-resident could be taxed in his name was removed, presumably because agents were avoiding tax on behalf of the principal by not receiving the profits.[265] The type of agent who could be assessed was also enlarged to include a branch or manager in addition to the original factor, agent or receiver. At the same time an exception was made so that the non-resident could not be taxed on transactions carried out through a broker, general commission agent[266] or another agent, not being an authorized person carrying on the non-resident's regular agency. Transactions between two non-residents through a UK agent were also exempted. As a result of these changes, a non-resident was taxed on all transactions carried out by an agent, unless carried out by a non-regular broker, general commission agent or other agent, unless the transaction was carried out with another non-resident.[267] This cannot have suited non-residents who must have preferred to use their regular agents.

In 1920 the Royal Commission on Income Tax[268] reported that they were in favour of taxing non-residents in this way, but pointed out that the 1915 Act had never really been tested as it had not been applied, presumably because of wartime conditions. They did acknowledge that the 1915 Act might drive non-residents to use commercial travellers instead of regular agents, and suggested that it should be kept under review. They even suggested extending the law to tax a business carried out through a broker who acted as a regular agent. In fact the courts later so interpreted it, by deciding that the phrase "not being an authorized person carrying on the non-resident's regular

258. In the OEEC First Report (1958) Paragraph 20 of Annex B. There is the added problem caused, we suspect, by a German author producing the 1963 commentary using what was to him a familiar term, permanent agent, without explaining its meaning in what is now Article 5 Commentary Paragraph 38.

259. See *Grainger v. Gough* 3 TC 462 HL for an example of this not being satisfied as the contracts were made outside the United Kingdom and the UK agents only solicited orders.

260. "I think the word 'factor' is used in that section in its proper legal sense, *viz.*, as meaning an agent who has possession of the goods for the purpose of sale. That is the true definition of a factor." *Grainger v. Gough* 3 TC 311, 319 C.A. *per* Lord Esher MR.

261. "A person appointed by his principal, the foreigner, to receive his profits or gains." *Grainger v. Gough* 3 TC 311, 319 *per* Lord Esher MR.

262. This included the receipt of the gross proceeds of sale: *Nielsen, Andersen & Co v. Collins* 13 TC 91, at 113-4, 121, 124. For an example of a case where the agent did not have receipt of the profits, although cheques were sometimes payable to him, see *Crookston Bros. v. Furtado* (1910) 5 TC 602.

263. See the cases cited *supra* in note 39.

264. F.(No. 2) A. 1915, s.31.

265. *Maclaine v. Eccott* 10 TC 481, at 582. This suggestion is also supported by the Revenue's advice to Ministers: Public Record Office Document IR 63, 107, at 257.

266. This was the first use of the expression in UK tax law. If factor was used in the section in its legal sense (see *supra* note 260) it is odd that commission agent was used in the same section when they mean the same thing.

267. Unless the agent had the receipt of the profits, when the earlier law applied: *Maclaine v. Eccott* 10 TC 481.

268. Cmd.615.

agency" applied to brokers and general commission agents as well as other agents.[269]

An opposition new clause which would have exempted from tax the profits of a non-resident made through a bona fide agency business receiving not less than the customary remuneration was debated and defeated in 1924.[270]

The Finance Act 1925 provision which is quoted above[271] completely reversed the Royal Commission's thinking, but on the same lines as the proposal of the previous year's opposition, now in government. It exempted the non-resident principal from being taxed in the name of the agent[272] on transactions carried out by a non-resident through a broker or general commission agent (but not other agents[273]) in the ordinary course of their business as such, notwithstanding that they acted regularly for the non-resident, so long as they were bona fide carrying on the business of broker or general commission agent in the United Kingdom and receiving not less than the normal rate of commission. This, we have argued, was the origin of the 1927 League of Nations draft which was the forerunner of Paragraph 6. The justification given in Parliament for this legislation was that the 1915 Act had still not been operated in view of practical difficulties. One of these was that profits made in a transaction between two non-residents through a UK broker were exempt, but when a transaction was carried out between two commission agents or brokers it was impossible to know whether the exemption applied because they would not reveal their clients' identity.[274] It was said that to assess non-residents in this way would be disastrous to "our vast international and entrepôt trade."[275] There was clearly a fear expressed in the debates of driving the business away from the United Kingdom and losing tax on the agents' profits as well. The brief to Ministers shows that the London Chamber of Commerce was pressing for the change on the ground of potential loss of business to UK agents. The Revenue argued against the change on the grounds of principle, as the Royal Commission had said that non-residents should be taxed on profits made in the United Kingdom. In the end, the clause was accepted on the grounds of practicality, that it was not possible to collect the tax anyway. The London Chamber of Commerce had made the point that the evidence to the Royal Commission on taxation of non-residents was not very representative.

Mitchell B. Carroll's comments in his 1968 article[276] are substantiated by the Royal Commission report that said that there had been a delay in implementing the 1915 Act, but are slightly contrary to the statement in Parliament in 1925 that the tax had still not been generally collected, although the Revenue's advice to Ministers suggests that it had just begun to try to collect some tax.[277] By 1930 the Revenue was advising Ministers that it hardly collected any tax because agents were careful to make contracts abroad: "In the past, the administration of the law has given rise to a vast amount of friction and irritation."[278] But about the same time the courts were beginning to move away from looking only to the place where the contracts for sale were made, and Mitchell Carroll points out that assessments were made on regular brokers and general commission agents even though the contracts were made abroad.[279] Although the more immediate cause of the 1925 change was the London Chamber of Commerce and the fear of the United Kingdom losing business, it is quite possible that pressure at League of Nations meetings had contributed to the change, although there is no evidence of this.

Finally, it should be noted that in 1930 the United Kingdom enacted legislation enabling by Order in Council the making of tax treaties relating to profits made through agents. The purpose was recorded in the 1930 League of Nations report as being to enable the United Kingdom to conclude double taxation agreements to avoid double taxation resulting from the divergent definitions of the term autonomous agent.[280] The legislation seems to have been requested by bodies representing business interests in the United Kingdom but it was not made clear publicly what purpose the legislation served.[281] The Revenue's briefing to Ministers, however, disclosed that, while non-residents were in practice paying no tax in the United Kingdom because they were careful to make contracts abroad, Germany, Switzerland and Belgium had started to retaliate for the UK legislation and to tax UK residents doing business through agents in those countries, so the treaties were really made on account of self-interest.[282] One of the restrictions on the treaty-making power was that there was no exemption for profits accruing to a non-resident from the sale of goods effected in the United Kingdom through any agency in the United Kingdom where the agent had and habitually exercised a general authority to negotiate and

269. *Nielsen, Andersen & Co. v. Collins* 13 TC 91, at 117, 121, 125.
270. Hansard 8 July 1924, Vol. 175, col. 2092.
271. S.17, see text *supra* at note 92.
272. It is only by concession (ESC B40) that the Revenue does not tax the non-resident directly in these circumstances. The concession does not apply if the employment of the agent is outside or goes beyond the normal use by non-residents of brokers etc., or if the non-resident has some other presence or representative in the United Kingdom which carries on activities related to the transactions conducted through the agent, unless the other representative is also protected by what is now TMA 1970, s 82(1).
273. Although brokers and commission agents were the two main classes of mercantile agents, see *supra* note 140.
274. Public Record Office Documents IR 61, 107, at 266, 112, 132.
275. Hansard, 22 June 1925, Vol. 185, col. 1122.
276. See *supra* note 89.
277. Public Record Office Document IR 61, 107, at 260.
278. Public Record Office Document IR 61, 125 (notes on cl. 16 of the Finance Bill).
279. See, for example, *Smidth v. Greenwood* 8 TC 193, at 204 (decision in Court of Appeal 1921, facts 1914 to 1918), *Maclaine v. Eccott* 10 TC 481 (decisions 1924 to 1926, facts in 1916 to 1918), *Balfour v. Mace* 13 TC 537, at 558 (decision in Court of Appeal 1928, facts 1916 to 1918).
280. LHUSTC at (4206); the clause is set out at (4212). During Parliamentary proceedings the limitation to profits from the sale of goods was removed: Hansard vol. 240, col. 1621.
281. According to Hansard the clause was required to deal with the old controversy between the continental point of view and the UK's as to where the profit arises: Vol. 239, col. 2524. The Federation of British Industries, the International Chamber of Commerce and the Manufacturers Agents Association are mentioned in the Revenue's advice to Ministers in Public Record Office Document IR 63, at 125.
282. Public Record Office Document IR 61, at 125. David Williams in *Trends in International Taxation* (Amsterdam: International Bureau of Fiscal Documentation, 1991), at Paragraph 556 quotes government papers of 1945 (Public Record Office Document IR 40, 12093) showing that avoiding discrimination was considered a major reason for having treaties: "Moreover in both of these countries (China and Egypt) we have to look for a wave of nationalist and anti-foreign feeling which, in the absence of treaty safeguards, may work serious harm to British interests operating there."

conclude contracts.[283] Ten treaties were concluded pursuant to this legislation and this expression was included in all of them.[284] These treaties would have made little difference in the United Kingdom since the 1925 Act exempted brokers and general commission agents as a matter of internal law, leaving the principal to be taxed in respect of dealings through other regular agents. The treaties, for UK tax purposes, would therefore affect only those other regular agents who did not conclude contracts on behalf of their principals.

283. At that time the League of Nations had not adopted the wording of contracting in the name of and referred to power to conclude contracts binding upon the enterprise. LHUSTC at (4206). The 1963 OECD Commentary (Article 5 Commentary Paragraph 16) records that although *general* authority had been used in treaties it was not included in the Model because it was unlikely in practice that agents would have a completely unfettered authority. The other cases where there was no exemption were where there was a branch, and where the agent had a stock of goods.

284. Sweden (1931), Switzerland (1932) (the only one of the countries which were the cause of this legislation), Finland (1935), Canada (1936), Newfoundland (1936), Netherlands (1936), Greece (1937), Norway (1939), South Africa (1939), New Zealand (1942). The last three treaties referred to the 1925 UK law exemption for brokers and general commission agents and the other country applied the same rule so long as the UK law remained in force.