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Dependent Agents as Permanent Establishments

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The Origins of Articles 5(5) and 5(6) of the Model

John F. Avery Jones

I. Introduction[1]

An Englishman and a German are sitting in a room in the *Château de la Muette* in Paris in 1956.[2] They are OEEC Working Party 1 (Working Party 1), charged with drafting the definition of "permanent establishment". They would have known each other through membership in the Fiscal Committee, and certainly the German had been involved in the negotiations for a treaty between those two countries only two years earlier. The strange thing is that they are not talking to each other, and, nor it seems, did they ever do so. The problem was not language, as the German spoke English; the treaty negotiations between those two countries had been in English, and the only time an interpreter is mentioned is in the drafting committee.[3] Perhaps they thought it would be quicker if they each were to write their own contribution – which would have been fine but for the fact that they did not seem to have reviewed the other's contribution either.

This makes a good story, but in the author's opinion there is an even better explanation: they never met at all! Travel in the post-war years was not as it is today. If an Englishman wished to meet someone in Paris, he would have taken the 10:30 Golden Arrow/*Flèsche d'Or* from Victoria which, after an often-rough Channel crossing, arrived in Paris at 17:30, with the return train leaving the *Gare du Nord* on the other side of Paris from the OEEC at 12:15 and arriving in London at 19:30.[4] In practice, therefore, he had to spend two days travelling and spend two nights in Paris to have a proper meeting – to say nothing of the then problems of

1 This article contains a number of statements about German law for which the author gratefully acknowledges the assistance of Professor Jürgen Lüdicke and Jörn Grosch, University of Hamburg, with whom he has been discussing this topic in connection with a longer piece that the three of them are writing jointly. The difficulty of this whole topic is that in addition to knowing about tax, one needs to have a deep understanding of both common law and civil law of agency – which few people have. Most must be content with deep knowledge of one system and an amateur's knowledge of the other, which in turn makes it difficult because one does not know what questions to ask. This chapter can deal with only a small part of the topic. For those interested in delving deeper, the author highly recommends an article by Hans Pijl, *Agency Permanent Establishments: In the Name of and the Relationship between Article 5(5) and 5(6) (Part 1)*, 67 Bull. Intl. Taxn. 1 (2013), at 3; and H. Pijl, *Agency Permanent Establishments: In the Name of and the Relationship between Article 5(5) and 5(6) (Part 2)*, 67 Bull. Intl. Taxn. 2 (2013), at 62. His research is highly comprehensive. Those who have read these articles will be aware that he is critical of the views of the present author. This is not the place for the present author to reply, but the present author believes that the common ground between the two of them is far greater than it appears.

2 17 September 1956 is the date of their first report (FC/WP1(56)1) which contains a draft of the PE article and Commentary. Working Party 1 had been set up by the Fiscal Committee on 24 May 1956 (FC/M(56)1(Prov.). OEEC and OECD papers up to 1977 are available at www.taxtreatieshistory.org. It appears from the Questionnaire of 4 February 1957 in TFD/FC/12 that the rapporteurs of Working Party 1 were Dr Mersmann (who had led the German negotiating team for the United Kingdom-Germany treaty (1954)) and Mr Norman Leach (who was not involved with the negotiations for that treaty).

3 The minutes of the negotiations between the United Kingdom and Germany for the 1954 treaty are available in the UK National Archives, file IR40/9629A. The author deduces that if Mr Leach had spoken German, he would have been involved in the negotiations with Germany – which he was not.

4 http://en.wikipedia.org/wiki/Golden_Arrow_%28train%29.

currency restrictions. The Germans were rather better off, but their trains did not fit with the English ones. The Paris-Ruhr connection had been set up in 1954 and covered the distance from Cologne (the station closest to Bonn) to Paris in less than 6 hours, leaving Cologne early in the morning at around 7:00 and arriving in Paris at 12:45. To go back, a traveller would take the eastbound train on the same route leaving Paris at 17:40, reaching Cologne at close to midnight. The schedule of the Paris-Ruhr route was intended to enable travellers to have a short business meeting in Paris, go back on the same day and have dinner on the train. As the Working Party 1 minutes are always circulated about one month before the Fiscal Committee meeting and were included in the latter's agenda, it is not credible that the members of the Working Party went to Paris twice in one month.[5] So they must have done everything by post.[6]

The above is exaggerating in one respect. Both members of Working Party 1 were members of the Fiscal Committee and they (and others from their countries) may well have discussed the draft a day before or after the meetings of the Fiscal Committee (or an afternoon during these meetings, which the author understands was routinely used for advancing the work of the Working Parties). However, the focus of such meetings could well have been on the changes discussed in the Fiscal Committee rather than the type of fundamental discussion that was required.

A. The common law of agency

Before turning to the draft article, a few common law principles of agency should be outlined in order to demonstrate where the Englishman was coming from. These are:

(1) In common law, which is almost entirely judge-made law, instead of having a number of contracts[7] named in a civil code (which does not exist), each with defined legal consequences, there is potentially an infinite variety of types of contract, none of which has pre-defined legal consequences. Nothing similar to a commissionaire can exist as a ready-made contract. One may ask how a broker and general commission agent could exist under domestic tax law (a subject that will be addressed further, below). For now, what can be said is that there are commercial, not legal, terms.

(2) An agent's contracts are regarded as contracts between a principal and a third party which are made through the medium of the agent. There is no distinc-

5 The Working Party 1 minutes do not say that they actually met in Paris.

6 The author has looked at the UK National Archives, file IR40/11993 ("OEEC: effect of differential tax treatment in various countries"), but it contains only correspondence between the United Kingdom and the OEEC secretariat, not country-specific correspondence. It is thus doubtful that any correspondence between Working Party 1 members is available.

7 Even the meaning of "contract" is also different between common and civil law, but not materially to the present discussion.

tion as in civil law, and particularly in Germany where it was invented,[8] between the internal mandate and the external power of representation.

(3) In common law, in principle, all of an agent's contracts bind the principal, whether or not the principal is disclosed.

(4) There used to be an exception to (3), such that an agent did not bind an undisclosed *foreign* principal because in the nineteenth century the courts implied this as a presumption of fact (therefore depending on the entire facts) – rather like a commissionaire, but not as a legal category which could not exist.[9] The approach of the courts in the twentieth century was along the lines that the fact the principal was foreign was merely a factor to be taken into account; whether the foreign principal was liable depended on the terms of the contract and the intention of the parties as ascertained from the facts, one of which was that the principal was foreign. The presumption was finally abandoned in 1968,[10] some ten years after the OEEC was working on the agency provisions. It therefore theoretically existed when Working Party 1 was working, but in the author's opinion most people would then have doubted whether it would still be applied.[11] It is would have been difficult to obtain clear advice from a lawyer – and the Englishman was not a lawyer[12] – on the question as to wheth-

8 By Paul Laband in an article published in 1868. *See* Michel Pelichet, Report on the law applicable to agency, Hague Conference on private international law, Agency (The Hague, The Netherlands, 1979) (on this and the common/civil law distinctions generally).

9 For an example, but still giving rise to tax, of contracts being entered into by an agent in the United Kingdom which did not bind the principal because of the presumption that undisclosed foreign principals were not bound, *see* UK: Court of Appeal, 1922, *Weiss, Biheller and Brooks Ltd v. Farmer*, (1922) 8 TC 381, at 406, 407.

10 UK: Court of Appeal, 1968, *Teheran-Europe Co. Ltd v. S.T. Belton (Tractors) Ltd.* (1968) 2 Q.B. 545 , in which that great judge Lord Denning MR stated: "I do not think that usage of one hundred years ago applies today. Overseas business is conducted very differently now from what it was then…. In the light of modern usage I think that an undisclosed foreign principal can sue and be sued on a contract, just as an undisclosed English principal can, save, of course, when the contract on its true construction limits it to the English intermediary and excludes a foreign principal. The fact that the principal is a foreigner is an element to be thrown into the scale on construction, but that is all".

11 The 1951 (11th) edition of the leading textbook, *Bowstead on Agency*, included the presumption about foreign principals unless a contrary intention plainly appeared from the contract or surrounding circumstances. The 1959 (12th) edition stated that the present status of the presumption was doubtful.

12 The reason the author can be certain about this is that in the United Kingdom, the legal professions (barristers and solicitors) do their own training, then lasting about two and a half years (with a law degree – which Messrs Leach and Lord did not have – and rather longer without), and it is by no means unusual, and is often desirable, for a prospective lawyer to take a first degree in a different subject. The people being considered here would have been recruited by the Revenue (strictly by the civil service and allocated to the Revenue, probably for only part of their careers) in the fast stream straight from university (then probably meaning Oxbridge, but not necessarily only after a first degree). If he had taken the time out to become a lawyer, he would no longer have been eligible. Mr Leach read English, and Mr Lord, the other member of the Fiscal Committee from the United Kingdom, read classics, both at Cambridge. Mr Leach moved to become Under-Secretary at the Ministry of Pensions and National Insurance in 1958; Mr Lord later became a member of the Board of Inland Revenue and Deputy Chairman, moved to the Department of Trade and Industry in 1971, then the Treasury, leaving to become Deputy Chairman and Chief Executive of Lloyd's of London. (*Who's*

er in any particular case the principal was bound, both because the answer depended on all the surrounding facts, and because of the slightly uncertain state of the law relating to foreign principals.

(5) It will be apparent that UK tax law could never have been built on whether the agent's contract was binding on the principal. Instead it depended on whether the agent contracted at all and, if he did, whether the contract was made in the United Kingdom (in which case the United Kingdom taxed under domestic law).[13] Who the contract bound was not therefore in the Englishman's mind, and therefore contracting "on behalf of" carried no implications about who was bound. What is more, if the German had mentioned that the wording they agreed made binding important, the Englishman would have insisted on changing the wording because it could not have been administered, given the uncertainties of No 4 above.

As it is assumed that the reader is familiar with the civil law of agency, it will not be discussed here. In short, there was little or no common ground between the Englishman and the German on the law of agency.

II. United Kingdom-Germany Treaty (1954)

A convenient starting point is the agency permanent establishment provision in article II(1)(l) of the United Kingdom-Germany treaty (1954) two years earlier, which read:

> (aa) … The term [permanent establishment] shall also be deemed to include –
>
> an employee who is permanently retained by an enterprise of one of the territories to work in the other territory, whether or not that enterprise has a fixed place of business in the other territory, if he is engaged in activities carried on with a view to obtaining profits for the enterprise in that other territory,[14] and
>
> in the United Kingdom an agent, in the Federal Republic a *Handelsvertreter* or other *selbständiger Vertreter*, who has and habitually exercises a general authority

Who and Who Was Who). A very small number of people reached this grade, starting from Inspector of Taxes. The author is aware of only one example of a legally-qualified person in this position: Barry Pollard, who had become a barrister through taking a correspondence course, while an Inspector (Obituary, The Times, 9 Aug. 2012).

13 This rule about the place of contracting was developed almost entirely in case law concerning French wine merchants.

14 In spite of the suggestion by Bühring (Betriebs-Berater 1954, 945/946) who states that this reflects UK treaty practice according to which every employee who permanently works for the benefit of his employer in the other state is deemed to be a PE, even if his work is restricted to advertise or to supervise the delivery of goods (which the author does not believe is a correct statement of UK treaty practice (or tax law)), the author thinks it more likely that the provision was included for German reasons which are not material here. UK treaties do not make a distinction between agents and employees (often these are treated together, as in the following treaties: Austria-United Kingdom (1956), which is similar to Austria-Germany (1954), Canada-Germany (1956) and United States-Germany (1954)). The author believes that this provision is found, among UK treaties, only in the Germany-United Kingdom (1954) treaty.

> to negotiate and conclude contracts on behalf of an enterprise [*für ein Unternehmen*] of the other territory, or maintains a stock of merchandise belonging to that enterprise from which he regularly fills orders on its behalf.
>
> In this connexion –
>
> (bb) A United Kingdom enterprise shall not be deemed to have a permanent establishment in the Federal Republic merely because it carries on business dealings in the Federal Republic through a *Handelsmakler*, *Handelsvertreter* (unless he is a *Handelsvertreter* of the type described in sub-paragraph (aa) above) or a *Kommissionär*, where such persons are acting in the ordinary course of their business as such.
>
> A Federal Republic enterprise shall not be deemed to have a permanent establishment in the United Kingdom merely because it carries on business dealings in the United Kingdom through a *bona fide* broker or general commission agent, where such persons are acting in the ordinary course of their business as such.

An interesting feature of text is that they were careful to specify by using the German terms what types of agents were being dealt with.

A. The meaning of "agent"

It is fortunate that there is a detailed record of discussions during the negotiation of this treaty in the UK National Archives.[15] Two extracts provide a good indication of the care that went into the negotiations.

> Dr Mersmann [the leader of the German delegation[16]] wanted to know, further, what is meant by an agent in the United Kingdom, (a) is he always independent?, (b) does he contract exclusively in the name of others or in his own name? Mr Willis [the leader of the UK delegation[17]] said that the main characteristic of an agent is that he holds him-

15 *See supra* note 3.

16 Dr Mersmann was very much a tax professional and matters of international taxation were a focal point of his administrative, judicial and scientific work. He was educated as a lawyer and entered the financial administration in 1930. After the war – before and during which he was denied promotion for his Jewish origins on his mother's side (he was awarded, according available sources, the title of a Dr. h.c. only in 1967; it remains unclear why the UK minutes name him as Dr Mersmann, which seems deliberate because the minutes for 14 to 21 July 1952 list *Mr* (Horst) Vogel, *Dr* Bühring, *Mr* Schultze-Brachmann, *Mr* Wollermeber and *Prof.* Spitaler). He was appointed head of the tax department within the financial administration of the so called Unified Economic Area of post-war Germany and contributed greatly to the reconstruction of a nationally functioning fiscal system. Starting early in the 1950s he represented the Federal Republic in tax treaty negotiations. He was active in the OECD and a leading member of the IFA. In 1962, Dr Mersmann was appointed president of the Federal Fiscal Court and presiding judge of its senate dealing with international and corporate taxation. He also published numerous scientific books and papers on international taxation and taught at university. If one met Dr Mersmann, as a former colleague and his successor as president of the Court once wrote, one could learn how persuasive a low voice can be, if it is an expression of thought-out conviction.

17 The author had the privilege to have sat on two committees with Mr Robert Willis (1909-2001) after he had retired as Deputy Chairman of the Revenue in 1971: the major one being *The Structure and Reform of Direct Taxation, Report of a Committee chaired by Professor J E Meade* (London, George Allen & Unwin, IFS, 1978), and the other being C.T. Sandford, J.R.M. Willis and D.J. Ironside, *An Accessions Tax* (London, IFS, 1973). He was not a lawyer, although one would not know this from the impeccable answers below. He was a classical scholar, gentleman, superb administrator and a man who did not need to raise his voice to win an argument; he had thought out every consequence of his

> self out to be Mr X selling for the Y company, and not as an employee of Y. He is therefore independent, but has an arrangement with Y to sell their goods and is paid by them on commission. He pointed out that we can have a case of X selling on his own account and also as the agent for Y under conditions which show that he is really representing Y. It is further possible for one person to be an agent for two or more companies in such circumstances that all are regarded as liable to tax in the United Kingdom on what they are selling through it. He said that it was often difficult to say whether arrangements are such that the foreign company is taxable here. The connection between it and its agent must be reasonably close. Dr Mersmann said that the English term "agent" was narrower than the German term "Handelsagent", as the latter does not include a man carrying on business on his own account. Mr Willis said that in English law a man might carry on business on his own account and at the same time be an agent for someone else. Dr Mersmann tried to find a formula to do justice to both sides, and suggested "a person who has permanent general authority and carries on business on behalf of a foreign enterprise shall be considered as a permanent establishment." Herr Vogel asked whether we could include the words "belonging to the firm in [the PE definition]." Mr Willis thought we could. He said, however, that we may find it awkward to get words bringing in the idea of agent without bringing in the word "agent" itself. "So shall see what we can do, and wish to avoid the difficulty flowing from the fact that 'agent' has no German equivalent."[18]

This is an example of misunderstandings piled upon misunderstandings. Dr Mersmann begins by asking what he sees as a simple question: whether a UK agent contracted in the name of the principal or in his own name. This indicates that what he really wanted to know was who the agent's contract bound, as this was the relevant issue from his perspective. This was misinterpreted by Mr Willis by assuming that contracting in his own name meant acting as a principal (he could just as well have interpreted it as meaning whether the principal was disclosed, but for some reason he did not). He adds that there is nothing to prevent a person's being an agent for one transaction and a principal for another. The answer was further misinterpreted by Dr Mersmann to mean that in the United Kingdom the term "agent" includes a person who acts as a principal, which would mean that it was broader than the German concept. They then proceed to attempt to draft something to cover this supposed difference. By then the situation is knee-deep in misunderstandings that were the basis for drafting a treaty. All of this because Dr Mersmann asked what, to him, was a perfectly ordinary question using technical vocabulary of civil law ("in the name of") that had no meaning in common law. This is not to be critical of him; anyone in his position would have done the same. But it shows the dangers of assuming that one's own legal system applies universally.

argument, so one was forced to agree with him. He shared that last quality with Dr Mersmann, but in another respect they were opposites. While Dr Mersmann spent his working life in the field of international taxation, Mr Willis may have been dealing with double taxation today but might well be moved to something completely different, say death duty policy, tomorrow, to which he would bring the same acuteness of mind uncluttered by preconceptions.

18 UK National Archives, file IR40/9629A, Minutes 14 July 1952 (afternoon), at 6.

B. The meaning of "broker"

The second extract is more helpful because it contains verbatim quotations

> Dr Mersmann asked whether a broker has the same type of general authority as an agent. Mr Willis: "No, as the broker acts on his own behalf, i.e. he does not buy first and then sell, instead the sale is made by the producer to the customer through the broker. On the other hand, the general authority of an agent is that of negotiating and concluding contracts." Dr Mersmann asked whether this authority is limited to certain classes of goods and whether the prices are limited. He also put forward two further points: – (1) What is the distinction between an agent and a broker? (2) What constitutes general authority? To take the second point first, he said that the "general authority" as used in (k) [the definition of permanent establishment] had been explained as the equivalent of "*Generalformat*" [sic; it probably means *Generalvollmacht*]. The holder has authority not only to conclude contracts but to take charge of organisational matters, i.e. he has full powers to deal with his principal's business. Does "general authority" correspond to this concept, or is it confined to selling certain classes of goods? As to the first point, he has been told that [an agent, crossed out and a broker substituted] can act for several principals. Is the difference between an agent and a broker that the former acts on behalf of one principal and the latter on behalf of many? Mr Willis: "As to the distinction between an agent and broker, in principle an agent acts for a particular principal and a broker acts for several. More accurately, the agent is a person regularly appointed by an enterprise to act on its behalf as a separate part of the agent's business. A broker is a man who will act for any enterprise which wants business done in his commodity. In some cases, however, one man may have several agencies." Dr Mersmann asked whether a broker is free to sell in his own name. Mr Willis replied that the sale is not from broker to customer, but from producer to customer.
>
> After discussion among themselves, the Germans said that they now understood that a '*Markler*' [sic; it should be *Makler*] was more or less equivalent to a broker.[19]

One is full of admiration for the searching nature of Dr Mersmann's questions and for Mr Willis's answers, including the latter's impeccable explanations of the law of agency despite the fact that he was not a lawyer. This is obviously a discussion between two intellectual giants searching for a meeting of minds that they never quite reach, simply because they failed to start with an understanding of the basics of each other's law of agency; indeed, there is no suggestion that they understood that there were differences. A good example is the last sentence of the first paragraph: Dr Mersmann is asking about the civil law concept of the broker selling in his own name, and the reply is given from the perspective of the common law concept of agency as a single contract binding the principal to the third party made through the agent, rather than the broker acting as a principal. Similarly, Mr Willis was asked earlier whether the broker's general authority is the same as that of the agent, and he replies, "No, as the broker acts on his own behalf, i.e. he does not buy first and then sell, instead the sale is made by the producer to the customer through the broker." However, it is unclear why the answer was not *yes* because the last words correctly describe a normal agency, and the UK broker

19 UK National Archives, file IR40/9629A, Minutes 15 July 1952 (morning), at 8.

is no different, but the rest is clear. The only point to come out clearly is that a broker normally acts for many principals, and an agent normally acts for one.

It is difficult to see how the German delegation could possibly have reached the conclusion in the second paragraph that a *Makler*, who seems merely to bring the parties together, was more or less equivalent to a broker, who enters into contracts, based on this exchange.

Suppose, hypothetically, the final question and answer had been:

> Dr Mersmann asked whether a broker is free to sell in his own name, in other words: does he bind only himself and not the enterprise? Mr Willis replied that he had no idea because "binding" was not a consideration that had ever crossed his mind, as it was irrelevant in UK tax law, but he would send for the Solicitor of Inland Revenue.[20]

On arrival, the Solicitor would have stated that while the question was meaningful in civil law with its defined categories of agency contract, it was difficult to apply to the potentially infinite variety of contract in common law, none of which has pre-defined legal consequences (as every case depended on its facts).[21] While the general rule was that the principal, rather than the agent, was liable, it was perfectly possible to envisage particular cases where the facts pointed towards the liability of the agent, rather than the principal. But it was not possible to answer the question in general.

One can imagine it taking only a fraction of a second before Dr Mersmann immediately saw the significance of this. He would have said that they had been talking for some time at cross purposes because the question as to who the contract bound was of fundamental interest from a German perspective, so they had better go back to the beginning. How different history might have been!

Because of these earlier discussions, the members of Working Party 1 may have not thought it necessary the cover the same ground again. But it is clear that they never got to the bottom of the differences between the civil law and common law of agency, or even appreciated that they understood that there was a difference. They are not likely to have corresponded about a difference that they did not even appreciate existed.

III. The OEEC Draft Article

So far as the agency PE provisions are concerned,[22] the author deduces that the Englishman wrote the draft article, and the German the Commentary.

20 The Revenue's senior in-house lawyer.

21 *See* section I.1 (The common law of agency), point (1). He might also have added the slight uncertainty about the continued existence of the presumption about the liability of agents for foreign principals (*see* point (4) under section I.1).

22 This qualification will not be repeated but should be read into everything that follows.

A. Concluding contracts

The second paragraph of article II(1)(l)(aa) of the United Kingdom-Germany treaty (1954)[23] contains two alternative ways in which an agent might create a permanent establishment: first, having a general authority to negotiate and conclude contracts on behalf of the enterprise and, secondly, maintaining a stock of merchandise belonging to the enterprise from which he regularly filled orders on its behalf.[24] So far as the first is concerned, the wording "the agent has and habitually exercises a general authority to negotiate and conclude contracts" had been used in the United Kingdom in ten treaties relating to agency profits since the early 1930s,[25] although not one with Germany. Germany was one of the countries that gave rise to the 1930 legislation granting authority to enter into these treaties, but in 1937 it amended its interpretation of the law to stop taxing foreign enterprises with a permanent agent or representative in Germany who did not have authority to conclude contracts binding on the principal, such that a treaty in this form would not have had had any different effect.[26] Consider the following example of a provision from one of the 1930s UK agency profits treaties:

> The profits or gains to which this Article relates are any profits or gains arising, whether directly or indirectly, through an agency in the United Kingdom to a person who is resident in Switzerland and is not resident in the United Kingdom, unless the profits or gains either –
>
> (i) arise from the sale of goods from a stock in the United Kingdom; or

23 *See* section III.

24 *See infra* section III.2 (Removal of the "stock of goods" provision).

25 Pursuant to enabling legislation in the Finance Act 1930, section 17, the United Kingdom entered into treaties with: Sweden (1931), Switzerland (1932) (the only one of the countries which was the cause of this legislation; *see* below), Finland (1935), Canada (1936), Newfoundland (1936), the Netherlands (1936), Greece (1937), Norway (1939), South Africa (1939) and New Zealand (1942). Their purpose was recorded in the 1930 League of Nations report as being to enable the United Kingdom to conclude agreements to avoid double taxation resulting from the divergent definitions of the term "autonomous agent" (*see* http://setis.library.usyd.edu.au/oztexts/parsons.html, under Legislative History of US Tax Conventions, vol. 4, Part 1 (League of Nations) and Part 2 (OEEC), at 4206; the clause is set out at 4212)). The Revenue's briefing to Ministers, however, disclosed that Germany, Switzerland and Belgium had started to retaliate for the UK legislation that had been changed in 1915 to tax the principal even when the UK agent did not receive the proceeds from the transaction (even though little tax was collected because contracts were agreed abroad) and to tax UK residents doing business through agents in those countries, so the treaties were really made on account of self-interest (UK National Archives, file IR 63/125).

26 Now R 49 EStR 2005. Before that, Germany taxed foreign enterprises – in the absence of a PE – if a permanent agent/representative was appointed in Germany (*im Inland … ein ständiger Vertreter bestellt ist*). Under domestic law, it was not relevant whether that person could conclude contracts; mere factual work was sufficient (art. 3 Income Tax Act 1925, later art. 49 Income Tax Act 1934). The amendment provided that in a non-treaty context there would be no tax if the permanent agent/representative was a *Kommissionär* or *Makler* who has business relations on behalf of (*für*) the foreign enterprise. The same applied if the person was a *Handelsvertreter* (art. 84 BGB) who had no *allgemeine Vollmacht* (Germany-United Kingdom "general authority", Germany-United States "full power") to negotiate and conclude contracts on behalf of the enterprise and who did not maintain a stock of merchandise belonging to that enterprise from which he regularly fills orders on its behalf.

(ii) accrue directly or indirectly through any branch or management in the United Kingdom or through an agency in the United Kingdom where the agent has and habitually exercises a general[27] authority to negotiate and conclude contracts.[28]

One may wonder why the last sentence stopped there, without the addition of "on behalf of" or "in the name of."[29] The reason is that what mattered from the UK perspective was merely whether there was a contract at all. If there were, the UK could then analyse whether the contract was made in the United Kingdom, in which case the United Kingdom would tax under domestic law (and the treaty would not prevent this), or whether it was made elsewhere, in which case the United Kingdom did not tax under domestic law and the treaty would have no effect.[30] The wording had the advantage that the other country could read it as it wished (and probably did). The author has not found any earlier treaties than this series of UK agency profits treaties which use this wording.

As can be seen from the above, the United Kingdom-Germany (1954) treaty contained the addition of contracting *on behalf of an enterprise/für ein Unternehmen*. This was also contained in many contemporary treaties, although to a far larger extent in UK (over 60), than German (four), treaties.[31] The author is fairly certain

27 For an explanation of the meaning of *general* in the later OEEC Model Commentary, *see supra* note.33.

28 The Relief from Double Income Tax on Agency Profits (Switzerland) Declaration 1932 (SR&O 1932 No 925). This wording has some similarities with earlier UK domestic law in Finance (No. 2) Act 1915: "A non-resident person shall be chargeable in respect of any profits or gains arising whether directly or indirectly, through or from any branch, factorship, agency, receivership, or management, and shall be so chargeable under section forty-one of the Income Tax Act, 1842, as amended by this section, in the name of the branch, factor, agent, receiver, or manager." This treats agency in the same way as branches etc and does not deal with contracting. The Revenue's evidence to the 1920 Royal Commission stated that the effect of the word "indirectly" was that "the non-resident became liable if he derived any profits or gains indirectly as well as directly through or from any branch, agency, etc, thereby surmounting the difficulty which arose where the contract and delivery were made abroad." (Minutes of Evidence q 10,309(c) (Mr F.L. Mace, Assistant Chief Inspector of Taxes)). The author is not aware of any authority supporting this, which seems to place more weight on one word than is justified.

29 An example where "on behalf of" was added to a treaty otherwise in similar form to the UK agency profits treaties is Southern Rhodesia-South Africa (1939). In 1939, South Africa entered into an agency profits treaty with the United Kingdom which is the obvious source of the drafting.

30 In view of UK tax law, it is surprising that the draft did not refer to where the contract was made. However, a later (1957) draft (FC/WP1(57)3 (12 Nov. 1957), previously TFD/FC/25 (2 Oct. 1957)) did so. The reference to *general* authority had been dropped in FC/WP1(57)2 (29 Aug. 1957), and negotiate *and* conclude was first changed to negotiate *or* enter into in FC/WP1(57)2, and then *negotiate* was dropped in FC/WP1(57)3:
4. A person acting in one of the territories on behalf of an enterprise of the other territory –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 territory if he has and habitually exercises in that territory an authority to contract on behalf of the enterprise unless his activities are limited to the purchase of goods or merchandise for the enterprise.

31 The United Kingdom continued to use the wording "who has and habitually exercises a general authority to negotiate and conclude contracts" from the 1930s agency treaties, but adding "on behalf of the enterprise" in its comprehensive treaties starting with United States-United Kingdom (1945).

that even with the addition of these words, each country understood the words differently, reading them through the spectacles of domestic law. The focus of UK legislation was on *whether a contract was made* and, if so, whether it was made in the United Kingdom; in Germany the focus was on *whether the principal was bound* by the contract. Being bound was not an issue in the United Kingdom because all agents bound the principal, even if not disclosed.[32] Certainly, whether the agent's contract bound the principal had no effect for tax purposes, and it would have been impractical if treaties were to have depended on whether the contract was binding. Thus, no one in the United Kingdom would originally have read "on behalf of" as meaning "binding." In Germany, on the other hand, the term *Ausübung einer Vollmacht* (English: exercise a general authority to conclude contracts) indicates strongly, from a German law perspective, the power to conclude contracts binding on the principal, regardless of the meaning of "on behalf of."

The Englishman in his Working Party 1 capacity therefore copied this normal treaty practice and came up with something extremely similar to UK current treaties, but without the German terms used in the Germany-United Kingdom treaty which would not have been appropriate for the OEEC draft:

> 4. An agent acting in one of the territories on behalf of an enterprise [*pour le compte d'une entreprise*] of the other territory – 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 territory if the agent:
>   (a) has and habitually exercises a general[33] authority to negotiate and enter into[34] contracts on behalf of the enterprise [*pour le compte de l'entreprise*] unless the agent's activates are limited to the purchase of goods or merchandise; or
>   (b) habitually maintains in the first-mentioned territory a stock of goods or merchandise belonging to the enterprises from which he regularly delivers goods or merchandise on its behalf.
>
>   An employee of the enterprise shall be deemed to be a permanent establishment of the enterprise if he also satisfies the further conditions of (a) and (b).
> 5. An enterprise in one of the territories shall not be deemed to have a permanent establishment in the other territory merely because it carries on business dealings in

32 Subject to the exception; *see* section I.1 (The common law of agency), point (4).

33 The OEEC Model Commentary explains this as follows. "Where the agent is, for example, merely allowed to enter into contracts at prices and terms fixed by the enterprise, thus having no discretionary power at all, the authority held by such agent cannot be deemed to be a *general* authority to negotiate and enter into contracts. In this connection, however, the fact must be pointed out that, under the provisions of the London and Mexico Drafts (Article V, paragraph 4A, of the Protocol) as well as under the provisions of a number of conventions would appear to be sufficient to constitute that agent a permanent establishment, such authority not necessarily having to be a *general* one." FC/WP1(56)1 (17 Sept. 1956). Later, the "general" was dropped on the ground that "in all cases the authority must be to some extent circumscribed." FC/WP1(57)2 (29 Aug. 1957).

34 Changed from "conclude" in United Kingdom-Germany (1954). It reverted to "conclude" in TFD/FC/25 (2 Oct. 1957) and FC(58)1 (31 Jan. 1958). There does not appear to be any difference in meaning.

> that other territory through a broker [*un courtier*], general[35] commission agent [*un commissionnaire général*] or any other agent of a generally independent status where such persons are acting in the ordinary course of their business as such.[36]

Compared to the Germany-United Kingdom (1954) treaty, the above-quoted text suffers from the disadvantage of not being able to identify the types of agent concerned. There was, of course, an official French version from which the author has added what seem to be the vital words. Pausing there, the French translation (the original version was in English, the working language of the English and German members of Working Party 1) made by the OEEC secretariat which used the apparently natural expressions is extremely significant and is the origin of some real problems of interpretation of article 5(6). There is no connection between the English broker[37] (who, in this sense,[38] does conclude contracts, which generally disclose the principal and were binding on the enterprise),[39] and the *Handelsmakler/courtier* who does not conclude contracts at all. Nor is there any connection between a general commission agent (who also concludes contracts which may or may not disclose the principal and will be binding on the principal whether or not they do), and the *Kommissionär/commissionnaire* (who also concludes contracts, but binds only the agent to the third party). Again, this was not something the members of Working Party 1 would have written to each other about; indeed, it is not known whether they read French.

The final version, which was included in the OEEC First Report (1958) and then the OECD 1963 Draft, contained the important change from contracting "on behalf of" to "in the name of." How and why the change was made is something of a mystery for which no explanation is contained in the minutes. The series of changes to the two references (in the opening line, and in paragraph (a), respectively), both of which started as "on behalf of/*pour le compte de*," were: (1) to change the second reference only to "on behalf of/*au nom de*,'[40] (2) to revert to the

35 Not to be confused with the "general" in note 33. In UK domestic law, this has been interpreted to mean that the agent holds himself out as ready to work for clients generally, in the manner of a broker. *Fleming v. London Produce*, (1968) 44 TC 582, at 596H.

36 FC/WP1(56)1 (17 Sept. 1956).

37 The author should emphasise the common law difference, as it has no defined types of contract (like *Kommissionär/commissionnaire* in civil law) (*see* section I.1 (The common law of agency), point (1)) and so "broker" and "general commission agent" are commercial, not legal, terms, the meaning of which is uncertain today.

38 The term "broker" is sometimes used in a similar sense to "*courtier*," that of a person who introduces the parties to a contract without taking part in the contract, for example a mortgage broker. This cannot be the relevant sense here, where the context is that of the agent entering into contracts.

39 Stockbrokers are an exception, as under the rules of the Stock Exchange they contract as if they are principals.

40 FC/WP1(57)1 (5 Jan. 1957) (original English language minutes) and FC(58)2 (13 Feb. 1958) (original French language minutes). The author gratefully acknowledges the research on this by Professor Richard Vann, *Travellers, Tax Policy and Agency Permanent Establishments*, Brit. Tax Rev. 6 (2010), at 20.

original,[41] (3) to change both references to "in the name of/*au nom de*'[42] and (4) to revert to the original wording of the first reference while leaving the second as "in the name of/*au nom de*."[43] The change in (1) must have been made by the translator of the English minutes into French, which no doubt correctly conveys the intended meaning in French if read with the background of the civil law significance of whether the agent's contract bound the principal. Then someone with a tidy mind must have noticed that the two references did not match and so made them the same. Moving in both directions was tried. The change at (2) was to revert to the original wording for both, and the change at (3) was to change both to "in the name of/*au nom de*." Finally, someone must have realized that a difference in meaning between the two references was intended, and so the first ended, as it had begun, with "on behalf of/*pour le compte de*," and the second was changed to "in the name of/*au nom de*."

If therefore, as is the author's opinion, the United Kingdom and Germany had been reading general authority to enter into contracts "on behalf of" differently, the German view had now prevailed. All this was after Working Party 1 had finished its work, and so it is not known how seriously the changes were considered by the Englishman, although he was on the Fiscal Committee and would (or should) have seen the changes. The author suspects that the United Kingdom woke up to the significance of the change to "in the name of" only much later, and as, in principle, all agent's contracts are binding on the principal it did no harm, except in those rare cases where under the true construction of the contract only the agent was liable. Apart from these cases, the only agents it excluded were those who did not contract at all.

Therefore, the Englishman wrote what became article 5(5) including "on behalf of" in the second reference, and they did not correspond with each other about it, more importantly because of the different implications of "exercise a general authority to conclude contracts" in the English and German languages, as has been seen.[44] The Englishman would never have agreed to a criterion that depended on whether the contract bound the principal, as this depended on the facts of individual cases and would have been far too uncertain to be administered in the United Kingdom.

B. Removal of the "stock of goods" provision

The second alternative to concluding contracts in the Working Party 1 proposal was that the agent "habitually maintains in the first-mentioned territory a stock of

41 TFD/FC/32rev (19 Mar. 1958) (original minutes in both English and French).
42 FC(58)2rev1 (19 Apr. 1958) (original French language minutes).
43 C(58)118 (22 May 1958 (French); 28 May 1958 (English)) (original French language minutes).
44 *See* accompanying text at the end of the paragraph containing *supra* note 32.

goods or merchandise belonging to the enterprises from which he regularly delivers goods or merchandise on its behalf." This applied therefore in all cases where the agent did not conclude contracts, initially "on behalf of," and ultimately "in the name of," the enterprise. This provision was not used in UK domestic law but, as has been seen, derived from the 1930s agency profits treaties and was in use in all the UK treaties up to that time. In the same Working Party 1 draft, one might think somewhat inconsistently,[45] "the maintenance of a stock of merchandise, whether in a warehouse or not, merely for convenience of delivery" was excluded from constituting a permanent establishment except where the agency provision applied.[46] The reference to the stock of goods, so far as the agent was concerned, was deleted by Working Party 1,[47] and the Fiscal Committee added this explanation to the Commentary:

> 16. During the drafting of the Article it was at one stage suggested that one of the tests that should be used to determine whether or not an agent is to be regarded as a permanent establishment should be the availability in the country in which the agent operates and at the disposal of the agent of a stock of goods or merchandise belonging to the enterprise. This is, of course, a criterion commonly employed in bilateral Conventions for the avoidance of double taxation. For a number of reasons this suggestion was not pursued and in its present form paragraph 4 of the Article is founded on the view that the only real criterion is the nature of the authority entrusted to the agent; in brief, whether or not he has and habitually exercises an authority to enter into and conclude on behalf of the enterprise.[48]

The change is significant because those agents who did not contract (using the ultimate wording) "in the name of" the enterprise, such as the *Kommissionär/commissionnaire* and *Handelsmakler/courtier*,[49] were no longer relevant and could have been deleted from what is now article 5(6), which will be considered below.

45 The UK delegate to the Fiscal Committee stated that he was unable to accept this provision and that the United Kingdom would make a formal reservation if it were approved. FC/M(57)1 (8 Feb. 1957). *See* the correction to the minutes in FC/M(57)2 (3 July 1957). This is strange as it was UK treaty policy to include it. Presumably the explanation lies in the inconsistency, which did not arise in UK treaties.

46 FC/WP1(56)1 Appendix 1 (17 Sept. 1956).

47 It was not contained in FC/WP1(57)2 (29 Aug. 1957); the Commentary stated that the reason was to give the same result as for non-agency permanent establishments.

48 FC(58)1 (31 Jan. 1958). As has been seen, the final words later became "*in the name of* the enterprise."

49 It may seem unlikely that a *Handelsmakler/courtier* would hold a stock of goods. Indeed, the business of a *Handelsmakler* (as described by the German Commercial Code) did not entail holding a stock of goods for the enterprise. However, this is recognized as a possibility by the Mexico and London Drafts: "6. The fact that a broker places his services at the disposal of an enterprise in order to bring it into touch with customers does not in itself imply the existence of a permanent establishment for the enterprise, even if his work for the enterprise is, to a certain extent, continuous or is carried on at regular periods, *and even if the goods sold have been temporarily placed in a warehouse*" (emphasis added). The business of a *Handelsmakler* (as described by the German Commercial Code) did not entail holding a stock of goods for the enterprise.

C. Origin of what is now article 5(6)

It was even clearer that the Englishman wrote what became article 5(6). The original source is the much earlier UK legislation of 1915:

Nothing in section forty-one of the Income Tax Act, 1842 (as amended by any subsequent enactment or by this section), shall render a non-resident person chargeable in the name of[50] *a broker or general commission agent*, or in the name of an agent, not being an authorised person carrying on the non-resident's regular agency or a person chargeable as if he were an agent in pursuance of this section,[51] in respect of profits or gains arising from sales or transactions carried out through such a broker or agent. [52]

The context of this legislation was that the previous requirement that the agent receive the proceeds of the transaction before he could be taxed was removed because tax was being avoided by the agent's arranging not to receive it, which, as has been seen, led to the 1930s agency profits treaties.[53] This exception was provided for the removal of doubts because brokers, general commission agents and non-regular agents had not been regarded as leading to the principal trading *in* the United Kingdom (which was the taxing criterion).[54] The exception was refined in 1925 when the "ordinary course of his business" was introduced:

> (1) 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 satisfies the conditions required to be satisfied for the purposes of this section, 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 to income tax in the name of that broker in respect of profits or gains arising from those sales or transactions.
>
> (2) The conditions required to be satisfied for the purposes of this section are that the broker must be a person carrying on bona fide the business of a broker in Great Britain or Northern Ireland, and that he must receive 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.
>
> (3) In this section the expression "broker" includes a general commission agent. [55]

50 Another problem is the use of "in the name of" here in the completely different sense of "in whose name the assessment was made," but it may have meant that the Englishman was not alerted to the change in article 5(5) because the words were vaguely familiar.

51 In the case of *Gavazzi v. Mace*, (1926) 10 TC 698, Rowlatt J (a very distinguished tax judge) was puzzled by the section, stating (at 744): "I have great difficulty in understanding the fabric of this enactment. First of all, I do not quite see why you want the words 'broker or general commission agent' at all, because a broker or general commission agent is an agent who is not an authorised person carrying on a regular agency of the non-resident person, and therefore they would be protected without being mentioned at all. But they are put in, I suppose, as a sort of indication of the line on which the draftsman's mind is travelling before he comes to the phrase which supersedes these words, and expresses a larger idea which includes them."

52 Finance (No. 2) Act 1915 sec. 31(6) (emphasis added).

53 *See supra* note 25.

54 UK National Archives, file IR63/55, at 97; 1920 Royal Commission on the Income Tax, 1920, Cmd.615, Minutes of Evidence q 10,307(a).

55 Finance Act 1925 sec. 17 (emphasis added).

One point of interest is the definition of "broker" in subsection (3) to include a general commission agent, indicating that they are similar.[56] That legislation also heavily influenced the League of Nations 1927[57] and 1928 drafts, which used the same concepts (broker, commission agent, although not *general* commission agent,[58] bona fide, and, in the League of Nations Commentary, normal remuneration), the main difference being that the reference to the ordinary course of business in UK domestic law is missing from the League's draft; it was introduced for the first time into the OEEC draft.[59] The League's draft also includes other independent agents subject to the same conditions, but the UK expressions probably include most independent agents.[60] So all the elements of what became article

56 The difference seems to be that broker did not have possession of the goods and contracted (in the sense of describing what the contract said, which did not in any way affect the liability of the principal) in the name of the principal, and a general commission agent had possession of the goods, and might contract (again in a descriptive sense) either in his own name or in that of the principal. The Inland Revenue's briefing to Ministers in connection with the Finance Act 1925 stated that non-residents used general commission agents for selling produce or raw materials, rather than manufactured goods (UK National Archives, file IR 61/112, at 204). However, the explanation of the difference was the other way round during the negotiations for the United Kingdom-Germany treaty (1954) (IR40/9629A).

57 A memorandum on the UK system of taxing non-residents trading through agents had been tabled before the League of Nations committee on 3 January 1927, and so the UK law was known to them at the time. League of Nations document D.T.82, Archives, Geneva. The author is grateful to Sunita Jogarajan, Senior Lecturer, Melbourne Law School, University of Melbourne, for providing this document.

58 *See supra* note 35.

59 In Germany "ordinary course of business" was introduced by EStR [Einkommensteuerrichtlinien = Income Tax Directives] 1955 Abschn. 222 1955 to exclude independent agents from being permanent agents if acting within their ordinary course of business (Blümich, EStG [Einkommensteuergesetz = Income Tax Code] 1937, 2. Aufl. 1937, art. 49, sec. 488). It had been used earlier, but its origin is untraceable to any significant source (which is why this criterion was abandoned by the Federal Tax Court (BFH) of 28 June 1972, I R 35/70, BStBl II 1972, 785). Most sources referred to case law of the *Reichsfinanzhof* of the 1920s which mainly established independent agents to be potential permanent agents (RFH of 13 Sept. 1929, I A a 263/29; RFH of 10 Feb. 1926, VI A 493, 494/25, RStBl 1926, 161), but, at a closer look, this case law did not introduce explicitly the prerequisite that those agents act outside their ordinary course of business. Also, the parliamentary notes on the tax acts that introduced the permanent agent as giving rise to tax liability of foreigners (changes in the Corporate Tax Act in 1922 and Income Tax Act 1925) say nothing about restricting independent agents to those acting outside their ordinary course of business. On the contrary, these notes have independent agents as the typical kind of permanent agents in mind without regard to their ordinary course of business or to having an authority to conclude contracts "in the name of" the principal. BFH of 28 June 1972, I R 35/70, BStBl II 1972, 785 (citing and referring to the original parliamentary notes in the *Reichstagsdrucksachen*).

60 The is an obviously civil law origin of the League of Nations 1929 provision (C.516.M.175):
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.
The 1929 provisions were repeated in the 1930 Report, which represented a continuation of the discussion (C.340.M.140.1930.II), now with a statement about evidence of an employment contract. More surprisingly, the 1931 Draft Plurilateral Conventions (C.415.M.171.1931.II.A) reverted to the