Part 1 of this article discusses the concept of a permanent establishment ("PE") regarding offshore oil and gas activities, specifically focusing on when offshore activity satisfies the criteria for a PE under the OECD Model and analysing whether a vessel can be a PE.

1. Introduction


The legal rights of countries to claim taxing rights over activity performed on the continental shelf are defined in the United Nations Convention on the Law of the Sea ("UNCLOS"). The background to UNCLOS is set out below.

In the 17th century, the rights of nations over the sea were limited to a three-mile-wide belt surrounding the coast line, subject to the doctrine of the freedom of the seas. In the mid-19th century, countries around the world started to claim the right to the continental shelf. Following World War II, countries began to extend the three-mile belt to a 12-mile belt. Oil, tin, diamonds and fishing were the maritime resources that were primarily exploited.

The late 1960s saw a need for a more "stable order... and [the] better management of ocean resources." In 1967, Malta’s ambassador to the United Nations ("UN") gave a speech to the UN General Assembly, in which he highlighted the need for:

an effective international regime over the seabed and the ocean floor beyond a clearly defined national jurisdiction.

In 1973, the third UN Conference on the Law of the Sea was held and, in 1982, UNCLOS was adopted. As at February 2016, UNCLOS had been signed by 167 countries, being accepted worldwide to deal with all matters of the law of the sea.

UNCLOS defines the limits of the territorial seas of nations and the areas in which nations have the right to exploit marine resources. Specifically, UNCLOS distinguishes between the following zones of the sea:

- Baseline: this is the low-water line along the coast. The baseline is used to measure the boundaries of the sea from land.
- Internal waters: this is the water on the landward side of the baseline of the territorial sea, which forms part of the internal waters of a state.
- Territorial sea: this can be individually defined by each member state up to a limit not exceeding 12 nautical miles measured from the baseline. Within the territorial sea, states have exclusive sovereignty to the sea, airspace and seabed, which means that states are free to pass laws governing this area and to use any resource. Typically, a state’s tax legislation covers activities that take place in its territorial sea as a minimum.
- Contiguous zone: this is 24 nautical miles from the baseline. Within the contiguous zone, states are free to enforce their legislation relating to customs, taxation, immigration and sanitation to prevent the violation of such legislation in their territory or territorial waters.
- Exclusive economic zone (EEZ): this can measure up to 200 nautical miles from the baseline. In the EEZ, states have the exclusive rights to exploring and exploiting, conserving and managing natural resources, whether living or non-living, in the water or on the seabed. Contrary to the rights in the territorial waters, a state’s rights within the EEZ are limited to activities that relate to the natural resources below the surface, whereas the surface of the sea outside the territorial sea is considered international waters.
- Continental shelf: this is defined as the seabed and subsoil of the areas that extend beyond the territorial seas of states either throughout the natural prolongation of their land territory to the outer edge of the continental margin or to a distance of 200 nautical miles from the baselines. On its continental shelf, each state has the exclusive right to exploring and exploiting natural resources. In addition to the 200 nautical miles boundary, states may elect to extend their continental shelf up to 350 nautical miles following the baselines according to the provisions set out in article 76 of UNCLOS.

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1. This historical summary is based on the historical description available at www.un.org/depts/los/convention_agreements/convention_historical_perspective.htm.
2. Id.
3. Id.
A country that has signed UNCLOS has exclusive sovereignty to the sea within the limits described and must extend the area of its domestic (tax) legislation to include taxation of offshore activities.

1.2. International tax law

1.2.1. Opening comments

As companies in the offshore oil and gas industry are often resident in one state and perform business offshore in the sea or on the continental shelf of another state, it is relevant to determine how income earned by non-residents is treated in the source state. The following factors determine how income generated offshore is treated:
- a tax treaty in force between the source state and residence state, and does this tax treaty apply in the geographical area where offshore activity takes place; and
- if there is no tax treaty in place or the tax treaty does not cover the geographical area where activity takes place, what are the domestic tax rules in the source state?

1.2.2. Tax treaties

If a residence state and a source state have concluded a tax treaty, this determines which of the two states has the right to tax given income. A tax treaty based on the OECD Model,11 UN Model12 or US Model13 allocates the taxing rights with respect to income specifically referred to in a tax treaty and income that may be allocated to a permanent establishment (“PE”) to the source state. If a specific type of income is not referred to in the tax treaty or cannot be allocated to a PE, only the residence state may tax such income. The latter follows from article 7 of the OECD Model, which states that:

Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.

Tax treaties override domestic tax legislation. This is in the sense that, if the residence state has domestic rules in place for taxing worldwide income, and the taxing right under the tax treaty is conferred on the source state, the residence state must adhere to the exemption rules set out in the tax treaty.14

A tax treaty, on the other hand, is not the basis for taxation in itself. If a tax treaty allocates taxing rights to one of the states, but that state does not have domestic rules for taxing income, the taxing right cannot be exercised.15 Specific tax treaties include a provision that allocates the taxing right back to the residence state where a source state does not exercise its taxing right.16

Where no tax treaty has been concluded between the residence state and the source state, domestic rules apply in the residence state and in the source state. Whether the income is taxed in both states typically depends on the tax rules applicable in the residence state, i.e. is income from foreign PEs exempt from domestic taxation, or is a tax credit granted in respect of any foreign-paid taxes?

1.2.3. Territory of tax treaties

A tax treaty defines the geographical area to which it applies.17 This is typically stated in the definitions in article 3 of the tax treaty and can be worded in many different ways. As examples of different wordings, the tax treaty could apply within “the Federative Republic of Brazil”,20 “Denmark including the territorial sea”,21 or “Greenland, including the territorial sea and the continental shelf”.22

If a tax treaty does not extend to the continental shelf, there are two ways of interpreting the geographical area to which the tax treaty applies. One way is that the tax treaty applies in the same area as the tax legislation of the two contracting states. The other way is that the tax treaty only applies within the territorial area specifically referred to in the tax treaty, regardless of the domestic tax legislation.

In this context, Carvalho (2003)23 refers to an article by Skaar (1991)24 in which these two directions are labelled as the “universal view” and the “territorial view”, respectively. An example of this situation can be seen in the Norwegian Høyesterett (Supreme Court, “HR”) ruling in Heerema (1992),25 in which the court concluded that the Norway-Switzerland Income and Capital Tax Treaty (1956)26 did not apply to the Norwegian continental shelf and that the Norwegian domestic rules, therefore, applied in respect

11. Most recently, OECD Model Tax Convention on Income and on Capital (26 July 2014), Models IBFD.
12. Most recently, UN Model Tax Convention on Income and on Capital (1 Jan. 2011), Models IBFD.
13. Most recently, UN Model Tax Convention on Income (15 Nov. 2006), Models IBFD.
14. OECD Model Tax Convention on Income and on Capital: Commentary on Articles 23A and 23B, para. 8 (26 July 2014), Models IBFD, which reads: “[t]he articles, therefore, apply only to the State of residence and do not prescribe how the other Contracting State ... has to proceed.”
17. UN Vienna Convention on the Law of Treaties art. 29 (23 May 1969), Treaties IBFD, which states that: “[u]less a different intention appears from the treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory.”
19. Convention between the Swiss Confederation and the Kingdom of Denmark for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital (23 Nov. 1973) (as amended through 2009), Treaties IBFD.
24. Convention between the Kingdom of Norway and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital (7 Dec. 1956), Treaties IBFD.
of the Norwegian continental shelf, regardless of the tax treaty.

A similar example of a tax treaty that only applies to the states’ territorial waters and, therefore, provides no protection on the continental shelf is the Denmark–Switzerland Income and Capital Tax Treaty (1973). Article 3(1) of the tax treaty defines the applicable treaty area as follows:

(a) the term “Denmark” means the Kingdom of Denmark including the territorial sea as determined in conformity with international law; the term does not comprise the Faroe Islands and Greenland and their territorial sea;
(b) the term “Switzerland” means the Swiss Confederation.

In this context, the phrase “in conformity with international law” means that this area does not include the Danish continental shelf and would be an example of the "territorial view" as referred to above.

2. Is There a PE?

2.1. The definition of a PE

2.1.1. Opening comments

According to the definition in article 5(1) of the OECD Model (2010),

26 a PE is a fixed place of business through which the business of an enterprise is wholly or partly carried on. This definition consists of the following three criteria:

1. the existence of a “place of business”, such as premises or machinery and equipment (see section 2.1.2.2.);
2. such a place of business must be “fixed”, which means that the place of business must be established in a certain place and must have a certain degree of permanence (see section 2.1.2.3.); and
3. the carrying on of an enterprise’s business is undertaken through that fixed place (see section 2.1.3.).

Some countries adopt a fourth criterion, the "right to use" criterion, to determine whether or not a PE exists.26 Other countries consider a “disposal criterion” to be the third criterion.27 This article focuses on the criteria derived directly from article 5(1) of the OECD Model as being the "carrying on business through" (see section 2.1.3.).

2.1.2. Place of business

2.1.2.1. Initial remarks

According to the Commentary on Article 5 of the OECD Model, a “place of business” includes any premises, facilities or installations used wholly or partly to carry on the business of an enterprise.28 In this context, article 3(h) of the OECD Model states that:

the term business includes the performance of professional services and of other activities of an independent character.

2.1.2.2. Location

It follows from the Commentary on Article 5 of the OECD Model that, in order to have a "fixed place", both geographical and commercial coherence is required. These two concepts are now examined.

Geographical coherence means that operations must take place within either a single place or a limited area if the business is of a mobile nature. There is no specific requirement with regard to the size of this area and, therefore, it should be determined on a case-by-case basis.

Commercial coherence takes into consideration the customers of the business. If many different customers are served in a small geographical area, the commercial test may not be met. On the other hand, if a business has one customer in many different geographical areas in the same state, the commercial coherence test might be met, but not the geographical test.

The Commentary on Article 5 of the OECD Model notes that, unless both of these criteria are met, there is no fixed place and:

it is immaterial how long an enterprise of a contracting state operates in the other contracting state if it does not do so at a distinct place.29

2.1.2.3. Permanence

In order for a place of business to be fixed, it is also necessary that the presence of the business is not of a temporary nature, but must last for a given amount of time. This may be difficult to assess, as neither article 5 of the OECD Model nor the Commentary on Article 5 of the OECD Model defines the duration for which an activity has been carried on for long enough to be considered to be "fixed".

According to the Commentary on Article 5 of the OECD Model, the OECD member countries normally consider a six-month time limit in respect of which permanency can be established.30 However, if the business is of a recurring nature, a business that is carried on for less than six months in a year, but which recurs every year, could be considered to be permanent.

Attention must also be paid to the expected and intended duration of the activity in question. If a business is only intended to be carried out for a short period of time and is not considered to be permanent from the outset, but, ultimately, lasts for more than six months, the business could, retroactively, constitute a PE. Similarly, if the activity was expected to last for more than six months but was discontinued early, this could still be considered to be a PE, regardless of the time during which the activities were carried on in the source state.31

25. OECD Model Tax Convention on Income and on Capital (22 July 2010), Models IBFD.
29. Id. at paras. 5 and 5.5.
30. Id. at para. 5.
31. Id. at para. 6.
32. Sasseville & Skaar, supra n. 26, at p. 29.
2.1.3. “Carrying on business through”

The final part of the definition of PE is that the business of the enterprise must be carried on through the fixed place of business. The Commentary on Article 5 of the OECD Model does not provide much input that is relevant to the offshore industry as to what is meant by “carrying on business through” a fixed place. The Commentary on Article 5 of the OECD Model discusses the leasing of tangible property to third parties and concludes that leasing of tangible property to a third party through a fixed place of business generally makes such a business a PE. However:

If an enterprise of a State lets or leases facilities, ICS equipment [being industrial, commercial or scientific equipment], ... to an enterprise of the other State, without maintaining for such letting or leasing activity a fixed place of business in the other State, the leased facility, ICS equipment or intangible property, as such, will not constitute a permanent establishment of the lessor provided that the contract is limited to the mere leasing of the ICS equipment etc.

It follows from this that, if personnel are supplied to maintain industrial, commercial or scientific (ICS) equipment, which falls under the direction and responsibility of the lessee, this could constitute a PE under article 5(1) of the OECD Model. Alternatively, this could constitute a PE according to article 5(3) of the OECD Model where the activity relates to a construction or installation project and the 12-month limit in article 5(3) is satisfied.

2.2. Illustrative list of PEs: Article 5(2) of the OECD Model

Article 5(2) of the OECD Model contains an illustrative list of places that can constitute a PE. Sasseville and Skaar (2009) note that whether places contained in the illustrative list in article 5(2) of the OECD Model are examples of PEs or of places of business is debatable. These authors have found that most OECD member countries agree that the list should be regarded as examples of places of business that can constitute a PE if the general conditions for a PE are satisfied. If so, a more precise wording would have been, “the term place of business includes especially ..., rather than “the term permanent establishment includes especially ...”.

2.3. Construction or installation PE

Article 5(3) of the OECD model states that:

A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

According to Sasseville and Skaar (2009), this clause is generally viewed as an exemption clause, with a building site or construction or installation project only constituting a PE if it lasts for more than 12 months. The authors point out that there is no common understanding between OECD member countries as to whether this clause is also a “deeming clause”, whereby an activity that does not meet the general conditions for a PE under article 5(1) of the OECD Model is deemed to constitute a PE if it relates to a construction or installation project and if it lasts for more than 12 months.

Building sites, construction and installation projects on the seabed also fall within article 5(3), as long as a state’s seabed is included in its territory and the relevant domestic law or tax treaty covers the continental shelf (see section 1.1). This is supported by Schaffner (2013), who states that “Installations can be underground or undersea, for example, in relation to pipelines and cables”. The same author also notes, however, that only construction carried out for someone else is considered to fall within the construction clause. As such, an oil and gas company working on its own construction project on the seabed would be regarded as preparatory works under article 5(4) of the OECD Model, with the primary activity being exploration or extraction on the seabed.

3. Exploration and Exploitation Activities

3.1. Introductory remarks

Exploration and exploitation in respect of oil and gas is usually carried out by an oil and gas company, typically a national or international oil company. Such an entity is either granted a licence to explore and develop oil in a given state, or enters into an agreement with the national oil company to explore or exploit oil fields in that specific state.

Exploration activity includes various activities, such as sampling and seismic testing. Following initial tests, a company carries out drilling to confirm whether a reservoir contains oil or gas. If this proves successful, additional wells are drilled to test production possibilities and determine the quantities of oil and gas in the reservoir before a production or development well is created. During these activities, an oil and gas company may engage subcontractors, such as drilling companies or other service providers, if the company does not have these capabilities in-house.

In order for countries to be able to protect revenue from natural resources, companies engaged in exploration and exploitation of natural resources are covered by domestic petroleum tax regimes. Local presence, such as an incorporated entity or registered branch of the international oil company, is typically required to be able to bid for oil or gas concessions or enter into an oil or gas exploration or exploitation agreement with a state.

In this context, disregarding the requirement for local presence, Zimmer (1993) states that:

There is no doubt that income from oil and gas production is covered by the domestic rules and that such production is carried out through a permanent establishment (where a treaty applies). The problem concerns all the other activities carried out in connection with exploration and exploitation.

34. Sasseville & Skaar, supra n. 26, at pp. 31-32.
35. Schaffner, supra n. 27, at p. 181.
36. Id.
3.2. PEs

As article 5(2) of the OECD Model includes “extraction of natural resources” in the illustrative list of examples of PEs, it is, therefore, clear that a foreign oil and gas company engaged in the exploiting of natural resources has a place of business in the source state. However, as noted in section 2.3., some OECD member countries agree that the list should be read as an illustrative list of places of business, rather than as examples of PEs.

If the list is merely illustrative, an extraction activity should also meet the “fixed” and “business through” criteria before constituting a PE. As most countries have domestic rules to protect their fiscal sovereignty that require local presence for companies performing extraction or exploration of oil and gas, such as the incorporation of a local company or the establishment of a branch, article 5(1) of the OECD Model does not have much practical relevance in respect of an extraction or exploration activity, which confirms the statement of Zimmer (1993) quoted above.

If the “fixed” criterion were to be taken into account, the six-month threshold, including the expected duration discussed in section 2.1.2.3., would have to be considered. Given the expected timeline for oil and gas exploration projects, the six-month threshold would most likely always be exceeded and exploration projects, therefore, would be considered fixed.

Similarly, if the “business through” criterion were to be considered, an oil and gas company extracting oil or exploring for oil would be performing its core business by way of the “fixed place”. Consequently, the “business through” test would be satisfied in respect of oil and gas companies extracting or exploring for natural resources.

To conclude, disregarding any requirement for a local presence, all of the three criteria in article 5(1) of the OECD Model will, most likely, be satisfied for an international oil and gas company engaged in exploration or extraction in a foreign state.

3.3. Construction

With regard to the definition of building sites and construction and installation projects contained in article 5(3) of the OECD Model, Sasseville and Skaar (2009) state that:

there is also guidance confirming that activities related to oil exploration and extractions (as opposed to the construction and installation of oil rigs) are not covered.

As discussed above, it is, in practice, not critical to establish whether to use article 5(1) or (3) of the OECD Model with regard to extraction or exploration activity, as an international oil company is most likely required to have local presence in the state of operation by way of an incorporated entity or a registered branch of the foreign international oil company. It can also be expected that exploration or extraction activity would not only satisfy all three of the criteria contained in article 5(1) of the OECD Model, but would also exceed the 12-month threshold contained in article 5(3).

4. Drilling Activity

4.1. Introductory remarks

If the oil and gas company does not own and operate drilling rigs itself, it may well engage a drilling service provider to undertake drilling on the seabed to confirm the presence of oil and gas, test the production environment and construct production or development wells. Drilling is typically undertaken both in the exploration and extraction phases.

Fixed platform drilling rigs are installed on offshore platforms and remain in the same place for many years. Mobile drilling rigs consist of different types, depending on the depth of the sea and whether they are jack-up rigs, semi-submersible rigs or drill ships. A jack-up rig is the only one of these that rests on the seabed, even though it is not fixed to the seabed as are fixed platform rigs. Even though mobile rigs are not fixed to the seabed, they can remain in the same area for a long time and, even though they are mobile, not all are necessarily self-propelled.

As with the oil companies, the operator of a drilling rig is often a local entity, a company or a branch of the foreign company, whereas the owner of the drilling rig could be a separate, related or unrelated, company. As a drilling rig can easily be, and often is, moved from country to country, it is not commercially efficient for the owner and operator to be one entity, as this would mean having to sell and often reflag the drilling rig every time it is moved to a new jurisdiction.

Many of these offshore activities were more or less unknown when the definition of a PE in the OECD Model was drafted. How the definition applies to these activities is analysed below.

4.2. Place of business

A drilling rig is where the entity providing the drilling services performs its business activity, being drilling into the seabed under instruction of its customer, i.e. the oil and gas company. Consequently, drilling rigs constitute a place of business of a non-resident entity operating the rig. This is supported by Skaar (1991), who states that:

practice makes it clear that drilling rigs, ships... are “places of business” with respect to the definition of PE.

4.3. Fixed

Fixed platform rigs, by their nature, are fixed to the same geographical spot for a long time and, therefore, satisfy the “fixed” test. If this is the case, fixed platform rigs could be considered to be immovable property. Ships, boats and aircraft are explicitly excluded from the definition of immovable property in article 6 of the OECD Model. The fact that drilling rigs are not excluded indicates that fixed platform drilling rigs may constitute immovable property.

38. Sasseville & Skaar, supra n. 26, at p. 47.
39. Skaar, supra n. 22, at p. 120.
Depending on domestic legislation. In the absence of provisions specifically addressing mobile drilling rigs, such rigs should be treated as any other vessel, i.e. not being immovable property.

Whether mobile drilling rigs are considered to be fixed depends on the circumstances. A drilling rig that is anchored to the seabed for a long period of time could meet the fixed criterion. The same applies to semi-submersible rigs and drill ships, which, even though they might not be anchored to the seabed as other types of drilling installations, can remain in the same place for a long time on the same contract with the same customer. In these circumstances, such drilling rigs can meet the geographical and commercial criteria and be considered to be fixed. Schaffner (2013) suggests that this issue should be approached by considering each oil field to be one geographical area; a floating platform or rig moving around in the same oil field would, therefore, satisfy the geographically fixed criterion, even though it is not fixed to the ground. Contrary to this argument, the Danish State’s Tax Directorate (Statiskatte-direktoratet, "SD") held that a Norwegian company operating two drilling rigs on the Danish continental shelf for more than 12 months had a PE, even though the drilling rigs were operating on different locations on the Danish continental shelf.

Both the intended duration and the actual duration of a contract must be considered. Consequently, in analysing article 5(1) of the OECD Model, if a contract is intended to last for more than six months, but only lasts for four months, the activity should still be considered to be fixed.

4.4. Business through

The way in which drilling activity is structured may have an effect on whether the owner is considered to be carrying on a business through the drilling rig. An owner of a drilling rig may provide a drilling service to its customer, by way of a time charter, whereby the owner provides the drilling rig with a full crew to operate the rig, or the owner may rent out the rig, often to a related company, on bareboat terms. In the latter case, the bareboat charterer takes possession of the drilling rig and is the disponent owner of the equipment.

As noted in section 2.2., the Commentary on Article 5 of the OECD Model mentions that tangible property leased to a third party through a fixed place of business can constitute the business as a PE, depending on the level of service provided to maintain the equipment. In this context, it should be noted that the Norwegian HR case of Trinc/Trag (1997) dealt with leasing out of equipment in the offshore industry and the “carrying on business” criterion under Norwegian law. In this case, the HR held that the rental of a drilling rig on bareboat terms was insufficient to cause the rig owner to be taxable in Norway, as the rig owner did not take part in the risk of operating the drilling rig.

Trinc/Trag concerned two related companies. Trigon Contracting AG (“Trag”, which was resident in Switzerland) was taxable in Norway due to drilling activity conducted on the Norwegian continental shelf. Trag had rented the drilling rig from Trigon Inc. (“Trinc”, which was resident in Liberia) on bareboat terms. As Norway did not have a tax treaty with Liberia, the case was based on Norwegian domestic law. In this respect, it should be noted that Norway has a lower threshold for taxing non-residents than that under the OECD Model, which is based on a “carrying on business” test with no reference to a fixed place.

The result of the case was that the rig owner, Trinc, was not considered a participant in Trag’s business on the Norwegian continental shelf due to leasing out a drilling rig on bareboat terms. Consequently, Trinc was not considered to have a PE in Norway.

In this regard, the deciding judge stated that:

Nor can I see that the business has been going on for shared risk. Trag had the risk of gain or loss, a risk that depended on how the company [Trag] performed the task for Saga [being the end client]. Trinc was paid rent, which was independent of the fulfillment of this contract [with Saga]. The rent was indeed based on what Saga paid Trag, but I can hardly see that it matters that the rent was influenced by the market situation and the character of Trag’s contract. (Author’s unofficial translation)

Generally, a domestic ruling cannot be directly used to interpret the OECD Model. However, for the purpose of interpretation of other domestic law, this Norwegian case may be considered relevant.

How remuneration is calculated has not been addressed by the Commentary on Article 5 of the OECD Model, which, instead, takes a more practical approach by considering whose personnel is responsible for maintaining and/or operating the equipment in considering the operational risk. The Norwegian HR, therefore, went further than the OECD in stating that an owner who is leasing out equipment on bareboat terms can be “carrying on business”. For the purpose of domestic law, the Norwegian case illustrates that whether an enterprise is considered to be carrying on its business through a fixed place for leasing out of equipment may depend on the type of contract, the risk allocation between the lessor and lessee, and whether the lessor assumes part of the operational risk, i.e. the risk of operating the equipment, risk of receiving payment, etc.

In Trinc/Trag, even though the bareboat fee was calculated based on a third-party fee, it was paid to Trinc, regardless of whether Trag had received the fee from a third party and, therefore, no operational risk existed for the rig owner in relation to the contract with the client on the Norwegian continental shelf. Trinc/Trag also demonstrates that, under Norwegian law, the requirement of presence in the source state can be satisfied by leasing out equipment.

40. Schaffner, supra n. 27, at p. 160.

41. See Danish State’s Tax Directorate, Decision 1984, T/S 1984, 44. The ruling concerned the issue of whether drilling activity on the Danish continental shelf was considered to constitute a PE. In considering the fixed criterion, the continental shelf as a whole was considered to be one area.

42. Para. 8 OECD Model: Commentary on Article 5 (2014).


44. Id., at 9.
In some tax treaties, the use of substantial equipment in the source state has been included in the definition of a PE.\textsuperscript{45} As such, under these tax treaties, it is agreed that a bareboat agreement meets the "carrying on business through" criterion and that this is not left to domestic legislation. Up to 1992, the definition of royalties in article 12 of the OECD Model (1977) included:

... payments of any kind received as a consideration for the use of, or the right to use ... industrial, commercial or scientific equipment.\textsuperscript{46}

In the Australia-Denmark Income Tax Treaty (1981)\textsuperscript{47} and the Canada-Denmark Income and Capital Tax Treaty (1997),\textsuperscript{48} this wording is retained in article 12 even though the phrase "the use of equipment" is no longer included in the OECD Model definition of royalties. This means that a bareboat of equipment, i.e. drilling rigs, vessels or other offshore equipment, may result in the imposition of withholding tax under article 12 of these tax treaties if domestic legislation imposes withholding tax on such payments, as long as the activity does not constitute a PE under the general rule in article 5(1).

The Commentary on Article 5 of the OECD Model does not specifically address the most common way of chartering a drilling rig or vessel to a third party, i.e. under a time charter contract.\textsuperscript{49} However, as a time charter of a drilling rig or a vessel, in essence, is the hiring out of equipment including a full crew to operate the equipment while maintaining the full operational risk, a time charter would meet the “carrying on business through” test.

4.5. Construction

Skaar (1991) refers to a number of tax cases concerning drilling activities in the light of the construction clause.\textsuperscript{50} In a Danish administrative ruling of 1985, drilling for petroleum was assessed according to the construction clause, while, in another Danish ruling of 1988 concerning a company engaged in collecting data during drilling of test wells, drilling activities were considered under the general definition of a PE.\textsuperscript{51}

Sasseville and Skaar (2009) conclude that some countries consider the installation and construction of fixed oil rigs to fall within the scope of building sites, construction and installation projects.\textsuperscript{52}

As a drilling rig is used for the actual construction of the hole in the seabed, and for the extraction of natural resources via pipes and subsea installations, such an activity would most logically fall within the scope of article 5(3) of the OECD Model. In the US Model (2006), drilling rigs and ships are included in the construction PEs, insofar as these are used for exploration of natural resources. The fact that the same wording is not used in the OECD Model does not mean that these activities are excluded from article 5(3).

5. Service and Supply Ships

5.1. Introductory remarks

Service and supply ships cover a wide range of maritime support services provided to oil and gas and drilling companies. These vessels are regarded as mobile assets not fixed to the seabed. A number of examples from the industry are listed below:

- Platform supply vessels (PSVs): these are used for transporting supplies from a port to a drilling rig or other installation in an oil field. PSV activity is often carried out in a single jurisdiction. When these vessels are contracted for a longer period of time to support the same drilling rig, they are typically sailing the same route to and from a port and drilling rig over a long period of time.

- Anchor handling tug supply vessels (AHTSVs): these are used for towing drilling rigs and performing anchor handling for drilling rigs as well as PSV duties for the drilling rigs. The towing of drilling rigs may be from one jurisdiction to another. Once the transport of the rig is completed, the vessel sails on to the next customer in another jurisdiction.

- Construction support vessels (CSVs) and multi-purpose support vessels (MPSVs): these are used for supporting or performing subsea construction work. Subsea construction includes activities such as dredging and/or ploughing on the seabed, laying pipelines, subsea oil field installations and/or construction, diving support, supporting remotely operated vehicles (ROVs) operating on the seabed, etc.

- Emergency response rescue vessels (ERRVs): these are vessels that operate along offshore installations in an oil field. The purpose of these vessels is to perform rescue services in the event of emergencies, such as transporting personnel away from the place of emergency. Alternatively, ERRVs may provide warning services and pollution control. The presence of ERRVs alongside offshore installations is legally required in many jurisdictions. ERRVs are not fixed to the seabed.
but, by their nature, can be present in an offshore field in one geographical area on a more permanent basis than other types of support vessels.

- Salvage vessels: these are used for recovering or removing other vessels or equipment in the sea or on the seabed. Similar to the ERRVs, these vessels can work in the same area of the sea for a long period of time. In addition, the object, which a salvage vessel has been contracted to recover, can, in itself, be in a given area of sea for a long time.

As well as activities performed by these vessels, many other activities are carried on in the offshore industry, such as floating production storage and offloading (FPSO), towage and tug boats, accommodation vessels, crew change vessels, catering services, manning services, etc.

Historically, it was the general understanding that a vessel could not create a PE, as it was not a fixed asset. As such, the definition of a PE in the OECD Model has to deal with activities that were more or less unknown when the definition in the OECD Model was drafted. Whether this understanding has changed to deal with a more advanced offshore industry is analysed in the following section.

5.2. Place of business

Similar to drilling rigs, a vessel is the place where the owner or operator performs its business activity, whether the business consists of performing transportation of supplies, safety and/or standby services, or other services. As a consequence, vessels, regardless of type, may constitute places of business for a non-resident company.53,54

Following the increase in the frequency of foreign-service vessels operating on continental shelves of various countries, the revised proposals of 2012 to the Commentary on Article 5(1) of the OECD Model (2010)55 suggested including, in paragraph 5(5):

> ... a ship or boat that navigates in international waters or within one or more States is not fixed and does not therefore, constitute a fixed place of business (unless the operation of the ship or boat is restricted to a particular area that has commercial and geographical coherence). ...56

The proposal indicates that, as it is relevant to discuss whether a vessel is fixed, the same vessel can be considered a place of business. If a vessel has not been considered a place of business, it would not be relevant to consider whether it is fixed.

5.3. Fixed

A vessel, by its nature, is a mobile asset intended for transport or services that require a moving asset. Whether vessels satisfy the fixed criterion depends on the work that they are contracted for and if this takes place in a geographically and commercially coherent area.57 Not all jurisdictions share this point of view, which has developed over time along with the development of the offshore and shipping industry. Hoor (2014), for example, refers to a number of Luxembourg tax rulings and states that, according to these rulings:

> since ... ships ... are not fixed facilities they do not fall within the definition of fixed place of equipment.58

If a vessel operates in an area that is considered to be geographically and commercially coherent, the fixed test may be satisfied. This could be the case for PSVs transporting supplies, sailing the same route repeatedly, or CSVs working on only one subsea installation in the same oil field.

On the other hand, if the vessel works in more than one oil field on a country’s continental shelf, geographical coherence may not be considered to exist and, if a vessel is working in the same area for different customers, commercial coherence may not exist. However, the Danish 1984 ruling should be noted, which considered different oil fields on the Danish continental shelf to be one geographical area for deeming a PE to exist in respect of a drilling operator (see section 4.3.).59

ERRVs are required by law to be present alongside drilling rigs for 365 days a year. These types of vessels are, therefore, required to be present in a single place in the sea for a longer period of time. Moreover, if one vessel fulfils this requirement for a customer, it is likely that the geographical and commercial criteria are both satisfied. The same may apply to salvage vessels if they operate in a single spot of the sea for one customer, for example, if the vessel is recovering another vessel or shipwreck from the sea or seabed.

AHTSVs perform towing of drilling rigs and anchor handling for drilling rigs, which is somewhat different to other offshore services, in the sense that towing is not necessarily performed in one oil field, but often in different oil fields within one jurisdiction or across multiple jurisdictions. In addition to not operating in one geographically coherent area, this type of transport may also fall under the definition of international traffic, as it is not restricted to one state’s waters. Transport performed in international traffic is, according to most tax treaties and article 8 of the OECD Model, only taxable in the state of effective management, as long as the activity is not dealt with in an offshore provision that overrides article 8. If AHTSV’s perform anchor handling for drilling rigs, placing and moving and/or removing anchors, this can be done in one area with the...
duration varying, and the discussion on whether they are fixed is the same as for the other types of vessels.

5.4. "Carrying on business through"

Similar to drilling rigs, how a vessel is chartered may have an effect on whether the owner is considered to be carrying on business through its asset. An owner of a vessel often provides a service to its customer or charters the vessel by way of a time charter, whereby the owner provides a vessel with a full crew to operate the vessel according to the customer’s instructions. The owner may also rent out the vessel on bareboat terms, whereby the bareboat charterer takes possession of the vessel and becomes the disponent owner of the equipment. This can most often be seen between two related companies or in the context of a financial lease.

Whether a bareboat charter of a vessel may constitute a PE for the owner was considered by the Income Tax Rulings Directorate, Legislative Policy and Regulatory Affairs Branch of Canada (“ITRD”) in an advance income tax ruling.60 The ITRD concluded that entering into a bareboat agreement for a ship to be used in Canadian waters could not be regarded as carrying on business. The ITRD also noted that the activity was not covered by the offshore provision in the Canada–Norway Income and Capital Tax Treaty (2002).61 Consequently, the bareboat agreement was insufficient for the foreign owners to have a PE in Canada according to the general rules of article 5 of the tax treaty. The ITRD decision did not address the remuneration under the contract, but, instead, defined a bareboat charter as:

a contract under which a ship is leased or rented for a period of time on an unmaned basis. The person chartering the ship is responsible for manning and operating the ship and paying all expenses related thereto.62

By defining a bareboat charter as a type of contract where all of the operational risk is passed on to the lessee, the question of how remuneration is calculated was, therefore, less important.63

As noted in section 5.2., the proposed amendments to the Commentary on Article 5 of the OECD Model suggested including the following wording with regard to article 5(1) of the OECD Model:

... a ship or boat that navigates in international waters or within one or more States is not fixed and does not, therefore, constitute a fixed place of business (unless the operation of the ship or boat is restricted to a particular area that has commercial and geographical coherence) ...64

The wording “business activities carried on aboard such a ship or boat, such as a shop or restaurant” is likely intended to refer to the treatment of ferries or cruise lines. The explanation is, however, just as relevant for vessels in the offshore oil and gas industry. Even though the “carrying on business through” test is not specifically referred to in the proposed amendments to the Commentary on Article 5 of the OECD Model, the fact that “fixed” is discussed in the OECD Commentary on Article 5, indicates that operating a vessel does meet the “place of business” and “business through” criteria.

Finally, it should be noted that some service vessels carry out an activity that is covered by the shipping article in a tax treaty. For instance, this would generally be the case for AHTSVs towing drilling rigs from one jurisdiction to another. In this context, the definition in article 3(e) of the OECD Model in relation to international traffic reads as follows:

the term “international traffic” means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State.

Generally, income earned by an AHTSV in transporting a drilling rig from one country to another is only taxable in the contracting state in which the place of effective management (POEM) of the enterprise is situated.65,66

5.5. Construction

Depending on the type of work a vessel is carrying on, the activity could fall within the definition of construction and installation projects. In particular, if a vessel is contracted to support the installation or removal of pipelines, subsea constructions or drilling rigs, this could be covered by the construction and installation provision in article 5(3) of the OECD Model.

The Commentary on Article 5(3) of the OECD Model states that the time spent by subcontractors working on a building site is considered to be time spent by the general contractor on the building project, but that the subcontractors should count the time working on the same project separately.67 This indicates that, if the primary contractor is considered to have a building site and subcontracts part of the work to a service provider, the service provider can use a 12-month threshold in respect of the activity. In the offshore industry, this could be the case if a company operating a pipe-laying barge or a drilling rig hires a service vessel to move anchors for the barge or rig or to provide a stand-by service during part of the project.

62. ITRD, supra n. 60, at 2, definition (j)
63. This interpretation of bareboat charters could be read in the light of domestic Canadian tax law, which imposes withholding tax on non-residents’ use and non-use of equipment in Canada. The fact that domestic withholding tax is imposed on equipment could have impacted the ruling.
64. OECD, supra n. 56.
65. Article 8 of the OECD Model (2014) refers the taxing rights to profits from the operation of ships in international traffic to the state of the place of effective management. Some states prefer to allocate the taxing rights to the residence state and may freely substitute the wording in article 8 of the OECD Model (2014) to accommodate this. See paragraph 2 of the OECD Model: Commentary on Article 8 (2014).
66. See the comments on article 8 of the OECD Model (2014) in section 6.3 regarding tanker vessels.
6. Transport of Oil and Gas

6.1. Introductory remarks

The transport of oil and gas from the offshore well is carried out either by tanker vessels or through pipelines. Pipelines are permanent installations on the seabed or land used for transport of oil or gas to the refineries and markets. These can be located in one jurisdiction or across multiple jurisdictions. (See section 6.2. for pipelines in general.)

Tanker vessels are characterized as mobile vessels transporting supplies of crude oil or refined oil products, typically from one jurisdiction to another, but sometimes also within the same jurisdiction. Tanker vessels typically operate on demand and not on specific routes. When operating within one jurisdiction between an oil field and a port, tankers are referred to as ‘shuttle tankers’. (See section 6.3. for tankers in general.)

6.2. Pipelines

6.2.1. PEs

The Commentary on Article 5 of the OECD Model states that a place of business includes any premises, facilities or installations used to carry on business. Pipelines are intrinsically installations and the question, therefore, arises as to whether pipelines are used for carrying on business and which entity is using the pipelines. Even though it is not possible to point to one single part of a pipeline and consider that this is the place where the business is carried on, the purpose of a pipeline must be to conduct business, in the sense that the pipeline is facilitating the transportation of oil and gas. This is in line with the German Bundesfinanzhof (Federal Fiscal Court, BFH) decision in II R 12/92 (1996), in which the court stated that:

... it is the most important part of the corporation’s business [being the company owning the pipeline transporting oil for other enterprises].

Even though no single geographical place can be identified, a pipeline on the seabed is, as such, fixed to the seabed in the source state. As pipelines can span more than one jurisdiction, they can be considered to be fixed in more than one state. Olsen (2012) notes that, in addition to constituting a PE in the states where a pipeline begins and ends, the pipeline can constitute a PE in the transit states.

For companies owning or operating pipelines, the business may consist of either renting out the pipelines, i.e. not dealing with any maintenance, or offering to transport oil and gas and dealing with any necessary maintenance. The Commentary on Article 5 of the OECD Model states that the leasing out of equipment to another enterprise with no responsibility for maintenance is not considered a PE, unless this is done through a fixed place in a given state.

6.2.2. Construction

In the Commentary on Article 5(3) of the OECD Model, it is stated that the term “building site or construction or installation project” includes the laying of pipelines and dredging. The question of whether this applies to both land-based installation projects and installation projects on the seabed is not discussed in this article, but, as noted in section 2.3., both types of installation projects are expected to be covered by this term.

In the Denmark–United Kingdom Income Tax Treaty (1980), the construction or installation of a pipeline for the transport of oil or gas is specifically referred to in article 5(3)A and constitutes a PE whether or not it lasts for more than 12 months.

6.3. Tanker vessels

Similar to the other types of vessels referred to in section 5.4., a tanker is the place where an owner carries on its business. Consequently, the place of business test is satisfied.

Tanker vessels, which transport oil or gas from one jurisdiction to another, operate generally in a much larger geographical area than the other offshore activities. As a result, the vessels do not operate in a geographically coherent area, even though the commercial coherence test could be satisfied. Shuttle tankers sailing from an oil field to a port in the same jurisdiction would, depending on duration, be considered to satisfy the fixed criterion.

Even though tanker vessels may meet all of the criteria in article 5(1) of the OECD Model and give rise to a PE, a vessel transporting oil and gas from one jurisdiction to another is generally covered by a shipping article if there is a tax treaty in place between the jurisdictions that is based on the OECD Model. In this respect, it should be noted that, even though an activity is covered by a shipping article, the activity is not exempt from giving rise to a PE. The shipping article, i.e. article 8 of the OECD Model, is an exemption to article 7 and not article 5. As such, if an activity is covered by a shipping article, this only governs which state has taxing rights to the income earned.

With regard to tanker vessels, it is not relevant to consider the construction article. This is so as a tanker vessel transports oil and gas after the construction of an oil well has been completed and oil production is in place.
7. Interim Conclusions and Recommendations

The analysis of the PE definition in the OECD Model shows that, if the general criteria in the PE definition are met, different types of offshore activity can constitute a PE. As such, the general PE rule in the OECD Model can be applied to activity in the offshore industry. For offshore vessels, this indicates a change to the historical understanding, i.e. a vessel cannot constitute a PE.

Olsen (2012) makes a number of recommendations with regard to potential amendments to the OECD Model in his analysis of taxation of cross-border pipelines. With regard to this article, one recommendation especially stands out. This is the recommendation that an offshore provision should be added to the OECD Model. In this article, the author has not considered special offshore provisions, which are included in many tax treaties between states with significant natural resource reserves. These offshore provisions are the subject of part II of this article. It is, however, clear that the uncertainties relating to the (mobile) offshore industry should preferably be resolved by a specific offshore article, rather than the general article 5(1) of the OECD Model.

75. Olsen, supra n. 69, at ch. 8, sec. 8.2.

Finally, it should be noted that a further solution would be to include comments and guidance in the Commentary on Article 5 of the OECD Model as to how different activities relating to the exploration and exploitation of natural resources should be dealt with in analysing whether a PE exists according to article 5(1) of the OECD Model. For instance, it would specifically be beneficial to have:

- OECD guidance as to whether "drilling rig activity" includes services provided to drilling rigs or only services provided by the drilling operator; and
- a common approach as to whether construction and installation projects include service providers, i.e. service and supply vessels (such as pipelines and drilling rigs), which are supporting construction projects covered by article 5(3).

The foregoing would ensure a more consistent allocation of taxing rights with regard to offshore oil and gas activities, as well as providing certainty for non-resident corporations in the offshore industry.