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Controversy over the qualification of a “building site or construction or installation project” as a PE in the Covid-19 era

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Summary

The Covid-19 pandemic has shaken several rules applicable in conventional tax law, in particular with regard to determining the conditions for qualifying a “building site or construction or installation project” as a permanent establishment (hereafter “PE”), as defined by the OECD Model Tax Convention on Income and on Capital (hereafter “OECD MTC”). It should be noted that “exceptional situations call for exceptional measures”, and that the contracting jurisdictions of a Double Tax Convention (hereafter “DTC”) are required to play down the changes underlying the said pandemic in order to maintain a balance in the application of the distributive rules, including those relating to PEs.

I. Setting the Scene

The OECD MTC establishes clear rules on how to tax the income of both individuals and companies whose activities transcend the borders of a single jurisdiction. However, with the advent of the Covid-19 pandemic, several rules related to treaty tax law are being challenged, raising concerns for both taxpayers and tax administrations.

Among the DTC rules affected by Covid-19 are those applicable to PEs. According to article 5 para. 1 OECD MTC, a PE is “*a fixed place of business through which the business of an enterprise is wholly or partly carried on*”. This concept of PE is particularly important, insofar as it makes it possible to identify the source of a profit and to guarantee the State in which a PE is located to tax the profits of the company which are attributable to the said PE[2]. On the other hand, income from an activity that is not considered a PE within the meaning of the treaty may not be taxed in the State where the entity is located[3].

Paragraph 2 of the same Art. 5 OECD MTC specifies that the places of business which may be considered as PEs are in particular: (a) a place of management; (b) a branch; (c) an office; (d) a factory; (e) a workshop, and (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources. This list is by no means exhaustive – but rather indicative – and these

examples of places of business constitute a PE only if they meet the requirements of the general definition set forth in paragraph 1 above[4]. In the same vein, paragraphs 3 and following of the same article 5 determine other conditions under which a natural or legal person may or may not be considered to be a PE, in particular with regard to a “building site or construction or installation project”.

This paper attempts to clarify the conditions for qualifying a “building site or construction or installation project” as a PE, both in ordinary times (section II below) and in the current Covid-19 era (see section III). This analysis is essentially limited to the provisions of the OECD MTC as well as the “Analysis of Tax Treaties and the Impact of the COVID-19 Crisis” published under the pandemic[5].

II. Requirements for the Qualification of a “building site or construction or installation project” as a PE

Article 5 para. 3 OECD MTC states that: “*A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months*”. It follows that, in order to be qualified as a PE, a building site or construction or installation project must exist for a period of more than twelve months, otherwise (that is to say when the said site or project concerns work less than the said period) it would not be considered as such[6]. The OECD Commentary provides the following clarification of the content of the term “building site or construction or installation project”:

“The term “building site or construction or installation project” includes not only the construction of buildings but also the construction of roads, bridges or canals, the renovation (involving more than mere maintenance or redecoration) of buildings, roads, bridges or canals, the laying of pipelines and excavating and dredging. Additionally, the term “installation project” is not restricted to an installation related to a construction project; it also includes the installation of new equipment, such as a complex machine, in an existing building or outdoors. On-site planning and supervision of the erection of a building are covered by paragraph 3. States wishing to modify the text of the paragraph to provide expressly for that result are free to do so in their bilateral conventions” [7].

It should be noted that there are a few DTC worldwide that have implemented the last sentence of the above commentary, namely the possibility of amending the wording of para. 3 of article 3 by including “on-site planning” and “supervision” of the work site. This is the case of the Swiss-Argentine DTC, which states that “*the term “permanent establishment” likewise encompasses: (a) a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only where such site, project or activities continue for a period or periods aggregating more than six months within any twelve month period*”[8]. In the same vein, the South Africa-DR Congo DTC states that “*the term permanent establishment likewise encompasses: (a) a building site, a construction, assembly or installation project or any supervisory activity in connection with such site or project, but only where such site, project or activity continues for a period of more than six months; [...]*”[9].

In addition, for a “building site or construction or installation project” to be considered a PE, its duration must be at least 12 months. The United Nations Model Double Taxation Convention between Developed and Developing Countries (hereafter “UN MTC”) provides for 6 months[10] and, in specific cases, bilateral negotiations could reduce the 6-month period to not less than 3 months[11]. Neither the OECD Commentary nor the UN Commentary justify the respective

choices of a 12 and 6/3 month duration. Nevertheless, the UN Commentary states – as if by a matter of principle – that “*where a building site exists for six months, it will in practice almost invariably also meet the requirements of paragraph 1*”[12], i.e. the requirements for the existence of a PE. The choice of the six-month period is retained by several DTC concluded between developing countries as well as between these and developed countries. This is the case of the “*Convention between the Kingdom of Belgium and the Democratic Republic of Congo for the avoidance of double taxation and the prevention of fiscal evasion and avoidance with respect to taxes on income and on capital*”[13], whose article 6 provides that “*a construction or assembly site shall not constitute a permanent establishment unless its duration exceeds 6 months*”.

To take into account the *ab initio* period of 12 months, the OECD Commentary specifies that “a site exist from the date on which the contractor begins his work, including any preparatory work, in the country where the construction is to be established, e.g. if he installs a planning office for the construction”[14]. In addition, for the purpose of determining the length of time the site or project has existed, the time the contractor has already spent on other sites or projects should not be taken into account. A building site should be considered a “unit”, even if it is based on several contracts, as long as it is commercially and geographically coherent. Subject to this condition, a building site will constitute a unit even if the orders were placed by several persons, as in the case of a row of houses.[15]. Last but not least, in execution of a guarantee obliging a company to carry out post-construction repairs, any other work which may be undertaken on a site or project after the construction has been completed, will normally not be taken into account in the period initial of construction[16].

III. Current Exceptional Situations under Covid-19

The consequences of the Covid-19 pandemic – with its corollary the economic crisis – have been significant in the construction sector, the latter being sensitive to economic cycles, such that the sharp drop has hit construction companies and workers hard in economic activity due to the pandemic[17]. Logically, several activities carried out on construction sites have been temporarily interrupted by the ongoing pandemic. The question that we would therefore ask ourselves is whether the duration of this interruption dictated by the Covid-19 pandemic should be taken into account for the calculation of the 12-month period necessary for the qualification of a “building site or construction or installation project” as a PE.

By the way, according to the OECD guidelines, the duration of this interruption due to the Covid-19 pandemic “*should not, however, enter into the calculation of the duration of existence of a site or project and should therefore not be taken into account in determining whether a building site or project constitutes a PE*”[18]/[19].

It should be noted that, according to the OECD Commentary, the temporary interruption of work on a site does not mean that the latter has ceased to exist. As a result, seasonal interruptions (such as bad weather) and temporary interruptions (for example a lack of materials or labor difficulties) must be included in the calculation of the duration of existence of a building site or project[20]. However, the OECD Commentary does not provide a clear criterion for what constitutes a “temporary” interruption, with the result that States may have differing views on the duration of a “non-temporary” interruption, as well as on the other conditions that distinguish it from the above examples provided by the Commentary.

Thus, some States may consider that particular periods of interruption of work on building sites,

due to restrictions imposed in the country because of the COVID-19 pandemic, should not be taken into account in calculating the duration thresholds of “building site or construction or installation project” constituting a PE. According to this logic, it would not be possible to conclude that a PE exists “*since the duration test would only be satisfied by including days during which operations were prevented on the construction site as a result of COVID-19 restrictions*”[21].

Finally, it should be considered that, in view of the exceptional circumstances related to the Covid-19 pandemic, and having regard to the factual and circumstantial considerations specific to each case to be examined, certain periods during which operations or work were interrupted or suspended in compliance with public health measures (against Covid-19) dictated by the public authorities of the location of the building site, constitute a type of interruption that should be excluded from the calculation of the duration thresholds applicable to building sites constituting a PE[22].

Concluding remarks

The Covid-19 pandemic is certainly at the root of too many uncertainties generating potential disruptions to the equilibrium of DTC provisions; however, these disruptions should be put into perspective, particularly with regard to PE constituted in the form of a “building site or construction or installation project”. An interruption of the twelve-month period following health policy measures taken by the public authorities to fight against the pandemic should not be taken into account by the States, in the interest of maintaining the balance of the distributive rules of the DTC.

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[2] See Bernard Castagnède, *Précis de fiscalité internationale*, Paris, Presses Universitaires de France, 2015, p. 450.

[3] Marc Bauen & Raphael Gani, *La fiscalité internationale des Etats-Unis*, Zurich, Schulthess Juristische Medien AG, 2008, p. 297.

[4] 2017 OECD Commentary, Art. 5, para. 45.

[5] Indeed, as of April 3, 2020, the OECD Secretariat issued a document entitled “*OECD Secretariat analysis of tax treaties and the impact of the COVID-19 crisis*“. On January 21, 2021, it published a revised version, entitled “*Updated guidance on tax treaties and the impact of the COVID-19 pandemic*” (hereafter “*OECD Update guidance 2021*”).

[6] See B. Castagnède, *Op.Cit.*, p. 451.

[7] 2017 OECD Commentary, Art. 5, para. 50.

[8] Art. 5, para. 3, let. a) of the “*Convention between the Swiss Confederation and the Argentine Republic for the Avoidance of Double Taxation with respect to taxes on income and on capital*“, concluded on 20 March, 2014.

[9] Article 5, para. 3, let. a) of the “*Convention between the government of the Republic of South Africa and the Government of THE Democratic Republic of Congo for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income*“, concluded on April 29, 2005.

[10] See Art. 5, para. 3, let. a) MC-ONU.

[11] UN Commentary, Art. 5, para. 7.

[12] *Ibidem*.

[13] Concluded on May 23, 2007, in Brussels. Available online (only in French) at : <<http://www.droit-afrique.com/upload/doc/rdc/RDC-Convention-fiscale-Belgique.pdf>> (assessed on February 2, 2022).

[14] 2017 OECD Commentary, Art. 5, para. 54.

[15] 2017 OECD Commentary, Art. 5, para. 51.

[16] 2017 OECD Commentary, Art. 5, para. 55 (fourth sentence).

[17] For more details, see the ILO Sectoral Brief entitled “Impact of COVID-19 on the construction sector”, Geneva, January 2021, p.1. Available online at <https://www.ilo.org/wcmsp5/groups/public/—ed_dialogue/—sector/documents/briefingnote/wcms_767303.pdf> (assessed on February 5, 2022).

[18] OECD Update guidance 2021, para. 25.

[19] This quote is an English translation of the French version of the Update guidance 2021. There seems to be a mismatch between the English version and the French version of the Update guidance 2021. In French, it says that « *la durée de cette interruption ne devrait toutefois pas entrer dans le calcul de la durée d’existence d’un chantier et ne devrait donc pas être prise en compte pour déterminer si un chantier de construction constitue un ES* » ; while in English it says that “ *the duration of such an interruption of activities should, however, be included in determining the life of a site and therefore will affect the determination whether a construction site constitutes a PE* “.

[20] 2017 OECD Commentary, Art. 5, para. 55 (third sentence).

[21] OECD Update guidance 2021, para. 26.

[22] OECD Update guidance 2021, para. 27.

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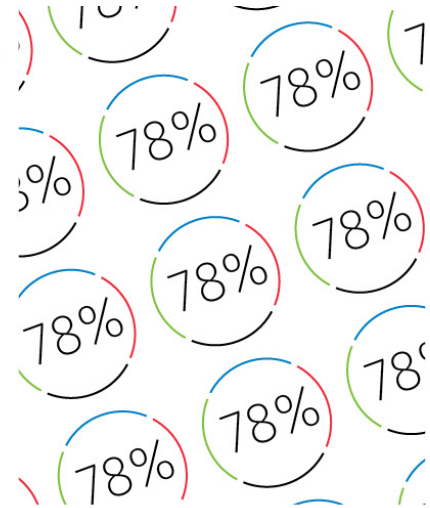
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