

The Existing Forms of Permanent Establishment Under Vietnam Double Tax Agreements: A Comparative Approach

Duong Van Hoc (LLM)

Lecturer of Business Law Department
School of Law, Can Tho University, Vietnam

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Abstract

Permanent establishment is a standard for distribution of taxing rights over business profits of a foreign enterprise in international taxation context. As dated to 10/8/2016, Vietnam has concluded Double Taxation Agreements with 76 countries and territories which contained the permanent establishment under Article 5. In order to assist relevant countries in drafting double tax treaties, the OECD and the United Nations (UN) have contributedly released Model of Tax Conventions (the Models) which also included the permanent establishment article therein. Additionally, both OECD and UN have individually published the Commentaries of the Model Tax Conventions which have been accepted as international customary law for interpretation of tax treaties. This study aims to analyze several existing forms of permanent establishment under Vietnam Double Tax Agreements and Circular 205/2013/TT-BTC of the Ministry of Finance as the implementing guidance for these treaties. Further, the study explored different approaches of Vietnam Double Taxation Agreements in comparison to the Model Tax Conventions of OECD and UN in respect of permanent establishment existing forms. The results showed that Vietnam DTAs substantially supported the UN Model rather than the OECD Model. Moreover, a number of recommendations were proposed for amending and modifying the Circular 205/2013/TT-BTC to catch up with modern businesses.

Keywords: Permanent establishment, Model Tax Convention, Vietnam Double Tax Agreements.

1. Introduction

Pursuant to Article 7 of Vietnam Double Taxation Agreements (DTAs), the profits of an enterprise of a Contracting Party (foreign enterprise) shall be taxable only in that Party unless the enterprise carries on business in

the other Contracting Party through a permanent establishment situated therein. In this circumstance, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on (Li, 2013, p. 210). This definition is enshrined under Article 5(1) of Vietnam DTAs and Article 11 of Circular 205/2013/TT-BTC as the guiding document. Besides, these treaties are also to regulate the existing forms of a permanent establishment in the remains of Article 5. Particularly, the existing forms of a permanent establishment could be classified (Harris and Oliver, 2010, p. 136-152):

- “Fixed-place” businesses like a branch, an office, a factory, a workshop, a place of extraction of natural resources (Article 5(2));
- A building site, a construction, assembly or installation project (Article 5(3));
- Furnishing services (Article 5(3));
- Dependent agent (regularly Article. 5(5))
- Independent agent (regularly Article 5(6) or Article 5(7))

The existing forms of a permanent establishment are mostly similar under Vietnam DTAs since they have been essentially negotiated based on the Model Tax Conventions of OECD and UN. However, both of the Models did contain a few discrepancies, therefore, they would considerably impact the current Vietnam DTAs. The subsequent parts of this study planned to discuss comparatively several existing forms of permanent establishment. The statistics were conducted upon 68 in-forced tax agreements of Vietnam up to 10/8/2016.

2. Analysis of Several Existing Forms of Permanent Establishment under Vietnam Double Taxation Agreements

2.1 Natural Resources Extraction site and Exploration activities

Natural resources extraction site is included in all of Vietnam DTAs, for instance, Article 5(2f) of Vietnam - Singapore DTA stated: “The term permanent establishment includes especially:... (f) A mine, an oil or gas well, a quarry or any other place of **extraction of natural resources**” (Vietnam General Department of Taxation, 2013). However, in regard to exploration of natural resources, there are 48/68 DTAs¹ (70.5%) to stipulate this matter. For example, Article 5(2h) of Vietnam - Cuba DTA specified: ““The term permanent establishment includes especially:... (h) An installation structure or equipment used for **exploration of natural resources**” (Vietnam General

¹ Vietnam DTAs included exploration activities: (with) Austria, Bangladesh, Belarus, Brunei, Bulgaria, Canada, Cuba, Czech Republic, Finland, Hong Kong, Iceland, Indonesia, Ireland, Israel, Kazakhstan, North Korea, Kuwait, Morocco, Myanmar, Oman, Pakistan, Philippines, Qatar, Romani, Saudi Arabia, Seychelles, Spain, Sri Lanka, Tunisia, Ukraine, Uzbekistan, Venezuela, Uruguay, Malta, San Marino, and Azerbaijan.

Department of Taxation, 2013). Comparatively, both OECD Model and UN Model did not contain this kind of businesses in the recommended text, however, in their Commentaries, the natural resources exploration activities could be recognized as a form of permanent establishment if the Contracting Parties agreed to designate. OECD (Commentaries section, 2010) read: "... Since, however, it has not been possible to arrive at a common view on the basic of questions of the attribution of taxation rights and of the qualification of the income from exploration activities, the Contracting States may agree upon the insertion of specific provisions" p. 99.

It is acceptable to enumerate a number of extraction locations like a mine, a quarry or gas well in the Article 5(2), however, it is also necessary to elucidate the phrase "any other place of extraction of natural resources" in this Article. It is assumed that this Article aimed to recognize the in-situs forms of resources extraction activities, however, a place of natural resources extraction could actually be extended as sizable as thousands hectare of forest or a large maritime zone used for marine exploitation. A few Vietnam DTAs also contained explicitly other types of nature extraction activities like a farm or plantation (Brunei, Indonesia, Qatar, Romania); a farm or plantation or place of extraction of timber/forest products (Myanmar, Malaysia); an agricultural, pastoral, and forestry property (Australia). Therefore, the phrase "any other place of extraction of natural resources" should be extended to all types of natural extraction activities instead of "permanent" character like the current Vietnam DTAs mentioned (OECD, Commentaries section, 2010, p. 98-99).

Additionally, it is observable that the foreign enterprise has to establish or acquire a building site or a construction project (regulated subsequently by Article 5(3) of Vietnam DTAs) before operating the exploitation or exploration businesses. Consequently, there are three possible scenarios that could be envisaged such as: (1) the construction project and the extraction activities are carried by the foreign enterprise itself; (2) the extraction business is carried by the foreign enterprise but the construction project was conducted by other enterprises; and (3) the extraction activities are carried through a leased extracting site of other enterprises. Thus, it is critical to contain the guidance for these circumstances in terms of determination of permanent establishment under Circular 205/2013/TT-BTC.

2.2 Building Site, Construction or Installation Project

Building site, construction or installation project of a foreign enterprise has actually posed a question for original concept of permanent establishment as an in-situs form (Keith R. Evans, 2002, p. 506). Conceptually, these kind of businesses could be conducted across numerous of working locations which are geographically distributed for a whole construction project (e.g. road construction) (OECD, Commentaries section, 2010, p. 101). As a result, it is

necessary to rule the building site, construction or installation project under a specific paragraph of Article 5 of DTAs. For instance, Article 5(3a) of Vietnam – Netherlands DTA states: “The term "permanent establishment" likewise encompasses: ... a building site, construction, assembly or installation project or supervisory activities in connection therewith, but only where such site, project or activities continue for a period of more than six months” (Vietnam General Department of Taxation, 2013). The Circular 205/2013/TT-BTC was texted similarly to this Article but the required period for constituting a permanent establishment would particularly depend on individual DTA (6 months or 3 months accordingly). There are several legal aspects for determination of building site or construction project as a permanent establishment.

First, the regulatory objects of the mentioned regulation are building site, construction or installation project and supervisory activities which marginally varies among Vietnam DTAs. Statistically, 6/68 DTAs (9%) (with Laos, Singapore, South Korea, France, Germany, and the UK) ruled that a building site, construction, assembly or installation project of a foreign enterprise could be recognized as a permanent establishment in a Contracting State while the remained DTAs (62/68 – 91%)² did include **supervisory activities**. In comparison to the Models, OECD approach was likewise to the minor group while UN approach supported the overwhelming one. However, both Vietnam DTAs and the Circular 205/2013/TT-BTC did not envisage the future maintenance or repairing activities for previous building site, construction or installation project. In this situation, OECD recommended that these after-sale organisations perform an essential and significant part of the services of an enterprise vis-à-vis its customers, their activities are not merely auxiliary ones (OECD, Commentaries section, 2010, p. 103). It means that if the foreign enterprise backed to previous building site or construction project to provide maintenance services, this type of businesses could expectedly constitute a permanent establishment of the foreign enterprise.

Second, the existing period to constitute a permanent establishment for a building site or construction or installation project is slightly deviated among Vietnam DTAs. Accordingly, 65/68 (95.5%)³ DTAs accepted six months

² Vietnam DTAs included supervisory activities: (with) Australia, Austria, Bangladesh, Belarus, Belgium, Brunei, Bulgaria, Canada, China, Cuba, Czech Republic, Denmark, Finland, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italia, Japan, North Korea, Kuwait, Luxembourg, Malaysia, Mongolia, Morocco, Myanmar, Netherlands, New Zealand, Norway, Oman, Pakistan, Palestine, Philippines, Poland, Qatar, Romani, Russia, Saudi Arabia, Seychelles, Slovak, Spain, Sri Lanka, Sweden, Switzerland, Taipei, Thailand, Tunisia, U.A.E, United Kingdom, Ukraine, Uzbekistan, Venezuela, Uruguay, Malta, San Marino, Iran, Serbia, Kazakhstan, Mozambique, Azerbaijan

³ Vietnam DTAs regulated six months period (or above 183 days) for a building site or construction or installation project: (with) Australia, Austria, Bangladesh, Belarus, Belgium,

period (or above 183 days) while three of the DTAs specified different formula: above three months (Philippines) and above 60 days of a twelve months period (Sri Lanka); and above 6 months of a twelve months period (Palestine). In relation to this aspect, OECD Model and UN Model did contain different requirements: twelve months and six months period respectively. Thus, it is perceptible that all of the Vietnam DTAs have approached in favor of UN Model or a less time-demand criteria.

Third, it is regulatory that a building site, construction or installation project could be conducted by a general contractor – subcontractor relationship. The Vietnam DTAs certainly did not contain this very specific case while the Circular 205/2013/TT-BTC clarified: “... a subcontractor of a Contracting Party participates to a building site, construction or installation project [which a foreign enterprise of a Contracting Party conducted as a general contractor], such subcontractor could constitute a permanent establishment if the conditions specified in 2.1.1.1 are fulfilled”.

“The existing period to determine a permanent establishment for a general contractor would be the cumulative time of the subcontractors and the general contractor”. However, it is questionable that if the operation of a building site, construction or installation project does not recognize between a general contractor and subcontractors, how could the existing period for permanent establishment be calculated?

2.3 Dependent Agent

A foreign enterprise could practically conduct its businesses in Vietnam through a dependent agent which does not fulfill the “in-situs” criteria for constituting a permanent establishment. For example, an employee could, on behalf of the foreign enterprise, negotiate and conclude contracts or representatively delivers goods or merchandises. Vietnam DTAs did regulate these business activities but there are different approaches among Vietnam tax treaties. Comparatively, Article 5(5) of OECD Model just included the activity of concluding contracts on behalf of foreign enterprise while the UN Model contained both concluding contracts and delivering goods or merchandises on behalf of the foreign enterprise. Statistically, 11/68 (16.1%)⁴ Vietnam DTAs

Brunei, Bulgaria, Canada, China, Cuba, Czech Republic, Demark, Finland, France, Germany, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italia, Japan, North Korea, Kuwait, Lao RDP, Luxembourg, Malaysia, Mongolia, Morocco, Myanmar, Netherlands, New Zealand, Norway, Oman, Pakistan, Poland, Qatar, Romani, Russia, Saudi Arabia, Seychelles, Singapore, Slovak, South Korea, Spain, Sweden, Switzerland, Taipei, Thailand, Tunisia, U.A.E, United Kingdom, Ukraine, Uzbekistan, Venezuela, Uruguay, Malta, San Marino, Iran, Serbia, Kazakhstan, Mozambique, Azerbaijan

⁴ Vietnam DTAs supported OECD Model: (with) China, France, Germany, Lao RPD, Singapore, South Korea, Taipei, Thailand, the UK, Venezuela, and Iran.

followed the OECD Model; 48/68 (70.5%)⁵ Vietnam DTAs approached as UN Model; the remained agreements indicated several different approaches⁶.

In terms of the representative entities, a foreign enterprise could carried its businesses in Vietnam by a physical person and another enterprise. In case of physical person, it is necessary to clarify several aspects for constitution of a permanent establishment as a dependent agent.

First, it is essential to emphasize that the dependent agent could be an employee of the foreign enterprise or not. In other words, the formal employmentship with the foreign enterprise is not a matter if an agent representatively concluded contracts or delivers goods or merchandises on behalf of the foreign enterprise (OECD, Commentaries section, 2010, p. 105). In this circumstance, it is also unnecessary to require the residential status of this agent in Vietnam if the agent could finish his or her representative tasks. The Circular 205/2013/TT-BTC does not mention these issues, therefore, such clarifications are useful to suggest.

Second, a dependent agent is actually entitled to conclude contracts or deliver goods or merchandises on behalf of the foreign enterprise. All of Vietnam DTAs similarly use the term “conclude contracts” in the Article 5, however, the Circular 205/2013/TT-BTC does contain “**negotiate**, conclude contracts”. Thus, it can be debatable whether the dependent agent has to complete all stages of contract completion including drafting, negotiating, and concluding with business partners or just simply conclude these contracts?

As guidance by OECD, an agent who has already negotiated all aspects and details of the contracts is deemed to be on behalf of the foreign enterprise although such contracts are concluded by other designated entities (OECD, Commentaries section, 2010, p. 106). In addition, Committee of Experts on International Cooperation in Tax Matters (UN) likewise explained that the representative criteria is fulfilled if an agent has already negotiated the main

5 Vietnam DTAs supported UN Model: (with) Austria, Bangladesh, Belarus, Belgium, Brunei, Bulgaria, Canada, Cuba, Czech Republic, Denmark, Finland, Hong Kong, Hungary, Iceland, India, Ireland, Israel, Italia, Japan, North Korea, Luxembourg, Mongolia, Morocco, Myanmar, Netherlands, Norway, Oman, Pakistan, Palestine, Philippines, Poland, Qatar, Romani, Russia, Saudi Arabia, Seychelles, Slovak, Sweden, Switzerland, Tunisia, Ukraine, Uzbekistan, Uruguay, Malta, San Marino, Serbia, Kazakhstan, Mozambique, Azerbaijan

6 Vietnam DTAs with **Indonesia, Malaysia, Palestine and New Zealand** approached similarly to UN Model but included the manufacturing or processing for foreign enterprise; **Kuwait** approached like four mentioned DTAs but included maintaining orders exclusively or almost exclusively for foreign enterprise; **UAE and Sri Lanka** also approached likewise to UN Model but included maintaining orders exclusively or almost exclusively for foreign enterprise; **Australia** supported OECD Model but included the manufacturing or processing for foreign enterprise; and **Spain** approached similarly to UN Model but the activities of delivering goods or merchandises have to combine with another sale-related activity (such as advertising, promotion, or after-sales services).

features of contracts regardless to supplementary matters (Committee of Experts, 2008, p. 20). Comparatively, the text of Circular 205/2013/TT-BTC is to meet the OECD and UN recommendations but more extensive than the Vietnam DTAs. However, it is questionable that whether this clarification from Circular 205/2013/TT-BTC legally contradicts to the Vietnam DTAs or not?

Third, a dependent agent is demanded to exercise its businesses in a regular basis. However, the current question is how to determine the regularity character? It could be the frequency of contracts' conclusion on behalf of the foreign enterprise or the available period of the representative in Vietnam? It is acceptable that both the Vietnam DTAs and the Circular 205/2013/TT-BTC do not mention this issue because the regularity character should specifically depends on the nature of the contracts and the business of the principal (OECD, Commentaries section, 2010, p. 106). For example, an agent (from a Contracting State) who has concluded seasonal-lychees exporting contracts on behalf of the foreign enterprise in Vietnam. Since such special fruit has been seasonally harvested, the representative tasks could be vacant in the non-lychees period. As a result, such vacancy could not be realized as the intermittent while determining a permanent establishment.

Fourth, the representative tasks are to conclude contracts or deliver goods or merchandises. OECD recommends that the representative tasks should be limited to the business contracts of the foreign enterprise. In other words, the representative tasks have to support the foreign enterprise for market penetration purposes (P. McGill and D. Yoder, 2003, p.146). Consequently, if the business-irrelevant contracts are concluded by an agent on behalf of the foreign enterprise, such activities should not be countable for determination of a permanent establishment. For instances, a training contract of an UK steel production enterprise is concluded by a representative in Vietnam. Because such contract is irrelevant to steel production business, this representative could not formally constitute a permanent establishment in Vietnam as a dependent agent.

Finally, it is possible to include on-spot import/export activities as a dependent agent of foreign enterprise in Vietnam. Article 2(4) of Circular 196/2012/TT-BTC defined on-spot import/export is a domestic enterprise (exported enterprise) delivers their exporting goods or merchandises to other domestic enterprises by the authorization of a foreign enterprise (an imported enterprise). Observably, the activities of delivering goods or merchandises on behalf of a foreign enterprise do exist in this circumstance, therefore, this agent of the foreign enterprise could constitute a permanent establishment in Vietnam. Similarly, as a guidance document, Circular 205/2013/TT-BTC ruled that a Vietnam joint venture company or 100% foreign-capitalized

company could be a permanent establishment if they carry on-spot import/export in Vietnam on behalf of a foreign enterprise.

Practically, an Official Correspondence No.2581/CT-TT&HT (28/3/2012) from Vietnam General Department of Taxation to Department of Taxation of Binh Duong Province about tax duties of Chin Hsin Limited Company explained that: "... in case of the Company (Chin Hsin) bought products from a foreign enterprise but these goods or merchandises are regularly delivered by another Vietnam Company on behalf of the foreign enterprise. This Vietnam Company deems legally to be a permanent establishment of such foreign enterprise in Vietnam...".

In conclusion, an agent who on behalf of the foreign enterprise concluded contracts or representatively delivers goods or merchandises in Vietnam could constitute a dependent agent of this enterprise which is characterized as an existing form of permanent establishment pursuant to Vietnam DTAs.

2.4 Furnishing services

Pursuant to Article 3(1) of Vietnam Commercial Law 2005, services is a type of commercial activities, therefore, a permanent establishment definitely deems to exist if a foreign enterprise has furnished its services in Vietnam. Article 5(4) of Vietnam – Sweden DTA read: "Notwithstanding paragraphs 1 and 2 the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, always constitutes a permanent establishment where activities of that nature continue (for the same or a connected project) within the country for a period or periods aggregating more than six months within any twelve month period." (Vietnam General Department of Taxation, 2013)

OECD Models (2003, 2008, and 2010) did not contain any regulations relating to furnishing services as well as the existing period of this commercial activity for constitution a permanent establishment. OECD mentioned that furnishing services should be characterized as other existing forms of permanent establishment if it meets all criteria of Article 5(1) of the DTAs (OECD, Commentaries section, 2010, p. 113). There are 18/68 (26.5%)⁷ Vietnam DTAs regulated as OECD Model. In contrast, the UN Model (2001, 2011) did include furnishing services as a form of permanent establishment in Article 5(3b) in which the existing period is specified as "The furnishing of services, including consultancy services, by an enterprise through employees

7 Vietnam DTAs supported OECD Model: (with) Australia, Austria, Bangladesh, Bulgaria, France, Germany, India, Lao RDP, Malaysia, Morocco, Pakistan, Palestine, South Korea, Sri Lanka, Taipei, Thailand, United Kingdom, Venezuela

or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period". There are 47/68 (69.1%)⁸ Vietnam DTAs agreeing with the UN Model. The remained tax agreements did comprise furnishing services but in different time period requirements - 3 months in any 12-months period (Indonesia); more than 12 months (Russia); and 180 days in any 12-months period (Hong Kong).

The Circular 205/2013/TT-BTC interpreted this issue similarly to UN Model, however, it also included the flexibility in determination of permanent establishment as: "... however, according to the nature of the services furnished, the existing period of these services can be less than six months in a twelve months period, in this circumstance, the permanent establishment still deems to exist if the general criteria are fulfilled as regulated by paragraph 1.2.1 (of Article11)"

3. Conclusion and recommendations

Regulations of existing forms of permanent establishment are divergent under Vietnam DTAs. The main reason is assumed that all of Vietnam DTAs have been drafted significantly based on both OECD and UN Model Tax Convention; and they visibly comprised different approaches. There are also some inconsiderable regulatory changes in a few of Vietnam DTAs. Statistically, Vietnam DTAs have significantly approached in favour of UN Model rather than OECD Model with regard to existing forms of permanent establishment. The text of Vietnam DTAs somewhere incurred ambiguity while the guidance document - Circular 205/2013/TT-BTC - did not contain appropriate clarifications. A number of recommendations for amending and modifying Circular 205/2013/TT-BTC should be as follow:

First, in respect of natural resources extraction site, since constructing activities have to be included at the beginning stage of the extraction operation, therefore, the Circular 205/2013/TT-BTC should clarify this kind of preparatory works. If the constructing activities was conducted by other enterprises, the permanent establishment deems to exist as a natural resources extraction site since the extracting activities actually took place. In case of the exploiting enterprise conducted both constructing and extracting activities, the constructing time would be deductible while identifying as a permanent

⁸ Vietnam DTAs supported UN Model: (with) Belarus, Belgium, Brunei, Canada, China, Cuba, Czech, Denmark, Finland, Hungary, Iceland, Ireland, Israel, Italia, Japan, North Korea, Kuwait, Luxembourg, Mongolia, Myanmar, Netherlands, New Zealand, Oman, Philippines, Poland, Qatar, Romania, Saudi Arabia, Seychelles, Slovak, Spain, Sweden, Switzerland, Tunisia, U.A.E, Ukraine, Uzbekistan, Norway, Uruguay, Singapore, Malta, San Marino, Iran, Azerbaijan, Serbia, Mozambique, Kazakhstan.

establishment because of preparatory or auxiliary activities as stipulated under Article 5(4) of Vietnam DTAs.

Second, in respect of building site, construction or installation project, the Circular 205/2013/TT-BTC did not envisage the case of the non-distinction between general contractor and subcontractors within a project. In this situation, the Circular should stipulate that if the building or constructing project does not legally recognize between a general contractor and subcontractors, all of participating contractors deems to be a partnership as a whole. As a result, the attributable time for constitution of permanent establishment for every contractor would be the aggregate time of the whole building or constructing operation (OECD, Commentaries section, 2010, p. 100)

Third, in respect of dependent agent, some aspects of Circular 205/2013/TT-BTC should be revised or modified:

- It is necessary to review the phrase “**negotiate and conclude** contract” (Article 11(1.2.2đ)) in case of identifying a dependent agent. The arising question here is whether or not this guiding text contradicts to Vietnam DTAs since all of the DTAs does contain “**conclude** contract” only.

- The Circular 205/2013/TT-BTC should limit the representative scope of a dependent agent to the business contracts only. In other words, a permanent establishment deems to exist if a representative conclude or execute business contracts on behalf of foreign enterprise. Otherwise, non-business contracts like concluding training or professional exchange contracts on behalf of the foreign enterprise should not be characterized as a permanent establishment.

In case of determination of on-spot export/import as permanent establishment, besides requirements of delivering of goods or merchandises on behalf of foreign enterprise and the frequency character, it is essential to examine the exclusiveness of such conducts. It means the dependent agent have to represent exclusively for the foreign enterprise in delivering goods or merchandises. In addition, the dependent agent should extend to all forms of company which have de jure or de facto carried their businesses in Vietnam instead of only 100% foreign-capitalized and joint venture companies as regulated by Circular 205/2013/TT-BTC.

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