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Tax Treaties, Transfer Pricing and Financial Transactions Division
OECD/CTPA

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Dear Sirs,

Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention – Revised OECD public discussion draft

1. Introduction

We are writing to provide the BVCA's comments on the OECD's revised public discussion draft on the "Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention (the "Discussion Draft").

2. About the BVCA

This response is submitted on behalf of the Tax Committee of the British Private Equity and Venture Capital Association ("BVCA"). The BVCA is the industry body and public body advocate for the private equity and venture capital industry in the UK. More than 520 firms make up the BVCA membership, including more than 250 private equity, mid market and venture capital firms, together with 250 professional advisory firms. In 2010, the ongoing number of people employed by UK private-equity backed businesses was 810,000 on a full-time equivalent basis.

The BVCA Tax Committee includes amongst its objectives the shaping of policy and the implementation of policy to ensure that it accommodates the needs of the British venture capital and private equity community.

3. Comments

We refer to our letter dated 9 February 2012 commenting on the OECD's previous public discussion draft on this subject (a copy is enclosed for ease of reference) and to the comments made by our representative at the public consultation meeting held by the OECD on 7 September 2012. As previously stated, we also endorse the comments made in section VI. of the Report of the Venture Capital Tax Expert Group on "Removing Tax Obstacles to Cross-Border Venture Capital Investments" published on 30 April 2010 (the "Expert Report").

We would respectfully ask the Working Group to reconsider the request in the Expert Report for published guidance that Fund Managers and their personnel will generally be regarded, in relation to VC Funds and their investors, as agents of independent status acting in the ordinary course of their business. As previously stated, we believe that Fund Managers and their personnel should generally be viewed as independent agents, given that:

(a) Fund Managers normally provide their services to VC Funds in which a disparate group of investors have invested, including a significant number of third party investors who otherwise have no economic or legal connection to the Fund Manager;

(b) Fund Managers are normally paid an arm's length fee for their services;

(c) Fund Managers are not normally subject to detailed instructions or day-to-day control by the investors in the VC Fund; and

(d) Fund Managers normally bear the risk of their business activities, in the sense that any poor performance is likely to result in reduced future fee income.

We acknowledge that the facts and circumstances of arrangements may vary. However, we believe that it should be possible to identify the normal, arm’s length categories of case in which Fund Managers will generally be regarded as acting as independent agents. We attach some proposed language for inclusion in the proposed guidance set out in Paragraph 125 of the Discussion Draft (our changes are marked in bold and italics).

We would, of course, be happy to discuss this proposal with the Working Group.

Please feel free to contact us if you have any queries about this letter.

Yours faithfully,

David Marks
On behalf of the British Private Equity and Venture Capital Association

Changes to proposed guidance in Paragraph 125 of the Discussion Draft

The definition of “enterprise of a Contracting State” in Article 3(1) refers to “an enterprise carried on by a resident of a Contracting State”.

The term “enterprise” itself is not defined, even though subparagraph d) of Article 3(1) clarifies that “it applies to the carrying on of any business”. The first part of paragraph 4 of the Commentary on Article 3 reflects different views as to whether the term refers to the organisation that carries on a business activity or to the activity itself:

The question whether an activity is performed within an enterprise or is deemed to constitute in itself an enterprise has always been interpreted according to the provisions of the domestic laws of the Contracting States. No exhaustive definition of the term “enterprise” has therefore been attempted in this Article.

This ambivalence between the view that an enterprise is a business organisation and the view that it is a business activity appears in different parts of the Convention. In the context of Article 5(1), which refers to “the business of an enterprise”, it seems difficult, however, to refer to an enterprise as an activity and the term therefore seems to correspond to a business organisation. On that basis, the term would cover any form of enterprise carried on by a resident of a Contracting State, whether this enterprise is legally set up as a company, partnership, sole proprietorship or other legal form.

In the particular case of an enterprise taking the form of a fiscally transparent partnership, that enterprise should be viewed as a distinct enterprise carried on by the partners who share the profits of that joint enterprise. Paragraph 19.1 of the Commentary on Article 5 confirms that position (see also the third example in paragraph 42.38); that paragraph deals with the situation of a transparent partnership and concludes that:

In the case of fiscally transparent partnerships, the twelve month test is applied at the level of the partnership as concerns its own activities. If the period of time spent on the site by the partners and the employees of the partnership exceeds twelve month[s], the enterprise carried on by the partnership will therefore be considered to have a permanent establishment. Each partner will thus be considered to have a permanent establishment for purposes of the taxation of his share of the business profits derived by the partnership regardless of the time spent by himself on the site.

Applying this analysis to a venture capital fund set up as a transparent limited liability partnership, one would therefore consider that the fund forms a distinct enterprise carried on jointly by the limited partners and the general partner, who all share in the profits of that joint separate enterprise (i.e. separate from the partners’ respective enterprises). This enterprise being carried on by each partner, it constitutes an enterprise of each Contracting State of which a partner is a resident as regards the share of that particular partner.

It follows from the above analysis that the reference, in Article 5(5), to a person acting on behalf of an enterprise and having the authority to conclude contracts in the name of that enterprise must therefore be applied with respect to the partnership, which is the relevant enterprise in whose name the fund’s investment contracts could be concluded. If the

conditions of paragraph 5 are met, it is that enterprise that will be a considered to have a permanent establishment, and the result will be that an enterprise of each Contracting State in which a partner is a resident (in proportion to the share of the profits of that partner) will be considered to have a permanent establishment.

The analysis should be the same for the purposes of Article 5(6) and the independent status of a local fund manager should therefore be determined in relation to the limited partnership itself rather than by reference to each investor in that partnership. ***However, this analysis (treating the local fund manager as acting on behalf of one enterprise, rather than a number of enterprises) will not of itself make it less likely that a local fund manager will be an agent of independent status. Although the position will depend on the facts, a local fund manager of a venture capital fund (or a similar investment fund) established as a limited partnership will normally be acting as an agent of independent status, provided that:***

(a) ***the local fund manager provides its services of identifying, making, managing and selling investments in the ordinary course of its business;***

(b) ***the fund is widely held (meaning that no majority interest in the assets or income of the fund is held, directly or indirectly, by five or fewer persons, taken together with persons connected with them);***

(c) ***any investors in the fund who control, or are under common control with, the local fund manager do not have an interest in the assets or income of the fund which in aggregate exceeds 50 per cent; and***

(d) ***the fund manager receives an arm's length fee for its services.***