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31. January 2013

OECD Model Tax Convention: Revised Proposals Concerning the Interpretation and Application of Article 5 (Permanent Establishment)

Dear Madam or Sir,

Please find in the following our general remarks regarding the above mentioned consultation.

The Federal Chamber of Tax Advisers represents the interests of more than 88.000 tax advisers in Germany vis-à-vis the Bundestag, the Bundesrat, the federal ministries, the top echelons of the civil service, the courts and the „institutions of the EU and OECD".

The Federal Chamber of Tax Advisers supports every measure to prevent double taxation and a just distribution of profits between the different countries.

Our tax experts, professor Lüdicke and professor Schmidt, took part in the public consultation meeting which was held on 7. September 2012 in Paris.

In addition to our former comments we wish to add some general remarks.

1. We support every measure to modernize the definition of „Permanent Establishment" in order to match the necessities of modern economy, for instance in the IT-environment.

2. As already mentioned in our statements before, we'd like to strengthen the following point:

   The German Federal Chamber of Certified Tax Advisers as well as German industry appreciates every effort restricting the expansion of the PE, because for businesses and their advisers it is of utmost importance to know in advance of whether or not a specific activity in another state constitutes a Permanent Establishment. This is true not only in respect of administrative obligations regarding the taxation of the Permanent Establishment itself, but also- and sometimes more importantly – with respect to administrative obligations regarding the enterprise's employees as well as their material tax position.

3. Referring to our letter from 25. September 2012 and as already mentioned by our delegate professor Lüdicke during the meeting in Paris, it would be very helpful to clarify of whether or not the presence of the painter in his clients' office building where he spends, for two years, three days a week constitutes a Permanent Establishment only because „he is performing the most important functions of his business (*i.e.* painting)". The referral to the relatively most important functions of the painter's business suggests that this criterion is decisive for the assertion of a Permanent Establishment. Hence, the example should be of no importance to larger enterprises with many clients at the same time; even if one of the employed painters would spend more than half of his working time, over two years, in the building of one client that would not represent the most important functions of the business of the enterprise.

   Therefore we'd like to repeat our question: Does this mean, may be in accordance with the example in Paragraph 6.2. („catering"), that the Painter example would be applicable only for sole proprietors?

4. Some differentiations/examples may be a little bit confusing, for instance regarding „Recurring activities" in Paragraph 6.1.

   While the decision if a PE does exist or not is very important for the businesses and their tax advisers, it is still unclear at which point recurrent activities constitute a PE, thus may lead to double taxation.

Yours faithfully,

Jörg Schwenker
Geschäftsführer

Statement for federal chamber of tax advisers

To the adapted proposals from

OECD

MODEL TAX CONVENTION
REVISED PROPOSALS CONCERNING THE INTERPRETATION AND APPLICATION OF ARTICLE 5
PERMANENT ESTABLISHMENT

In the context of this statement only points are mentioned, which are changed compared to the preliminary draft or which are highlighted.

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The qualification of a farm as a permanent establishment. It is pointed out that the existence of a permanent establishment is assumed , notwithstanding which rules are applied for the achieved income.. These clarifications are welcome. Regarding a farm, the characteristics of a permanent establishment are fixed, even if it is irrelevant for the allocation of income from immovable property. The question remains relevant to the application of Articles 11, 15 and 24

The importance of the power of disposal ("at the disposal"). The Working Group clarifies that the power of disposal requires the own authority of the entrepreneur, to use a place and decide independently the expansion of time using a place. Examples of this authority are legal ownership, the right or permission to use a particular place or the simple use of a particular place over a long period of time (for example Peter at CLIENTCO). That is not the case when such a use is only temporarily or occasionally by some employees having access to the offices of related companies they often claim for using for own purposes but not working there over a longer period of time. If this legal or actual opportunity doesn't exist, there is no power. Therefore, the facility of a contract-manufacturing venture is therefore not in the power of disposal of the principal, as this principal uses the products made by the contractor for purposes of his own company. Thus, the relatively vague criterion ("at the disposal") is concrete and is restricted. It is assumed that the company has a "real (legal) right of use" and that this right must relate to a specific place. Although the exact form is not fully described, the examples explain however, that neither the mere presence nor the activity "under the direction" (at the direction) of the company (for example, in the context of construction contracts) constitute a permanent establishment.

In exceptional cases, the home office of an employee can be a permanent establishment, too. This exception applies when the home office is used regularly and constantly for working purposes. A further condition is that the company requests that the home office is used by its employee for business purposes (for example, because no office space for an activity that requires an office, is available). This clarification of the further requirement is to be welcomed, because it requires a statement (and thus the participation) for the creation of a permanent establishment. One may have different views on whether this additional

requirement inherently has the effect that the home office is a fixed place of business "which is in under the power of disposal".

Time requirements for the existence of a permanent establishment. Addressed is the uncertainty, resulting from the commentary of the OECD regarding operational activities which are by their nature of short duration. In this context it is very helpful that the OECD has removed its controversial fair example and replaced it by an example of multi-year exploration activities. The now replaced fair example raised more questions (for example, regarding the necessary arrangements, the time of the initial reasoning of a permanent establishment, or the question of the retroactive correction) than settling questions. In this example, the activity is existing a number of years and can not be operated continuously for six or twelve months, because of the external conditions. The second example refers to a company in one country and a person, who is resident in another country. In addition, the company terminates after a short operation. This example is convincing, only because every company has to have at least one permanent establishment.

Personnel of a foreign company in the state of activity ***(state in which the work is carried out).***

The discussion refers to the difference between the employee in the legal and the economic sense. Besides the OECD draws a parallel to the corresponding provision in the commentary in Article 15. In the parallel to Article 15 the OECD explains, that the activity of an employee in the seat state does not constitute a permanent establishment in the state of activity of a subsidiary if the employee works in the area of responsibility of the subsidiary. A similar rule should apply to employees of a foreign company (temporary workers), working in the area of responsibility for the subsidiary. The indication of Article 15, to which the comment contains a manageable list of criteria for determining the economic employer, is helpful and brings a consistent application of these principles in the context of outsourced activities.

Total delegation to a subcontractor. The draft stipulates that the economic activity of subcontractors is attributed even if the company itself does not have any employee in the state of economic activity. A condition is that the company has the power of disposition the business establishment, as it has the power for legal reasons for example (ownership or usufructuary rights) to use the business facilities and legally binding the subcontractor for the creation of a permanent establishment during the necessary period of time. In general, it is difficult to reconcile the total delegation with the definition of permanent establishment, because this activity of the enterprise requires a fixed place of business and an activity in order (no establishment) becomes a permanent establishment, if the usufruct concerning the business facility does exist. To clarify the boundaries, the effective utilization of the employees of the subcontractor has to be clearly defined. Regardless of this (as with the permanent establishment constituted by representatives) problems of the allocation of profits between contractors and subcontractors arise.

Joint ventures. The OECD draft underlines that the term of the joint venture does not have to refer to a separate company. It can also include the case that two different companies, each performing parts of a project, decides to fulfill parts of the project and share its profit. Having the legal form of a transparent taxable entity, it may occur that to each partner of the company

an own permanent establishment is attributed.. In this case the conditions of the permanent establishment (for example, the time threshold) have to be examined separately. These, compared to the first draft, more differentiated considerations, are convincing.

Place of management. The OECD makes clear that a place of management (a branch or an office) only meets the requirements of a permanent establishment, when the general conditions are met, which require the existence of a business facility. This clarification seems to be helpful.

Additional work on a construction site. For construction and assembly permanent establishments the time factor is of central importance. In this context, the revised draft regulates the end of construction and installation activities. The proposal clarifies that the test runs carried out by the staff of the construction, before approving the plant, belong to construction and assembly activities. The warranty work, which is provided after the acceptance of the work, is not included (but latter works have to be considered whether continuing works constitute a permanent establishment). As a rule, the work ends with the acceptance and transition of the construction site. In case of continuing the work seamlessly in order to eliminate cases of warranty, the economic activity goes on; it can not be terminated by its formal acceptance. These differentiations should be manageable in practice and are countenanced..

Ancillary activities. Associated with ancillary activities it was examined, whether the data listed activities in paragraph 4 generally are exceptions or don't constitute permanent establishments under the condition, that they are not preparatory or supportive. The revised draft emphasizes that activities, covered by the a to d, are not a permanent establishment, while regarding point e the activities are decisive.. The exceptions in a to d are applicable notwithstanding the storage or delivery was made before or after the contract.. This clarification seems helpful in the case that the legal title regarding goods passes to the customer after delivery.. A condition is, that the goods belong to the company, as long as they are stored at the site, issued or prepared for delivery. The commentary underlines that a permanent establishment can not be avoided due to fragmentation of the activities. In comparison it is not possible to reject a permanent establishment by representatives with the argument that various activities are preparatory activities. Associated with ancillary activities the supplementing of the commentary concerning the active involvement of employees of offices in negotiating important contractual components in sales contracts should be possible. They should constitute a permanent establishment, if the condition of the fixed place of business is satisfied, even though they have no final authority. With this addition a caveat of the Czech and Slovak Republics is also remedied. Even when there are good reasons for this expansion, it seems more clear for legal purposes , to keep the feature "competence to conclude contracts." Should the need arise. it has to be examined if to focus on a "contractual competence in a material sense" when contracts are only contracted pro forma in the country of the legal seat.

Authority to contract. In connection with the authority to conclude contracts the question is raised in the review whether paragraph 5 is limited to operations related to sales. The revision denies this question clearly and reveals that it is also an deputizing when for example a person has the authority to conclude leases for the company and exercises this power. The condition is, that the contracts refer to company assets (but not, for example, the recruitment of staff). Even though the latter differentiation is difficult to bring in tune with the wording of the provision in paragraph 6, it meets the intent and purpose of this paragraph. Not justified by the wording is the interpretation of the draft, saying that a permanent establishment is justified even if the contract is not concluded in the name of the company (indirect representation). Similar considerations of the OECD draft should be reconsidered again.

Mannheim, den 28. Januar 2013 *Prof. Dr. Andreas Oestreicher*