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CONFEDERATION OF SWEDISH ENTERPRISE

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Position Paper: Confederation of Swedish Enterprise – Comments on the OECD Revised Public Discussion Draft entitled "OECD Model Tax Convention: Revised Proposals Concerning the Interpretation and Application of Article 5 (Permanent Establishment) 19 October 2012 to 31 January 2013"

Dear Grace,

The Confederation of Swedish Enterprise is pleased to provide comments on the OECD revised Discussion Draft regarding the interpretation and application of Article 5 of the OECD Model Tax Convention.

As mentioned in our previous comments, we welcome the initiative be the OECD to provide further guidance and clarification in relation to the concept of Permanent Establishment. We do however regret that our comments to the proposed amendments in the previous proposal have not been sufficiently addressed. There are still some proposals that raise concern and warrant further consideration. In order to facilitate the reading for WP1 we have revised our previous paper. We apologize for the fact that there will be some repetition of previous comments.

Issue 2. Meaning of "at the disposal of" (paragraph 4.2 of the Commentary)

The concept "at the disposal of" is no doubt an important and critical element in determining when a "place of business" is at hand. The current guidance in the Commentary to Article 5 provides little guidance in this respect, leaving business with legal uncertainty in investment decisions. Physical presence at a fixed place as opposed to legal responsibility for what occurs at a fixed place or some sort of more theoretical right to be present at a fixed place does give rise to uncertainty.

Consequently, we fully support the efforts made by the OECD to provide further clarification regarding the meaning of the phrase "at the disposal of".

The Discussion Draft proposes two new examples to the Commentary in paragraph 4.2 to determine whether an enterprise has premises at its disposal in such a way that it may constitute a "place of business through which the business of that enterprise is wholly or partly carried on".

The first example in paragraph 4.2 refers to a situation where "an enterprise has an exclusive legal right to use a particular location which is used only for carrying on that enterprise's own business activities (e.g. where it has legal possession of that location)". This situation seems quite straight forward since the language indicates that the enterprise owns or leases the property. That in turn would mean that the enterprise has control of the premises and thus is able to exclude others from those premises. Consequently, it is reasonable to conclude that such a situation would constitute a location to be at the disposal of the enterprise.

The second example in paragraph 4.2 of the Commentary for determining when an enterprise also would be considered to have premises at its disposal deals with a situation where the enterprise "is allowed to use a specific location that belongs to another enterprise or that is used by a number of enterprises and performs its business activities at that location on a continuous basis during an extended period of time."

This example cause greater concern than the first one, since the question of whether the enterprise has control of the premises does not seem to be sufficiently addressed.

As we see it, the definition of "at the disposal of" should include some degree of control over a physical "fixed place". The Discussion Draft states that an enterprise must have *effective power* to use the location. This would clearly not seem to be the case in the example discussed by the Working Party ("Consultant working at the client´s premises"), as the consultant (Peter) neither has legal power of disposition nor effective authority to dispose the rooms or exclude others from the rooms. Should the interpretation be that the independent consultant in the example is considered to have a PE, it would certainly be a step towards a more general application of the so called "Service-PE" principle, than what is the case under the current Commentary. That would mean that many cases that currently fall outside the scope of Article 5 of the MTC (cases where there is no "place of business" as the enterprise does not have any place at its disposal) suddenly would constitute a PE in accordance with Article 5.1.

Given the general wording in the second example in paragraph 4.2 in combination with the fact that the question of control is not sufficiently addressed, there is an obvious risk that any independent consultant providing services, in a case similar to the consultant example above, would be considered to have a PE even in cases where the facts clearly indicate that the person does not have any premises at his disposal.

Alternative provisions of services are dealt with in paragraphs 42.11- 42.48 of the Commentary. The conclusion to be drawn from paragraph 42.24 must be that unless a specific Service-PE provision is included in a tax treaty, then the normal standards of Article 5 shall apply.

Consequently, a service PE provisions should be dealt with between States on a bilateral basis through explicit provisions in a tax treaty and not incorporated through a back door into the OECD Commentaries.

Furthermore, the proposed language in the second example is problematic and may open up for interpretations that were not initially intended. When read in conjunction with the proposed new provision in paragraph 10.1, stating that an enterprise may carry on its business through subcontractors, it implies that an enterprise that carries on its business through a subcontractor is considered to have premises at its disposal on the mere fact that the business activities have been performed on a continuous basis during an extended period of time.

In our view, such a general statement seems incorrect. As a general rule, a subcontractor, being a separate legal entity, should be considered to perform its own business under a contract with the general contractor. Whether or not premises used by the subcontractor would be at the disposal of the general contractor would have to be determined based upon the facts and circumstances of each separate case.

Issue 6. Time requirement for the existence of a permanent establishment (paragraph 6 of the Commentary)

The current guidance on when short duration business and recurrent activities could constitute a PE is not very clear. This is also explicitly acknowledged in paragraph 6 of the Commentary which basically states that it is sometimes difficult to determine when the nature of a business is such that a very short period of time may constitute a PE. From a business perspective this is very unsatisfactory.

To suggest that a business activity which exists only for a short period of time is to be considered permanent is in itself in fact a contradiction in terms. All the more reason to be clear on the time frame required. The examples in the proposed paragraph 6.1 and 6.2 unfortunately provide little guidance beyond the specific situations in the examples themselves and may in fact be causing more concern than they are adding value. Both examples deal with situations where it clearly can be questioned whether the activities carried out could be considered to have any degree of permanency.

In relation to the example on *recurrent activities*, the question arises whether a PE would exist on a retrospective basis or in the year in which the cumulative presence exceeds the PE threshold. Creating a retrospective PE would, for obvious reasons, cause tremendous compliance difficulties. Furthermore, what if the expected 5 years drilling operations are shut down after 2 or 3 years? Is the *intention* to operate a business for a certain period of time enough to create a PE? If so, that would certainly be in contradiction with the provision in Article 5.3 of the MTC, according to which a building site or construction or installation project, irrespectively of the intention, only would constitute a PE if it actually lasts more than twelve months. Another question that can be posed is what would happen if there is a 2 or 3 year interruption in the recurrent activity.

As for the second example regarding a *short duration business*, this exception is somewhat clearer than the one on recurrent activities since it deals with a unique and self-contained business activity carried on for a short time exclusively in a specific State. It also clarifies that a PE does not exist if the activity conducted only is part of a larger multinational enterprise.

The time requirement is undoubtedly crucial for the assessment of whether a PE is at hand. The current Commentary leaves business with poor guidance in this respect. Although the OECD has taken some of the business comments on the 2011 Discussion Draft on-board, there are still a number of question marks concerning the time requirement for the existence of a PE. It is regrettable that a prescribed time frame is not considered instead of the elaboration with problematic distinctions. It is generally difficult to see why a prescribed time frame would cause such concern among administrations. The certainty a prescribed time frame would provide should definitely outweigh any negative consequences that could possibly be presented.

Issue 8. Main contractor who subcontracts all aspects of a contract (paragraphs 10 and 19 of the Commentary)

The proposed new paragraph 10.1

In the suggested paragraph 10.1, the Discussion Draft seems to be moving into dangerous territory by concluding that a subcontractor may constitute a PE for an enterprise if the enterprise carries on its business through the subcontractor (other than in cases where such subcontractor is a dependent agent to the enterprise in accordance with Article 5.5). It is important to make the distinction between the business of an enterprise and the business of subcontractors. The assessment of whether any particular enterprise has a PE under Article 5.1 should be determined on a strict entity-by-entity basis. There is a risk to the suggestion in paragraph 10.1, as it may undermine this fundamental entity-by-entity basis.

In the revised version of the Discussion Draft, the OECD has made some amendments. It now states that "in absence of employees of the enterprise, however, it will be necessary to show that such a place is at the disposal of the enterprise on the basis of other factors showing that the enterprise clearly has the effective power to use that site, e.g. because the enterprise owns or has legal possession of that site and controls access to and use of the site."

The fact that an enterprise has *effective* power to use a site does not necessarily mean that it *exercises* its power to use the same site. As can be concluded from paragraph 4.2, physical presence at a site is a requirement for having a location "at its disposal". The existence of a PE should depend on the enterprise's actual presence within the State, not only the responsibility or the theoretical availability over the premises.

Furthermore, the view expressed in the proposed paragraph 10.1 would have odd implications, as the same business (with the same personnel, location, equipment etc.) potentially could constitute a permanent establishment for more than one enterprise.

The proposed wording of paragraph 19

The Discussion Draft also suggests a change in paragraph 19 stating that the time spent by the subcontractor must be regarded as time spent by the general contractor not only when the general contractor subcontracts part of such a project, but also when the general contractor subcontracts the whole project. This is odd in two respects. *First*, it is difficult to understand how a main contractor has "a fixed place of business" and conducts his business "through" that place when he subcontracts all of the work at a particular site.

Second, in cases where a main contractor subcontracts parts of a project, the main contractor would normally have to have some physical presence at the location in order to perform the activities which have not been subcontracted. In cases where a main contractor subcontracts all parts of a contract, no such presence is required. To our understanding, the current wording of paragraph 19 (i.e. "[…] subcontracts parts of […]") primarily aims at preventing schemes where a main contractor carries out as much of a project as possible within the 12 month period and subcontracts the remaining parts of the project, in order to avoid having a PE under Article 5.3. Paragraph 19 makes clear that in such cases the period spent on the project by the subcontractors shall be considered to be time spent on the project by the main contractor. As we see it, the aim to prevent schemes in order to avoid having a PE is therefore not needed when the whole project is subcontracted.

Furthermore, the current wording of paragraph 19 only refers to the period spent on a project by a subcontractor. The proposed new paragraph 10.1 would change the current interpretation of Article 5 as it would not only allocate to the general contractor the period spent by a subcontractor on a project, but also the business activities performed by such subcontractors. In our view, that would mean a clear extension of the PE concept since such a wider interpretation would not only be relevant in relation to Article 5.3 but also in relation to Article 5.1.

To say the least, we find the proposals in the Discussion Draft regarding subcontractors to be very troublesome for business. It elaborates on language developed specifically for building sites or construction or installation projects (where there is a time frame). As the proposals appear to widen the PE scope not only in relation to building sites etc., but also in relation to other activities, the consequences could be far reaching and are likely to result in a dramatic increase of PEs.

As we see it, the current paragraph 10 of the Commentary offers no support for the conclusion that an independent subcontractor could constitute a PE for the main contractor merely by performing his own business activities. Creating the suggested link between paragraph 10 and paragraph 19 will mean that what is now a well-defined and limited exception for building sites, construction- or installation projects will become a general rule.

There is also the question of the rationale behind these amendments. Considering the possible implication for business with additional uncertainty and the risk of double taxation, is there a need for expanding the PE concept to cover these situations? The subcontractors in question will most likely be taxed either as residents or because they themselves will have a PE. What is the rationale behind identifying a PE for the general contractor? With these

amendments it will be extremely important to ensure that this new subcontractor PE in Article 5 is compatible with the guidance for attributing profits to PEs under Article 7.

Should these proposals be adopted, corresponding guidance under Article 7 would be necessary in order to avoid numerous cases of double taxation. The profits to be allocated to such a PE cannot be the profits taxed with the subcontractor and it cannot be the profits realized by the general contractor unless the general contractor is allowed to deduct all costs relevant to the income. Such costs would for example include the compensation provided to the subcontractor for his services.

It is difficult to foresee the full consequences of the proposed amendments. However, it is not difficult to foresee that the impact these changes would have on business would not be positive. Should these proposal be incorporated into the Commentaries we fear that there will be a dramatic increase in the cases of double taxation.

Consequently, we urge the OECD to reconsider its proposal in this respect.

On behalf of the Confederation of Swedish Enterprise

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