IATA Comments on OECD Paper

OECD MODEL TAX CONVENTION: REVISED PROPOSALS CONCERNING THE INTERPRETATION AND APPLICATION OF ARTICLE 5 (PERMANENT ESTABLISHMENT)

Background

On 19 October 2012 the OECD published its revised proposals on Permanent Establishments (Article 5 of the OECD Model Tax Treaty). The proposals follow an earlier discussion draft released in October 2011. The OECD work was not intended to lead to any changes in the text of Article 5, but rather focused on specific areas of guidance in the Commentary to Article 5.

It is expected that the OECD proposals will form the basis of an updated version of the Commentary to Article 5 when the Model Treaty is next updated (expected 2014). Comments on these OECD proposals are requested by 31 January 2013.

The International Air Transport Association (IATA) is pleased to hereby submit comments on behalf of its membership on the OECD's revised proposal on Permanent Establishments as follows.

Relevance to the airline industry

The concept of PE is generally of secondary concern to the airline industry, as a consequence of the overriding application of the Article 8 Airlines Profits Article. In this regard, we refer to the ongoing communication between IATA and the OECD (including submission dated 17 February 2012) in relation to possible amendments to the Model Tax Treaty Commentary in relation to Articles 8 and 15.

However, the definition of PE remains relevant in relation to activities of the airline enterprise which are not international airline operations (or activities which are ancillary or incidental to those operations). These might include:

- Aircraft leasing to the extent those activities are not ancillary or incidental to the operation of an international airline.
- Non-airline commission sales activities (such as sale of hotel and car hire) through on-line systems, call centres or through sales staff who may be temporarily located at foreign airport facilities.
- Provision of other services (such as management; IT systems and support, procurement etc.) which may be provided to other affiliated or third party enterprises through employees temporarily located in a foreign jurisdiction (with either continuing direct employment or through secondment to a local company).

In addition, third party or affiliated enterprises that provide services to the airline industry will often need to address the scope and interpretation of Article 5. These providers might include aircraft leasing companies, providers of communications/entertainment systems operated on aircraft and providers of cabin crew. In many instances, airlines will contractually indemnify such suppliers' tax liabilities.

Moreover, many airline non-treaty jurisdictions will look to the OECD interpretation of PE when interpreting their own domestic legislation definition of PE. Also, many jurisdictions indirect tax regimes will commence with the corporate tax definition of PE and as such the OECD commentary can even be relevant in those cases.

It is acknowledged that determining whether a PE exists if often difficult being a factual enquiry of activity and, given the importance of this inquiry in determining the impost of taxes, we view the commentary as playing an extremely important role. As such, IATA is very supportive of further updates including the provision of more specific examples.

Comments on proposals of interest to the airline industry

Section 2 – Meaning of "at the disposal of" (paragraph 4.2 of the Commentary)

The existing Commentary to Article 5 requires a place of business to be 'at the disposal of' the enterprise before a permanent establishment may be created under the fixed place of business test. The OECD now proposes a three-fold test: (i) a new test for an "effective power to use" the location; (ii) the extent (i.e. duration) of actual presence; and (iii) the 'nature' of the relevant activity.

The additional wording and new examples are somewhat helpful in providing further guidance on the meaning of the term "at the disposal of". However, in doing so, the proposed changes introduce a new concept of "effective power to use" with little explanation, particularly around what is meant to be conveyed by the reference to "effective". For example, should there be some power of exclusion of other parties to the extent it impedes the relevant "use"?

We recommend that the Commentary be expanded to provide further guidance on the concept of "effective power to use".

Section 5 – Shops on ships operated in international traffic

The Discussion Paper proposes the introduction of the following new paragraph in the Model Treaty Commentary:

> *5.5 Similarly, a ship or boat that navigates in international waters or within one or more States is not fixed and does not, therefore, constitute a fixed place of business (unless the operation of the ship or boat is restricted to a particular area that has commercial and geographic coherence). Business activities carried on aboard such a ship or boat, such as a shop or restaurant, must be treated the same way for the purposes of determining whether paragraph 1 applies (paragraph 5 could apply, however, where contracts are concluded when such shops or restaurants are operated within a State).*

This new paragraph provides useful additional guidance.

However, we would strongly recommend that the last few words of this new paragraph are revised as follows:

> ***... are operated <u>solely</u> within a State <u>for an extended period of time</u>).***

If a ship [or aircraft] is engaged in the international transit of passengers or freight, the fact that it temporarily moves into and out of the territorial waters or airspace of a particular country during the course of those international operations, should not render the activities conducted on that vessel (e.g. the activities of parties not protected by Article 8) to be treated as giving rise to a PE in any such State (under any paragraph of Article 5).

This issue should not be confused with the issue discussed at section 6. A ship (or aircraft) which temporarily enters and leaves the territorial waters or airspace of a particular country is a moving object. Neither it, nor the activities conducted on that ship (or aircraft) can constitute a fixed place of business in any one territory – no matter how recurrent are the visits of that ship (or aircraft) to that country. This is perhaps contrasted with activities on board a ship that operates solely within one State for an extended period of time.

In the context of the airline industry, historically, any services and sales activities provided to passengers on an international flight have been provided by the airline as activities which are directly connected or ancillary to the

operation of the international airline (and therefore covered by Article 8). However, new communications and entertainment services may be provided by third party service providers. While these services are unlikely to require the physical presence of employees on the aircraft, the question of "fixed place of business" may arise under Treaties which contain a "substantial equipment" clause.

Similarly, the example will be of interest to a third party or affiliated provider of cabin crew.

Section 6 – Time required for the existence of a permanent establishment

The main changes to the Commentary proposed under section 6 are to introduce two new examples – one dealing with activities of a recurrent nature (a drilling site operate 3 months a year for 5 years stated to constitute a PE); and the other dealing with a business carried on exclusively in a country but, due to its nature, is only a business of short duration (cafeteria set up to cater for the crew of a television production).

As discussed above we do not believe that examples of activities undertaken in a particular country on a recurrent basis are of relevance to those activities undertaken on board a ship or aircraft carrying on international operations.

However, we would observe that the changes proposed to the Commentary (including the new examples) do little to provide any additional guidance in relation to the issues covered.

We suggest that the current Commentary has created considerable uncertainty in relation to the circumstances of "recurrent activities". And we would recommend that further examples are provided to address this uncertainty.

Section 7 - Presence of foreign enterprise's personnel in the host country

The proposed revision of the Commentary to amend clause 10 and insert new clause 10.2 is helpful (and appropriate) in indicating that multinational corporations seconding employees to a foreign company (often a subsidiary or affiliate) would typically not create a PE unless they are carrying on the business of the foreign company (as opposed to the business of their temporary employer).

We agree with the proposed changes.

Section 10 - Meaning of "place of management"

The proposed new paragraph 12 of the Commentary appropriately provides a useful reinforcement of the position that the examples listed at paragraph 2 of Article 5 must still satisfy the requirements of paragraph 1 in order to constitute a PE.

We agree with the proposed changes.

Section 12 - Must the activities referred to in paragraph 4 be of a preparatory or auxiliary nature?

The amendments to the Commentary proposed at section 12 appropriately provide a useful reinforcement of the position that the activities of subparagraphs (a) to (d) of paragraph 4 of Article 5 need not be "preparatory or auxiliary" in order to fall within the PE exclusion.

We agree with the proposed changes.

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