January 30, 2013

Tax Treaties, Transfer Pricing and Financial Transactions Divisions
Organisation for Economic Co-operation and Development ("OECD")
Centre for Tax Policy and Administration ("CTPA")

Re: Comments on Proposed Changes to the Commentary on Article 5 (Permanent Establishment) of the OECD Model Tax Convention

Dear: OECD / CTPA

True Partners Consulting, in cooperation with its global network of affiliates (collectively "True Partners International Network"),welcomes the opportunity to provide comments to the OECD Committee on Fiscal Affairs (CFA) with respect to its undertaking of revised proposals concerning the interpretation and application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention, released October 19, 2012 ("Revised Commentary").

Permanent establishment ("PE") issues are clearly a very important topic for the international business community. Therefore, we welcome the OECD's efforts to clarify certain issues that arise in assessing a jurisdiction's ability to tax a company's cross-border business profits. As business models for conducting business internationally, as well as technologies for disseminating products, continue to evolve and change, we agree with the view that the OECD's existing commentary on the Model Tax Convention ("MTC") also needs to change and be updated. In the following sections, we share our ideas on how the Revised Commentary can provide more cohesive and practical international tax guidance.

The comments provided below are our own comments as tax professionals and do not necessarily reflect the views of our clients. We have focused our comments on the following specific areas of the Revised Commentary:

Topic number 2 – Meaning of "at the disposal of"– Proposed New Paragraphs 4.2 – 4.4

As a general matter we agree with the approach taken by the Working Party to clarify that "at the disposal of" is not synonymous with "at the direction of," thereby clarifying that pure contract manufacturing arrangements and toll-charge manufacturing arrangements do not create PEs. In addition, we agree that in order for an enterprise to be considered to have a PE in a particular jurisdiction, that such enterprise needs to have the ability to use a particular location at its choosing, for a sufficiently long [duration], to carry out its own business activities.

With regard to the first point, i.e., that pure contract manufacturing arrangements do not, in and of themselves, create a PE, we believe that the penultimate sentence in new paragraph 4.2 adequately addresses this issue.

With regard to the second point, the insertion of the wording "…will depend on that enterprise *having the effective power to use that location as well as*…" in the second sentence of new paragraph 4.2, tries to clarify that a particular enterprise needs to have a certain level of control as to the use of a particular location, before it can be considered to be a PE of that enterprise. This first factor appears to be an objective test, i.e., an enterprise either does, or does not, have effective power over a particular location, whereas the other two factors in that same sentence, 1) the extent of the presence of the enterprise at that location, and 2) the activities that it performs there, are subjective criteria that will depend on the particular facts and circumstances. This formulation, with the objective "having the effective power to use" factor, appears to be in conflict with the continued use of example 4 (former paragraph 4.5, renumbered as 4.7 in the Revised Commentary).

In example 4, the conclusion that a PE exists seems to rely solely on the last two subjective factors, i.e., the fact that the painter is conducting the most important functions of his business in a particular location (the "activities that it performs") and that such activities were being conducted over a period of two years (the "extent of presence"). However, in this case, the painter has no "effective power to use" the parts of the building he is painting, and is merely directed by his client to paint certain rooms or locations as it best suits the client. In this case, the painter has no "fixed place of business" "at his disposal" since he has no effective power over the locations he is painting. The fact that he is performing services within a particular jurisdiction for a prolonged period of time could perhaps give rise to a PE if a particular treaty were to include a new "Services PE" provision, but that would rely on a different provision entirely. In this case, we would recommend that the example be changed to indicate that the painter would not be considered to have a PE by virtue of paragraph 1 of the MTC.

Topic number 4 – Home office as a PE – Proposed New Paragraphs 4.8 and 4.9

As the trend in many OECD member countries is a growing mobile workforce, and many enterprises are beginning to make use of "virtual offices," the ability to assess whether a home office constitutes a PE will become more and more critical in the coming years. Accordingly, we are strongly in support of the Working Party's decision to provide specific Commentary as to what circumstances might lead to a home office being considered to be a PE of an enterprise.

The general tenor of new paragraphs 4.8 and 4.9 of the Revised Commentary is that, while it will be a facts and circumstances determination as to whether a home office is at the disposal of an enterprise, unless the enterprise affirmatively requires the employee to maintain a home office, and the nature of the employment is such that an office is required to carry out the bulk of the employment activities, a home office will not constitute a PE. In this regard, we believe that the following additional clarifications would be helpful in achieving the desired objectives of the new paragraphs 4.8 and 4.9.

The fourth sentence of new paragraph 4.8 states that where "…it is clear from the facts and circumstances that the enterprise has required the individual to use that location …" the home office may be considered to be "at the disposal of" the enterprise, and hence, a PE of the enterprise. In this case, we believe that the phrase "it is clear from the facts and circumstances" means that the enterprise has affirmatively required the individual to use that location as an office, and that inferences or implicit requests are not contemplated. In this case, we would suggest adding the following wording: "… it is clear from the facts and circumstances that the enterprise has affirmatively required the individual to use that location …"

With regard to new paragraph 4.9, since the issue of a home office will frequently arise in the context of dependent salespersons, we believe the first example considered by the Working Party, i.e., a large multinational insurance company with employees in various countries who sell insurance policies in the local market, where such employees are not reimbursed for the cost of maintaining a home office, and the supervisors cannot go to the homes of the employees without being invited, should be included as an additional example in new paragraph 4.9. Our view is that the arrangement discussed in example 1 does not rise to the level of a PE because the sales activity does not require an office (as most of the activity will be undertaken in visiting clients and prospective clients) and the activities undertaken at the home office would be considered as auxiliary or preparatory in nature. Including such an example in new paragraph 4.9 would also help clarify the parenthetical statement at the end of new paragraph 4.8, which, when giving an example of when an enterprise would be requiring an employee to have a home office, adds "(e.g., by not providing an office to an employee *in circumstances where the nature of the employment clearly requires an office)*…"

While we understand that a facts and circumstances analysis is applied to determine whether a home office is at the disposal of an enterprise, and is therefore a PE, we believe that additional guidance as to whether an office is *required* to carry out certain activities in question would be helpful. One factor we believe would be useful in making this determination is consideration of whether an enterprise which carries on particular business activities from a home office in a particular location, maintains an actual office in other locations for carrying on those same activities. If this is the case, then it is more likely that such home office is a PE. Similarly, if an enterprise has employees utilizing home offices in multiple states to carry out certain business activities, and none of those states require an actual office for these activities, then it is more likely that such home offices are not PEs. In a general sense, the same comparison analysis could be applied to other business enterprises carrying on a particular business activity in a particular state. This principle is illustrated by the following example.

> *Within state A there are many accounting enterprises, most of which operate from an office to carry out their accounting business within the state. Enterprise ABC is in the accounting business and has an office in state B. ABC also has an employee working from a home office in state A, carrying on the same accounting activities as are carried out by ABC in state B. In this case, it is likely that the home office used by an employee of ABC in state A is a PE.*

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Topic number 10 – Meaning of "place of management"

We have reviewed the proposed changes of the Working Party and we agree on the new wording of Paragraph 12 of the Commentary to Article 5.

The insertion of the words "*place of business*" and the reference to Paragraph 1 of Article 5 recommended by the Working Party in the first sentence of Paragraph 12 of the Commentary to Article 5 clarifies that a link between the listed examples of PE of paragraph 2 and the criteria indicated in paragraph 1 of Article 5 exists so that if a place of business does not pass the set of tests (location test, duration test, …) of paragraph 1 the existence of a PE is excluded.

The changes to the second sentence of Paragraph 12 proposed by the Working Party aim to stress furthermore the principle that the listed examples must be interpreted in the context of Paragraph 1 of Article 5. The words "*it is assumed that a Contracting State interprets*" the examples of Paragraph 2 in the light of Paragraph 1 are deleted with the scope of establishing a guiding principle whereby the interpretation of the examples must be encompassed in the context of paragraph 1.

The insertion in the second sentence of Paragraph 12 of a reference to the so-called negative lists contained in Paragraph 4 of Article 5 completes the logic of the guiding principles so that the examples listed in Paragraph 2 have to be considered a PE if they meet the requirements of Paragraph 1 and unless they fall in the list of exceptions of provided in Paragraph 4.

We also agree that no clarification is needed with reference to the example of ACO multinational group where some administrative functions have been centralized in ACO and provided by the same to its subsidiary as Paragraph 42 of OECD Commentary to Article 5 already examines the situation of services performed within a group of companies.

Topic number 12 – Must the activities referred to in paragraph 4 be of a preparatory or auxiliary nature? (Paragraphs 21 and 23 of the Commentary).

We have reviewed and we generally agree with the comments of the Working Party and the recommended changes to Paragraph 21, 23, 42.7 and 42.9 of the OECD Commentary to Article 5 related to the preparatory or auxiliary nature of activities stated as exceptions of permanent establishment in Paragraphs a) to d).

The main proposed change of Paragraph 21 effectively clarifies that the exemptions to the consideration of permanent establishment stated in subparagraphs a) to d) of Article 5 are automatic, and consequently it is not necessary to pass an additional "preparatory or auxiliary condition test." The new wording increases the legal safety for its application.

The changes proposed for paragraphs 23, 42.7 and 42.9 are technical, directly derived from the change mentioned in paragraph 21. We believe that adding the additional example below to Paragraph 42.9, distinguishing between activities that are core functions as opposed to preparatory or auxiliary, would provide additional clarity:

Another example is the activity of operating / managing hardware for the purpose of data storage, in which the core profit generating function of the service is storing data for customers (i.e., not storage of internal data). In such cases, this activity cannot be considered to be preparatory or auxiliary within the meaning of subparagraph 4 b), but is more appropriately considered an activity "belonging to the enterprise."

Topic number 17 - Negotiation of import contracts as an activity of a preparatory or auxiliary nature (paragraphs 24 and 25 of the Commentary)

Where an enterprise has an office in another member state and the employees working in that office take an active part in the negotiation of the contracts for the sale of goods to buyers in that state, such activity would typically not be regarded as preparatory or auxiliary. Therefore, such an office would constitute a permanent establishment of that enterprise in that member state.

Typically, negotiations of the essential parts of sale contracts is one of the key elements of the business activity of an enterprise and thus, it would be difficult to argue that such activities are of a preparatory or auxiliary nature within the meaning of the Article 5(4) of the model convention. This position is consistent with the approach taken in cases of persons acting on behalf of an enterprise and involved in the negotiation of substantial elements of a sales contract (where no fixed place of business of that enterprise exists in the other member state).

Consequently, where an enterprise has a fixed place of business in another member state and through that place its employees negotiate sales contracts, it should be concluded that such an enterprise has a permanent establishment in that other member state.

Topic number 19 – Meaning of "to conclude contracts in the name of the enterprise" - Paragraph 32.1

The Working Group acknowledges that it is not possible to reach a common view on the situations dealt with in current court cases dealing with Commissionaire arrangements, as were raised in the courts in France and Norway. In addition, the Working Group felt that the Commentary already provided enough guidance to deal with a variety of factual questions related to whether a contract was "concluded" by a particular enterprise, and other related questions. We agree with this general sentiment that the current commentary is adequate, and believe that the new inserted language could create additional confusion, as noted below.

It appears that the additional wording in paragraph 32.1 is providing an example of a Commissionaire arrangement where an enterprise is acting essentially as an undisclosed agent, as that term would be interpreted in common law states, on behalf of a principal. However, in many civil law countries, such an arrangement is specifically excluded from an "agency" relationship. The insertion of the example directly follows the following phrase: "…the paragraph applies equally to *an agent* who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise" (emphasis added). This sentence is directly addressing the specific question of whether an "agent" can be concluding a contract in the "name of an

enterprise" even if the contract itself doesn't have the actual name of the principal. This could arise where it is clear, from other documents, that an agency relationship exists, that the agent has the power to bind the principal, but that the contract merely doesn't contain the name of the principal. This is legally different than a commissionaire arrangement. Because the phrase, immediately prior to the example, still refers to "an agent," the question arises as to whether the example only applies in a situation where an actual agency relationship, under local law, exists between two entities. The actual MTC does not refer to an "agent," but rather merely refers to "a person … [who] is acting on behalf of an enterprise." Accordingly, to avoid any confusion we would recommend that the first sentence of revised paragraph 32.1 be amended by substituting "a person" in place of the words "an agent."

Topic number 21 – Does paragraph 6 apply only to agents who do not conclude contracts in the name of their principal?

We are of the opinion that since the criteria of "independence" and "acting in the ordinary course of their business" are included within paragraph 6, the paragraph should equally apply to agents who do conclude contracts in the name of their principal.

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Once again, we applaud the Working Groups efforts in clarifying and updating the OECD commentary with regard to PEs, and appreciate the opportunity to provide our comments thereon. We would be happy to discuss further with you any of our comments discussed above.

Sincerely yours,

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