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OECD Model Tax Convention: Revised Proposals Concerning the Interpretation and Application of Article 5 (Permanent Establishment) as of 19 October 2012

Our Comments on proposed changes

Dear Grace,

we appreciate the opportunity to comment on the revised proposals concerning the interpretation of the OECD Model Tax Convention Article 5 and support the effort of the OECD in specifying the regulations of permanent establishments.

Please find attached our general remarks and our comments on specific issues of the proposed changes. We would appreciate our comments to be taken into consideration in the subsequent discussion process.

For any further information and questions you are welcome to contact us.

Yours sincerely,

VOLKSWAGEN AG

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Comments on proposed changes

I. General Comments

The main purpose of the OECD commentary is to provide guidance on and clarification of the interpretation of the OECD model tax convention. However, the impression is that in many cases, it increases ambiguity and even confusion instead of providing more clarity.

One of the main reasons for this seems to be an interpretation of Article 5 par. 3 in a way that building sites and construction or installation projects are permanent establishments which fulfill all preconditions of Article 5 par. 1 with the only restriction of a clearly defined minimum duration time of 12 months. From our point of view, par. 1 and 3 are separate provisions, and construction or installation projects are a special form of permanent establishments which need not fulfill all the requirements of a "fixed place of business". But due to a different approach in the commentary, which negates the significant differences between a "permanent" establishment and a temporary construction site, the problem occurs that the requirements for a permanent establishment in par. 1 are lowered in such a way that they can be fulfilled even by a construction site. This has a detrimental effect on the clarity of the threshold and gives rise to an ongoing erosion of the permanent establishment definition.

An example for this is the proposed addition to par. 10.1 (Issue 8): "Paragraph 19.1 illustrates such a situation in the case of a construction site; this could also happen in other situations". This way of interpreting the relationship of par. 3 and 1 contributes to the dissolution of the definition of permanent establishment. The general tendency of broadening the definition of a permanent establishment leads to higher complexity and legal uncertainty for the international business community with the consequence of increasing risks for double taxation.

Besides that we would like to add another general comment: Examples may on the one hand help to illustrate the wording. On the other hand – if not clearly limited to explain a specific requirement - they can also encourage tax administrations to arbitrarily transfer the applied regulations to other cases and broaden the scope of the commentary beyond the intended content.

In the following we are commenting on three different issues of the revised proposal, which we regard as being of high importance.

II. Comments on special Issues

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

As stated by the WP1, "a place of business through which the business of an enterprise is wholly or partly carried on" is related to the nature of the business. We agree that service providers do not necessarily have contracts or other formal legal rights to use a particular location but still offer their services and create value even over a longer period of time.

With the wording "on a continuous basis during an extended period of time" the proposed commentary acknowledges that only a short period of time is not sufficient to create a

permanent establishment. However, this term refers not to a fixed minimum time requirement and therefore as a vague legal term adds even more uncertainty to the application of Article 5.

Particularly critical is in our view that as a consequence of the ambiguous concept of "legal possession", the mere legal capacity to use and control is sufficient independently from the decisive question whether this capacity is in fact exercised by the enterprise. In our view this requirement is not met in cases, where the actual on-site use and control of a location has been delegated to (and is in fact exercised by) another enterprise, e.g. a subcontractor.

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

Due to the reference of the revised paragraph 4.2 of the Commentary to the time requirement, the legal uncertainty of the determination of a permanent establishment is neither avoided nor improved. The exceptions from the six month time requirement in paragraph 6.1 and 6.2 are generally a good approach towards the prevention of double taxation but not feasible in practice. Unlike in the drilling example, the entrepreneur often does not know in the beginning of an activity whether it will be recurrent or not. Recurrent businesses and businesses exclusively carried on in another state that do not last for at least six months should not constitute a permanent establishment.

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

The extension of paragraph 10 regarding the existence of permanent establishments to businesses through subcontractors referring to the regulations for construction sites in paragraph 19 leads to double taxation, because the same personnel constitutes a PE for the subcontractor as well as for the general contractor. In our view, it is not possible to deem the subcontractor's personnel to be also personnel of the general contractor, because both are separate enterprises. The fact that the contributions by the subcontractor are elements of the fulfillment of the contract that the general contractor has concluded with his customer cannot justify the attribution of the subcontractor's activities to the general contractor.

Furthermore the regulation goes far beyond the permanent establishment rules for construction sites since the time requirement is only six instead of twelve months.

The introduction of the general contractor's legal possession of a location as mere precondition to constitute a permanent establishment for construction sites is very problematic, because a PE can be assumed without any presence of own personnel of the general contractor. This contradicts the AOA approach in Art.7 requiring a "significant people function" performed by personnel of the enterprise on the site of a PE for the attribution of profits to the PE. For this reason, even if a PE is going to be assumed, no profits can be allocated to the PE due to a lack of the enterprise's own personnel functions being employed at the PE.

In case this concept of "legal possession" will still be followed, we propose at least to add in par. 19 after "….has legal possession of the site" the additional words "**which is exercised by the own personnel of the general contractor**". This wording is suitable to avoid the above-mentioned contradiction with the AOA.