ZVEI:
Die Elektroindustrie

Berlin, 30.1.2013

OECD
Ms. Grace Perez-Navarro
Deputy Director, CTPA OECD
2, rue André Pascal
75775 Paris FRANCE

OECD Model Tax Convention
Revised proposals concerning the interpretation and application of Art. 5 (permanent establishment)
19th October 2012 to 31st January 2013

Dear Ms. Perez-Navarro,

the German Electrical and Electronical Manufactures' Association (ZVEI – Zentralverband Elektrotechnik- und Elektronikindustrie) is representing one of the largest brands of industry in Germany (12 % of all German industrial production) with 846.000 domestic employees and 659.000 employees abroad (2011). One seventh of total German exports and German industry's FDIs underline the importance of PE (Permanent Establishment). Thus, ZVEI watches narrowly the OECD's discussions and proposals concerning the interpretation and application of Article 5 OECD-MTC.

We appreciate that the revised OECD public discussion draft released on Oct 19th 2012 took up more than a few comments from the business and industry community. However some issues need further consideration, be it for systematical or practical reasons. As a general remark we are concerned about the commentary's more and more extensive interpretation of the clear wording of Art.5 OECD-MTC. The following comments only refer to major issues we urgently appeal to modify.

I. Issue 2: Meaning of "at the disposal of" (Paragraph 4.2)

The revised OECD public discussion draft now contains the wording "the effective power to use that location" which is indispensable but barely adequate. We would suggest to add an additional sentence that only a place "at the disposal of" or respectively a location with the "effective power to use" it forms a PE for the enterprise if

a) the enterprise actually makes use of its disposal right/power **and**
b) uses the location through its own employees.

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From our point of view a foreign enterprise does not make use of the location/place if the activities conducted there are solely performed by subcontractors which are local residents in the country and already pay taxes for their part of the work in that country. This would also be in line with the sentence in 4.2 of the draft commentary:

"...it cannot be considered that a plant that is owned and used exclusively by a supplier or contract-manufacturer is at the disposal of an enterprise that will receive the goods produced at that plant merely because all these goods will be used in the business of that enterprise..."

In this regard we also suggest to specify the wording of the draft commentary *"legal possession of that location".*

"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) that location clearly is at the disposal of the enterprise". What is meant by "legal possession" can be entirely delegated to subcontractors or to service providers comprehending the effective physical access control. In this case the criteria are not fulfilled and will lead to wide-ranging consequences (see Paragraph 10.1).

II. Issue 6: Time requirement for the existence of a permanent establishment (Paragraph 6.1 – 6.3)

We welcome that the revised example in Paragraph 6.1 has eliminated the unsuitable individual renting of a fair stand for 15 consecutive years to sell sculptures 5 weeks a year. On the other hand the new example "drilling enterprise" misses the case of recurrent activities. It especially does not give clear guidance for business and therefore does not provide for legal certainty. We suggest to set up a clear rule for recurring activities, based on the number of days the activity is being carried out (e.g. a 183 days rule as laid down in Art. 15 Para 2a).

The example in Paragraph 6.2 describes a borderline case and should be replaced. Firstly it is not clear whether the time limit standard of four months could be used as a general standard. Secondly there seems to be a contradiction between sentence 2 (four months) and sentence 7 (four weeks).

III. Issue 8: Main contractor who subcontracts all aspects of a contract (Paragraph 10.1 and 19.1)

According to the clear wording in Paragraph 4.2., the effective power to use a location as well as the extent of the presence of the foreign enterprise at that location and the activities that it performs are regarded as the relevant criteria for the establishment of a PE.

In connection with our comments to 4.2 we suggest to change the prerequisites when a foreign enterprise is carrying on its business through subcontractors. A PE of the enterprise is only created in case the place where the activity is performed is at the disposal of the foreign

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enterprise, the enterprise's employees are physically present at that place and the other requirements for a PE (e.g. certain time period of physical presence) are fulfilled. If all work is subcontracted and the enterprise is not physically present no (fictitious) PE is being created for the foreign enterprise.

Moreover there seems to be no reason for taxing a foreign enterprise via a PE concept: By owning that site (legal possession) or by controlling the access and the use of it from outside the country no value is added by the foreign enterprise on the territory of the relevant country; therefore no profit or loss should be attributed to this country.

It would be therefore without reason to allocate a profit portion related to subcontractor's work to a PE of the enterprise. Furthermore it would be without reason to allocate part of the enterprise's "entrepreneurial profit" to it. This change would open the door for tax authorities to put pressure on foreign enterprises in order to get more tax revenue. The foreign enterprise will end up in lengthy discussions and in worst case this will lead to double taxation. Unfortunately the commentary is silent on the point of income allocation to such type of PE as well as how this PE type goes together with the recent "Authorized OECD Approach" and its "significant people's function" concept.

It is important to differentiate between the business of the foreign enterprise and the business of the subcontractors. Whereas the subcontractor as the one adding value on the territory of the source country should be held tax liable in that country for his part of the project, the same should not apply to the foreign enterprise in the role of a main contractor.

Furthermore in case of physical presence of a foreign enterprise together with its subcontractor a similar view should be taken: In such case the PE of that enterprise should only include the adequate portion related to the time period of the enterprise's physical presence but should not include the subcontractor's activity. This means that a clear separation between the enterprise's and the subcontractor´s business is needed. Otherwise double taxation (subcontractor pays taxes and the foreign enterprise through the PE on subcontractor's activity as well) would be the consequence.

We would be very grateful if these comments and remarks would be considered in the final update to the Commentary. Please feel free to contact us if you have any queries about this letter.

Kind regards

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