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February 18, 2009

Mr. Jeffrey Owens
Director, Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development
2, rue André-Pascal
75775 Paris
France

Re: **Treaty Policy Working Group Comments on
Draft New Article 7 and Commentary**

Dear Mr. Owens:

We are writing on behalf of the Treaty Policy Working Group to comment on the *Discussion draft on a new Article 7 (Business Profits) of the OECD Model Tax Convention*, released on July 7, 2008 for public comment. The Treaty Policy Working Group is a group of companies with substantial global operations that are headquartered in OECD member countries throughout the world and represent a broad spectrum of sectors. Our member companies began working together in 2005 to analyze and address tax policy and administration concerns relating to treaty permanent establishment and profit attribution issues and other issues of mutual interest.

Treaty Policy Working Group members support the OECD as the primary international forum for development of common positions on cross-border tax policy and administration issues. We appreciate the time and effort that OECD member country officials and OECD Secretariat members devote to this important work. The current project on the attribution of profits to permanent establishments is particularly critical to us, as global companies seeking to avoid double taxation or unexpected taxation and the resulting cross-border controversies. We need—and believe that tax administrations also need—clear guidance in advance that provides adequate certainty, establishes a principled basis for determining how profits should be attributed if a permanent establishment exists, and reflects a true international consensus.

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We welcome the opportunity to comment from this perspective on the amendments to Article 7 and related Commentary changes proposed by the Discussion Draft. As noted in our previous comments, Treaty Policy Working Group members have a number of remaining concerns about the OECD *Report on the Attribution of Profits to Permanent Establishments* (the “2008 Report”) and the recently revised Commentary on existing Article 7 (the “2008 Commentary”). These comments focus exclusively, however, on the changes proposed by the Discussion Draft currently under consideration.

Executive Summary

Treaty Policy Working Group member companies appreciate the obvious care and thought with which the Discussion Draft was prepared. We share the OECD’s goals, expressed in the Discussion Draft, of providing consistency, “maximum certainty” regarding the manner in which profits are to be attributed to a permanent establishment, and relief from double taxation.

The Discussion Draft does not fully address our underlying concerns regarding the 2008 Report or the two-phase process recommended by the OECD for its implementation. However, the Discussion Draft clearly reflects the principles set forth in the 2008 Report more clearly and coherently than did the 2008 Commentary. It confirms some important points and would do more to advance the goals of certainty and consistency. Its approach is, therefore, preferable on balance to interpretations based on the 2008 Commentary alone, which could produce anomalous positions inconsistent with key principles of the 2008 Report.

We would like to limit our comments to two especially important aspects of the Discussion Draft—its provisions regarding documentation and its discussion of relief from double taxation—on which we believe there is still considerable room for improvement.

Documentation

The Discussion Draft represents a substantial advance over earlier OECD discussions of documentation in the permanent establishment context, in that it:

- Does not require the creation of contemporaneous documentation regarding dealings between a permanent establishment and other parts of the enterprise of which it is a part, but

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- Provides that tax administrations will, in principle, “give effect” to such documentation where it exists.¹

We appreciate the sophistication with which OECD member countries have refined their views on this important issue and believe that a reasonable balance has generally been established.

We would caution, however, that the requirements suggested for respecting documentation include points that have raised legal and policy concerns that are still under debate in the OECD’s current deliberations on business restructuring in the Article 9 context, such as the meaning of the “economic substance” and “commercially rational” concepts and the question of whether risks may be transferred separately from functions. This discussion is based on a section of the 2008 Report that jumped from a discussion of what countries would ideally like to see as documentation to a suggestion that certain requirements apply “by analogy” to paragraphs 1.26-1.29 and 1.36-1.41 of the Transfer Pricing Guidelines.²

Given the substantial lack of consensus regarding the meaning of those Guidelines provisions and the logical leap of the 2008 Report on these points, we respectfully submit that they should be revisited.

Relief From Double Taxation

The Discussion Draft is most in need of further refinement in its discussion of double taxation issues. We appreciate the general support expressed for double taxation relief and trust that OECD member countries do not intend to signal a lack of commitment to that principle. However, we would respectfully suggest that the current discussion suffers from some critical shortcomings that still need to be addressed.

First, although the Discussion Draft correctly starts from the proposition that Article 23 requires the elimination of double taxation on the profits attributable to a permanent establishment,³ it appears to condone departures from that requirement in a number of circumstances. For example, the new paragraph 3 proposed for Article 7 suggests, and the Discussion Draft’s proposed Commentary confirms, that Article 23 may not otherwise apply to eliminate double taxation of profits attributable to a

¹ See paragraph 23 of the Discussion Draft.

² See paragraphs 37 and 39 of Part I of the 2008 Report.

³ See, e.g., paragraphs 16 and 24 of the Discussion Draft.

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permanent establishment where domestic laws differ. The apparent deference to domestic laws on this point is at odds with the very purpose of tax treaties, which is to ensure relief from double taxation notwithstanding differences in domestic law or treaty interpretation. This proposed deference to domestic laws at the expense of double taxation should be rejected, not condoned, by the OECD.

Having implicitly acknowledged that Article 23 may not provide relief from double taxation of profits attributed to a permanent establishment, new paragraph 3 then provides a remedy only for a narrow category of cases: where both countries have domestic laws on the attribution of capital to a permanent establishment and these laws conflict. This remedy fails to address the general specter of potential double taxation that the Discussion Draft raises. The Discussion Draft should be revised to address this issue by reaffirming that Article 23 requires relief from double taxation in the permanent establishment context.

The Treaty Policy Working Group is also particularly concerned that the Discussion Draft offers countries the option of requiring that relief from double taxation in permanent establishment cases be provided solely through the mutual agreement procedure, with no legal obligation on either country.⁴ We believe that recourse to MAP and, if necessary, binding mandatory arbitration, should be available as a safeguard in all cases. However, we do not believe that it is viable or advisable to make the competent authorities the first port of call for this purpose. This approach would create a level of uncertainty and a demand for resources that would prove unacceptable to both taxpayers and tax administrations.

In its work on profit attribution, the OECD originally addressed double taxation more broadly, in the “symmetry discussion” of the August 2004 Discussion Draft of Part I. The fact that the 2008 Report and now the Discussion Draft have significantly retreated from that position could be taken to signal a lack of commitment by OECD member countries to avoid double taxation. We respectfully submit that neither the OECD as an institution nor its member country tax administrations should risk undermining the fundamental purpose of tax treaties in this fashion.

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⁴ See paragraphs 67 and 68 of the Discussion Draft.

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We appreciate this opportunity to provide comments on the Discussion Draft. We would be pleased to provide additional details or to discuss any or all of these issues as the OECD proceeds with its consideration.

Sincerely,



Carol A. Dunahoo



Gary D. Sprague