PUBLIC COMMENTS RECEIVED ON THE DISCUSSION DRAFT ON THE ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS – PART I (GENERAL CONSIDERATIONS)[1]

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Comments on the Discussion Draft on the "Attribution of Profit to Permanent Establishments"

1. We respond to the request for comments on the above paper. The OECD's initiative in issuing a paper on this topic is welcome, prompting debate as to whether a uniform international approach can be achieved in this extremely difficult area. We have discussed the paper with our colleagues in the PwC network around the globe and the following summary distils the key points arising from those discussions:

Content of the proposals

2. In our view the conceptual basis of the proposals requires further clarification. In particular, the rationale for relaxing the separate entity hypotheses in certain situations (e.g. on credit rating) needs explanation. It is not clear why, under a separate entity hypothesis, the *total* capital of a bank should be attributed amongst its branches, since there is no easily identifiable link between a bank's 'surplus' capital and the functions performed and risks assumed by a particular branch of the bank.

3. It appears to be implicit in the proposals that capital should be allocated by reference to external risk-weighted assets only and not in relation to inter-branch dealings. That should be made clear, although that in itself is another departure from the separate entity approach. The risk weighted assets approach will also entail a significant compliance burden, given the need to continually track risk-weighted assets and then allocate them on a geographical basis (a function which is not already fulfilled by the risk-weighted asset methodology itself).

4. If interest that has actually been incurred in one jurisdiction (for example in the case of a fully market-funded branch) is disallowed under the working hypothesis, it will be necessary to secure a clear reassurance that interest relief will be granted in another jurisdiction. It is not clear by what mechanism this will be achieved.

5. Non-banking institutions may be regulated differently from banks, making the way in which capital will be attributed to their permanent establishments potentially quite different. This may lead to significant tax differences despite possible similarities in the underlying economics of the business. The difficult is exacerbated in the current context by the fact that the OECD proposals for global dealing and insurance businesses are not yet available for comparison.

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1. Please note that comments received on the "Discussion Draft on the Attribution of Profit to a Permanent Establishment Involved in Electronic Commerce Transactions" are ***also*** included in this document, as these comments may also be of interest when examining Part I of the Discussion Draft on the Attribution of Profit to a Permanent Establishment.

Transitional issues

6. Although the paper does refer to this point briefly, it does not consider in detail whether the working hypothesis can be reconciled with the existing provisions of the OECD Model Convention. The working hypothesis arguably conflicts with these provisions, with the result that many treaties may have to be re-negotiated to give effect to the hypothesis.

7. Depending on the country involved, substantial amendments to domestic law may also be required. This may prove to be a complex process.

Suggested way forward

8. We recommend that the conceptual foundation of the working hypothesis is clarified further and that more detail is given in this regard.

9. It will be necessary to consider the magnitude of the steps that are required to implement the proposals and to ensure that the transition is practicable. These potentially include changes to the OECD Model Convention itself and lengthy treaty re-negotiations.

10. As a result of the above, what we understand to be the proposed timetable for finalising and implementing the proposals appears to be overly ambitious. We therefore recommend that the timetable be extended accordingly.