**Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention**
**Comments by the Chartered Institute of Taxation**

## 1 Introduction

1.1 We refer to the public discussion draft on the Interpretation and Application of Article 5 (Permanent Establishment (PE)) of the OECD Model Tax Convention published in October 2011 and set out the comments of the Chartered Institute of Taxation (CIOT) below.

## 2 Meaning of 'at the disposal of' (paragraph 4.2 of the Commentary)

2.1 The proposed new paragraph 4.2 set out on page 9 of the discussion document is helpful. However we would query what is meant by the phrase '*continuous and regular basis during an extended period of time*'. It is not clear whether this is intended to mean an extended continuous period or regular significant lengths of time over an extended period.

## 3 Home office as a PE (proposed new paragraphs 4.8 and 4.9)

3.1 The comments in the proposed new paragraph 4.8 are broadly reasonable, including the reference to the fact of whether or not the employer has required the employee to work from home as being relevant. However, there is no obvious logic in the distinction drawn in the new paragraph 4.9 between the non-resident consultant present for an extended period (undefined) in another state and working from a presumably temporary 'home' (as opposed to a hotel) as a PE and the cross-frontier worker performing most of their work from their home rather than in the office made available to them in the other state not being a PE. The consultant may well simply choose to work from home, rather than being required to do so by their employer. If the requirement by the employer of where the work is done is the decisive criterion envisaged by the working party, then we suggest the comments in paragraph 4.9 should be reconsidered.

3.2 Also a possible conclusion to be drawn from the new paragraph 4.8 is that where an enterprise decides to establish a new business in a territory, and hires staff to work in that territory prior to establishing an office, it may have created a PE at that point if the

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new staff work from home and their activities are part of the wider commercial activity. This may well be earlier than many enterprises anticipate, although profit attribution at that stage is likely to be small.

3.3 The phrase '*regular and continuous*' is used here. This gives rise to similar questions as those raised in relation to the proposed new paragraph 4.2 as set out above, which uses the phrase '*continuous and regular*'. At the very least, we suggest that the same phrase should be used throughout.

## 4 Time requirement for the existence of a permanent established (paragraph 6 of the Commentary)

4.1 The new paragraphs 6.1 and 6.2 propose exceptions to the general practice of Contracting States that, unless a place of business is maintained for six months or more, it does not constitute a PE. The two examples of an annually recurrent five week presence at an international commercial fair, and the single four month operation of a restaurant in a house in connection with filming a film on location may, of themselves, not be of general application, but the carving out of exceptions from the current well understood and straightforward to apply norm (that places of business operated for less than 6 months do not constitute a PE) is a very unwelcome development.

4.2 In respect of the short duration business example, at the very least it should be made clear that this would only apply to a totally discrete venture and not one that is merely part of any other business.

4.3 With regard to the example of recurrent activities, this is a difficult issue; the five weeks used in the example seems to us to be quite short, even if the recurrence is for a long period. If this is included as an example, it is feared that some states could seek to attribute a PE for much shorter periods, focussing on the recurrence and not any measure of duration. We suggest that three months each year in any five year period might be a better measure.

## 5 Presence of foreign enterprise's personnel in the host country (paragraph 10 of the Commentary)

5.1 Whilst the proposed changes to paragraph 10 regarding secondees are helpful, the comments in paragraph 44 of the discussion document are of concern. These relate to the situation where a secondee remains on their home country payroll (often for HR/benefits/compensation/currency reasons) and the host company is charged on a cost-plus basis. Paragraph 44 mentions the possibility that this cost-plus indicates that what the secondee is doing in the host country is not part of the host company's activity but rather part of the home company's activity, hence there is PE exposure. Reference is then made to the criteria in paragraphs 8.13-8.15 of the Model commentary regarding the host state company being the 'economic employer' for Article 15 183 day protection purposes to avoid a home state company PE in the host country. Whilst the changes are designed to be helpful, given the multiplicity of criteria in paragraphs 8.13-8.15 and the subjectivity sometimes involved (for example who instructs the individual (matrix management)), the outcome may not always be certain. In the worst case, this might leave multinational companies with the choice of accepting a local 'economic employer' and so host country taxation of secondees, even where they are present for no more than 183 days in the host country, or accepting a PE of the non-resident company in the host state.

## 6 Main contractor who subcontracts all aspects of a contract (paragraphs 10 and 19 of the Commentary)

6.1 We do not agree with the proposals made in relation to this issue. The new provision could leave open the issue relating to the overall responsibility of the contractor on the on-site operation by the sub-contractor. We suggest this should be dealt with under the dependent agency type PE rule rather than deeming the subcontractor(s) to be a PE of the non-resident main contractor. We fear also that, although discussed in the context of the construction industry, this principle of deeming a third party subcontractor to be a new type of PE of the main contractor could be extended to other industries – for example financial services in the context of brokers acting for non-resident principals. This seems a very dangerous precedent.

## 7 Does a development property constitute a PE (paragraph 22 of the Commentary)

7.1 The analysis at paragraph 86 of the discussion document is surely incorrect in terms of interaction of treaty and domestic law. A domestic charge under the Business Profits Article 7 cannot be justified by reference to the host state being permitted to charge under the Capital Gains Article 13. We refer to the Malaysian High Court case of *DIGR v Euromedical Industries Ltd* [1983] Part 1 Case 14 [FCM], where, in the absence of a PE, Malaysia's domestic withholding tax on technical assistance fees paid to a UK parent was blocked (the fees being business profits for treaty purposes rather than royalties, but there being no Malaysian PE).

## 8 Meaning of 'to conclude contracts in the name of the enterprise' (paragraph 32.1 of the Commentary)

8.1 The proposed addition to paragraph 32.1 of the Commentary will expressly provide that a principal enterprise bound by a contract concluded by another person with a third party would not be protected from having a PE in the country of that other person merely by virtue of that other person not disclosing that it was acting for the principal enterprise in its dealings with the third party. This would in particular appear to be targeted at principals in commissionaire arrangements, but as worded goes much wider than this. As it stands this is an unwelcome clarification, because the analysis is incomplete. The existence or otherwise of a PE should be with regard to all the facts and, in particular, the conduct of the parties. It would be preferable if the revised commentary reflected this.

## 9 The Chartered Institute of Taxation

9.1 The Chartered Institute of Taxation (CIOT) is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

The CIOT's comments and recommendations on tax issues are made solely in order to achieve its primary purpose: it is politically neutral in its work. The CIOT will seek to draw on its members' experience in private practice, Government, commerce and

industry and academia to argue and explain how public policy objectives (to the extent that these are clearly stated or can be discerned) can most effectively be achieved.

The CIOT's 15,600 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA'.