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Comments to the Public Discussion Draft on Permanent Establishments

10 October 2011 to 10 February 2012

Dear Mr. Perez-Navarro,

ICON Wirtschaftstreuhand GmbH is an Austrian tax consulting firm specialised in international taxation. We are consultants of large Austrian industrial enterprises doing business abroad and the Austrian Federation of Industries' nominee to the BIAC Tax Committee. Among them, but not limited to companies working in the field of plant construction. Hence the application and interpretation of the definitions of the term "permanent establishment" in the Austrian tax treaty network, which largely correspond to Art. 5 of the OECD Model Tax Convention (OECD-MTC) is part of our day-to day-business and for us of utmost importance.

We appreciate the activities of the Working Party (WP) installed by the Committee on Fiscal Affaires (CFA) having analysed and answered 25 questions relating to the application and interpretation of Art. 5 OECD-MTC and their proposals for changing and/or amending the Commentary on the OECD-MTC (the "Commentary") in the next update to be expected in 2014. We have carefully reviewed the discussion draft released on 10 October 2011 and take the opportunity to comment on some important disagreements between our (and the Austrian MoF's) interpretation what should constitute a PE under Art. 5 OECD-MTC and the conclusions reached by the WP in the discussion draft.

1. Can a farm be a permanent establishment? (No. 1)

According to the WP's proposal the Commentary should clarify in para 3.1. that the determination of whether or not an enterprise of a Contracting State has a PE in the other Contracting State should be made independently from the determination of which provision of the Convention should apply to the profits derived by that enterprise. As an example the WP uses a **farm** or an **apartment rental office**. A further important example could be a ticketing office maintained by an enterprise operating ships or aircrafts in international traffic in a source state. Although the profits from the operation of the ships or aircrafts shall be taxable in the resident

state only, the ticketing office would be considered to be a PE for purposes of para's 4 and 5 of Art. 11 or para 2 of Art. 15 OECD-MTC.

2. Meaning of "at the disposal" (No. 2)

Austrian jurisdiction and administrative practice requires an enterprise to constitute a PE to have the right to use a **distinct "place of business"** which is **different from the "object"** of the business. The Austrian MoF did not agree to the painter example given in para 5.3 of the Commentary on Art. 5 OECD-MTC. According to this example the building (the object) should be regarded as a single place of business. From an Austrian perspective the painter should require some space in the office building, which is different from the object of his painting work (e.g. storage facilities). Austria did not make an observation to the Commentary because the painter could be considered to have a PE under para 3 of Art. 5 OECD-MTC as well.

The discussion draft emphasizes that the main purpose of the PE-concept is to give taxation rights to the source state if an enterprise is performing activities and functions which require a permanent physical presence in the source state. The new draft of para 4.2. of the Commentary however considers **an exclusive legal right** to use a particular location to be sufficient. The draft further assumes a PE to exist if business activities are performed on a **continuous and regular basis** during an **extended period of time** unless the enterprise's presence at a location is **intermittent** or **incidential**. The Commentary does not define what "intermittent" and "incidential" means to be. In business practice this will cause uncertainty, confusion and finally double taxation.

A further example given in the background information considers a trainer providing training services to CLIENTCO's staff to constitute a PE purely because of maintaining a security card allowing him **unrestricted access to CLIENTCO's office building**. From our point of view a PE should be deemed to exist only if the trainer has the right to use a distinct place of business. Considering **the legal right** only to be decisive for considering a place of business to be "at the disposal" of an enterprise does not correspond to the wording of Art. 5 para 1 OECD-MTC. Art. 5 para 1 OECD-MA requires an enterprise to have roots in the source state which requires much more than the pure legal right to have access to the object of the business activities.

In international business groups employees of the headquarter responsible for centralized business functions regularly visit the group's subsidiaries from time to time and usually have unlimited access to the subsidiary's office premises. If CTPA's interpretation is true, the headquarter could be considered to have a PE in the foreign subsidiary's premises. Such an interpretation violates the principle that the source state should not be allowed to tax business profits unless the enterprise carries on business through a "fixed" place of business.

3. Home office as a PE (No. 4)

A new para 4.8./4.9. of the Commentary to Art. 5 OECD-MTC considers an employee's home office to constitute a PE if it is clear from the facts and circumstances that the enterprise has required the individual to work from home. Considering a changing business environment, the continuing mobility and flexibility of employees source states could attempt to deem a PE

where no place of business exists. We welcome the draft's assertion that the question whether an home office constitutes a PE will rarely be a practical issue and that the activities carried on at the head office will be merely auxiliary and therefore fall within the exception of subparagraph e of paragraph 4. Given this circumstances there is no need to introduce para's 4.8. and 4.9 into the Commentary.

4. Time requirement for the existence of a PE (No. 6)

4.1. Recurrent activities

The term "fixed" requires an establishment to be established at a distinct place with a certain degree of permanence. In other words an enterprise's business activity should not be of a purely temporary nature. Austrian administrative practice actually follows the opinion expressed in para 6 of the Commentary to Art. 5 OECD-MTC and considers a PE to exist if the place of business is maintained for a period of more than 6 months.

We support the opinion expressed in Working Group's description of the issue on a new language of para 6.1. to the Commentary saying that a minimum period of time should be introduced in order to make the "time test" more clear. The discussion draft refers to the 183 day rule of Art. 15 OECD-MTC or the twelve months period as used in Art. 5 para 3 OECD-MTC. The Working Group's recommendations to change the Commentary however are quite different.

The example used in para 6.1. of the Commentary considers an individual renting a stand at a commercial fair for a period of **five weeks** each year for **15 consecutive years** to constitute a PE regardless of the fact that any consecutive presence lasts less than 6 months. In practice such an excessive interpretation of the time requirement causes a lot of administrative problems both for the taxpayer and the tax administration. First of all the individual might not know in advance whether he will be present at the fair for the forthcoming 15 years. Let's assume he rents the stand on a year by year basis. Would the 5 week's presence be considered to be a PE, because the individual "might" come again? Let's assume the individual rent's the space for the whole 15 years' period in advance but decides to cancel the rental contract because of insufficient sales? Would a PE be deemed to exist because one could expect that the individual has planned to come every year? Translating the example to an international business group: Could the headquarter be considered to have a PE in the subsidiary's premises because employees providing centralized services visit the subsidiary every year for a few weeks?

From a practical point of view such an extensive interpretation causes uncertainty for taxpayers and tax authorities as well. One can expect that the volume of tax revenues attributable to such short term activities does not justify the administrative burden loaded to an enterprise. A practical solution could be to consider the **183-days test** as used in Art. 15 para 2 a) OECD-MTC as a measure for the time requirement to consider an establishment to be "fixed". This would allow taxpayers and tax authorities to asses in advance whether or not a PE will emerge.

4.2. Short duration business

Similar objections apply to the example presented in para 6.2. of the Commentary to Art. 4 OECD-MTC considering a **restaurant operating during a period of four months to** constitute a PE in the source state, if the restaurant is the only business activity carried out by the individual. We think that it should make no difference whether the entrepreneur is doing business in one state only or in the residence state as wll. The term PE as defined in Art. 5 para 1 OECD-MTC stands for a fixed place of business through which the business of an enterprise is wholly or partly carried on. The volume of the entrepreneur's business is immaterial for applying the PE test.

5. Main contractor who subcontracts all aspects of a contract (No. 8)

The WP recommends to change the language of para 19 of the Commentary to Art. 5 OECD-MTC by adding that a general contractor having undertaken the performance of a comprehensive project subcontracting **all** or parts of such a project to subcontractors should be deemed to constitute a PE because even in such a case the period spent by a subcontractor working on the building site should be considered as being time spent by the general contractor on the building project. Based on the grounds that in this case the site should be considered to be **at the disposal of the general contractor** during the time spent on that site by any subcontractor, **where** the general contractor has the overall responsibility for the site and the site is made available to that general contractor for the purposes of carrying on its construction business.

In practice the general contractor always has responsibility for the project site notwithstanding the fact that he might not be present at all in the source state. The WP obviously assumes that a **missing physical presence** in the source state can be **replaced by responsibility**. The general contractor shall constitute a PE because of his legal contractual responsibility. According to the current wording of para 19 of the Commentary to Art. 5 para 3 OECD-MTC the subcontractor's presence in the source state is considered just for time-test purposes. The draft of the new version allocates the activities of the subcontractor to the main contractor which violates the basic principle that an enterprise should be subject to tax in the source state only if executing its own business activities in the source sate.

Austrian administrative practice would not deem the general contractor to constitute a PE if he is not present as all in the source state. A further reason for this approach is that in such a case according to Art. 7 OECD-MTC and the separate entity approach (AOA) for attributing profits to permanent establishments no profits would be left to be taxed in the hands of the main contractor. Based on the grounds that functions (contract negotiations) and risks (responsibility for the subcontractor's work) decisive for the profit allocation would have to be attributed to the head office only. The profit allocation to the PE would be nil, since all functions were performed and all risks assumed by the head office. Considering, that a construction PE exists from the date on which the contractor begins his work at site it is clear that any functions relating to the employment of subcontractors to be done before the PE even exists (negotiation of terms and conditions) can be attributed to the head office only with **no profit left to the PE**. In some countries profits of a construction-PE are taxed on deemed profits'

basis. In such a case the source state would impose taxes twice. First in the hands of the general contractor and once more again in the hands of the subcontractor. Accordingly the extension of the PE definition to this set of facts makes no sense.

The problems arising to allocate profits was one of the reasons why certain business activities as mentioned in Art. 5 para 4 a) to f) are treated as exemptions, even if the activities are carried on through a fixed place of business. Para 23 of the Commentary to Art. 5 OECD-MTC well recognizes that such a place of business may well contribute to the productivity of the enterprise but was deemed not to constitute a PE because the services performed are so remote from the actual realisation of profits that it is difficult to allocate any profits to the fixed place of business in question. The same is true if a general contractor delegates the entire contractual work.

6. Additional work on a construction site (No. 11)

The question to what extent additional work performed on a construction site counts to determine whether a building site or construction or installation project constitutes a PE is of very important for business practice. The current wording of the Commentary gives only little guidance. The WP proposes to change para 19.1. of the Commentary to Art. 5 OECD-MTC to establish, that the period during which the building or its facilities are being **tested** by the contractor or subcontractors should generally be included in the period during which the construction site exists. The "**delivery**" of the building should represent the end of the period of work, provided that the contractor and subcontractors **no longer work on the site after its delivery**. In other words any physical presence of the contractor's personnel on the site would have be included in the time test, irrespective of the functions performed by this personnel. This is contrary to the last sentence of Art. 19.1. of the Commentary to Art. 5 OECD-MTC saying that work undertaken on a site after the construction work has been completed pursuant to a guarantee would normally not be included in the original construction period. This unequal language may confuse taxpayers and tax authorities.

The German Federal Finance court (BFH 21.4.1999, I R 99/97, BStBl II, 694) decided that a project site should cede to exist when the contractual obligations have been fulfilled and the project has been delivered to the customer after start up and performance tests. In other words any physical presence of the contractor's personnel after the final delivery of the plant should not be considered for time-test purposes. The contractor's or his subcontractor's presence after the project was completed could however constitute a PE if the requirements of Art. 5 para 1 OECD-MTC are fulfilled.

7. Meaning of "to conclude contracts in the name of the enterprise" (No. 19)

The difficulties described above in attempting to allocate profits to a PE are behind the concept of the "dependent agent" (Art. 5 para 5 OECD-MTC) as well. According to the proposed new wording of para 32.1 of the Commentary on Art. 5 OECD-MTC a dependent agent PE could be deemed to exist if the enterprise would be bound by a contract concluded with a third party by a person acting on behalf of the enterprise even if the person did not formally disclose that it was acting for the enterprise. Assuming that the person resident in the source state receives an arm's length remuneration for all functions performed and risks assumed there would be no

profit left to be allocated to the agency-PE. Following the WP's attempt to broaden the definition what constitutes an agency-PE tax authorities endeavour to deem a parent company to constitute a PE because of acts of a subsidiary. If any acts done by a subsidiary on behalf of the parent company are remunerated on arm's length basis again there would be not profit left for an agency PE. If the remuneration is not at arm's length transfer prices should be changed rather than deeming a PE to exist. Such a concept already has been incorporated into No. 2 of the protocol to Art. 5 of the Tax Treaty between Austria and Germany. Austria and Germany agreed that in case of related enterprises no enterprise should be considered to be a PE of the other enterprise, if the functions performed which might constitute a PE are remunerated by reasonable transfer pricing. Such a concept should be introduced into the Commentary on Art. 5 para 5 OECD-MTC as well not at least to reduce taxpayer's administrative burden.

Please consider our comments when finalizing the changes of the Commentary on Art. 5 OECD-MTC. We expressly agree that our comments in response to the subject Public Discussion Draft is posted on the OECD website

Kindly yours

ICON Wirtschaftstreuhand GmbH
Steuerberater und Wirtschaftsprüfer

Dr. Stefan Bendlinger