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Dear Ms Perez-Navarro

Comments on Public Discussion Draft: Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention

It is with pleasure that we submit comments[1] on the OECD's public discussion draft *Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention* (the "Discussion Draft"). We welcome the efforts of the OECD Committee on Fiscal Affairs to provide further guidance relating to the concept of permanent establishments as found in Article 5 of the OECD Model Tax Convention.

Executive Summary

1. Article 5, paragraph (1) of the Model Tax Convention:

    a) Meaning of "at the disposal of" (proposed paragraph 4.2 of the Commentary). We support the inclusion of principles and factors, in addition to examples, that can be used to establish whether a location is "at the disposal of" an enterprise.

    b) Presence of goods at the premises of a third party service provider (proposed paragraph 4.2 of the Commentary). An example illustrating the application of the principles and factors to the situation of an enterprise engaging a third party logistics service provider would be useful in further clarifying the interpretation and application of Article 5(1).

    c) Reference to "contract manufacturer" (proposed paragraph 4.2 of the Commentary). The reference to "contract-manufacturer" in proposed paragraph 4.2 is confusing as the scenario being referred to would appear in fact to refer to a "toll manufacturing" arrangement. We recommend that the use of terminology here be clarified.

    d) Identification of examples (proposed paragraph 4.3 of the Commentary). For convenience, we recommend that a "signpost" be included at proposed paragraph 4.3

[1] The significant contribution of Ms Melissa Dejong (Deloitte Singapore) in preparing these comments is gratefully acknowledged.

of the Commentary, identifying the location of examples of the application of the "at the disposal test" which are interspersed throughout the Commentary.

e) Time requirement for the existence of a permanent establishment ("PE") (proposed paragraph 6 and 6.1 – 6.3). Although previously declined by the Working Group, we support the adoption of a bright-line time test for the creation of a PE.

f) Presence of foreign enterprise's personnel in the host country (proposed paragraph 10). The Commentary on presence of a foreign enterprise's personnel in a host country should include a comment on Article 5(3)(b) of the UN Model Tax treaty, to ensure consistency across different treaties. The Commentary on this point should also include guidance as to when an employee of a subsidiary would be deemed to be an employee of the parent company of a group.

2. Article 5, paragraph (6) of the Model Tax Convention:

a) Independent agents. Examples of agents having independent status should be included to further illustrate the application of the principles contained in the Commentary.

1. Article 5, paragraph (1) of the Model Tax Convention

a) "At the disposal of" – proposed paragraph 4.2

The Commentary currently contains examples of situations in which a particular location is (or is not) at the disposal of an enterprise. It does not currently include a statement of guiding principles or factors that should be used in establishing whether a location is at the disposal of an enterprise.

Proposed paragraph 4.2 includes two ***principles*** relevant to an enquiry into the "at the disposal" test: (i) the extent of the presence of an enterprise at a particular location; and (ii) the activities that the enterprise performs at that location.

Proposed paragraph 4.2 further includes ***factors*** that would indicate (or otherwise) that a location is at the disposal of an enterprise. These factors assist in resolving the issues raised by the two principles. The factors indicating that a location is at the disposal of an enterprise are: (i) exclusive legal right to use a location and the location is used only for carrying on the enterprise's own business activities; and (ii) continuous and regular performance of an enterprise's business activities during an extended period of time, although the location may belong to, or be used by, another enterprise (or multiple enterprises). The factors indicating that a location is not at the disposal of an enterprise are: (i) the presence of an enterprise at a location is so intermittent or incidental that the location cannot be considered to be a place of business of the enterprise; and (ii) the enterprise does not have a right to be present at a location, and does not in fact use the location itself.

It is our view that the inclusion of principles and factors assists in the interpretation and application of Article 5. In particular, we view the principles and factors as drafted in proposed paragraph 4.2 as being consistent with the existing examples included in the Commentary, as well as being capable of application to a diverse range of situations.

b) Presence of goods at the premises of a third party service provider – proposed paragraph 4.2

Proposed paragraph 4.2 illustrates the principles and factors using the example of a plant, stating *"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…"*

This paragraph touches on the broader issue of when the premises of a third party service provider can give rise to a PE of the service recipient. However, the Commentary does not currently address the creation of a PE by virtue of an enterprise engaging the services of a third party logistics (warehouse storage) service provider. In our view, guidance on this point is necessary in light of the February 2010 ruling by India's Authority for Advance Rulings in respect of *Seagate Singapore International Headquarters Private Ltd*.

In that case, Seagate, a Singapore resident company, engaged a third party logistics service provider, which operated from its own warehouse located in India. Seagate had no physical presence or staff based in India, although its goods were to be stored in a specifically designated location in the warehouse and its staff had a certain amount of access to the warehouse for the purpose of inventory and inspection of goods and other incidental purposes. Seagate shipped the goods to India following which the logistics company collected the goods from the shipping port (with title to the goods being retained by Seagate). The logistics company would also liaise with the customs officers, store the goods in a bonded warehouse, and when instructed would deliver the goods to Seagate's customer.

The Authority for Advance Rulings held that the warehouse constituted a fixed place of business through which Seagate carried on its business in India, and that it therefore had a PE in India. The Ruling stated: "*Both the applicant and the warehouse / service provider act in cohesion to ensure the product delivery to the customers promptly. By merely outsourcing the operations leading to supplies of products, it cannot be said that the applicant does not carry on any business in India from a fixed place.*"

The outsourcing of certain functions within an enterprise's supply chain is not an unusual occurrence. As such, the risk of creating a PE when service providers (such as logistics companies) are engaged in overseas locations is not insignificant to multinational companies. Although the inclusion of the principles and factors in proposed paragraph 4.2 provide some guidance, given the potential significance of this issue, and in response to the *Seagate* Ruling, it would be useful if a new example on this point was included in the Commentary. Such an example, commenting on when the engagement of a third party (warehouse storage) service provider will constitute a PE for the engaging enterprise, would also be useful in further demonstrating how principles and factors mentioned in proposed paragraph 4.2 are to be applied.

c) Reference to "contract-manufacturer" – proposed paragraph 4.2

Proposed paragraph 4.2 uses the example of a "*plant that is owned and used exclusively by a supplier or* ***contract manufacturer****…*" in applying the "no right to be present at a location and no actual use of the location" factor mentioned above. However, it is difficult to conceive of an enterprise having a PE by virtue of it engaging a contract manufacturer (which directly obtains raw materials, processes the materials and sells the finished goods to the enterprise). The PE issue is more likely to arise where the title to the goods is retained by the enterprise – which is the case in a toll manufacturing arrangement but not a contract manufacturing arrangement. It is this toll manufacturing arrangement that is on view in the "CARCO" example in paragraph 17 and

following of the Discussion Draft, although it is labelled as a contract manufacturing arrangement. As such, it appears that the more appropriate reference is to a "***toll manufacturer***" and we recommend that this use of terminology in proposed paragraph 4.2 be revisited.

d) Identification of examples – proposed paragraph 4.3

Proposed paragraph 4.3 introduces the examples of situations in which a particular location may be (or may not be) at the disposal of an enterprise, of which there are several throughout the Commentary. For ease of reference, we suggest that as a prelude to introducing the examples, the location of the examples in the Commentary be identified upfront.

For example, proposed paragraph 4.3 might be amended to read as follows:

> *"4.3 These principles are illustrated by examples throughout this Commentary. Examples so included are: a salesman visiting a customer (paragraph 4.4); an employee using an office in a related company's headquarters (paragraph 4.5); a road transportation enterprise at a delivery dock (paragraph 4.6); a painter at a customer's office building (paragraph 4.7); leased property (paragraph 8); a foreign telecommunications network utilised under a "roaming agreement" (paragraph 9.1); services provided within a multinational group (paragraph 42); and an enterprise using a computer server (paragraph 42.3)."*

e) Time requirement for the existence of a PE – paragraph 6 and proposed paragraphs 6.1 – 6.3

In our view, the commentary and new examples included in proposed paragraphs 6.1 and 6.2 create, rather than reduce, difficulties in the application of Article 5. In the case of short-term but recurrent business operations, such as the sculpture stand at a fair over 15 years, it is difficult to determine the point at which taxing rights (and obligations) are triggered / ceded. Using the example in proposed paragraph 6.1: where an individual is not certain from the outset that his activity will recur in following years, after how many years of recurrent activity should the individual's profits be subjected to tax in the source country? Supposing there could be said to be a precise triggering point, at which his activity has become of a sufficiently recurring nature: this may necessitate amended tax assessments in both resident and source countries for the relevant number of prior years. In the absence of a bright-line time test, it may be that an enquiry into whether a short-term business activity gives rise to a PE requires significant cooperation between multiple taxing jurisdictions and the taxpayer that is often disproportionate to the level of business activity actually undertaken.

Instead, we support the views of BIAC reproduced in Part 6 of the Discussion Draft. In our view, the benefits of certainty (such as ease of administration and compliance with tax obligations) outweigh any detriments to source countries resulting from a loss of taxing rights over the profits of short-term business operations. Furthermore, as noted by BIAC, a bright-line time test has successfully been adopted in Articles 5(3) and 15. As such, we see no compelling reason that such a test could not successfully be included as a rule of more general application (subject still to anti-abuse provisions in both the Model Tax Convention and domestic law as appropriate). Although we do not necessarily oppose a 12 month rule, it would appear fair that a source country would have taxing rights over profits arising from a business which is present for a minimum of six months in a 12 month period.

f) *Presence of foreign enterprise's personnel in a host country – proposed paragraph 10*

Proposed paragraph 10 includes a new cross-reference to paragraphs 8.11 and 8.13 to 8.15 of the Commentary on Article 15 ("Income from Employment"). In our view, this is a helpful and entirely appropriate inclusion.

For completeness and consistency, we recommend that a comment be included in connection with Article 5(3)(b) of the UN Model Tax Convention ("furnishing of services PE"). That Article provides:

> *"The term "permanent establishment" also encompasses: … The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any 12 month period commencing or ending in the fiscal year concerned."*

The words in Article 5(3)(b) of the UN Model contemplate that the enterprise is acting "*through employees or other personnel engaged by the enterprise*…" Accordingly, the furnishing of services PE as contemplated by Article 5(3)(b) may arise by virtue of a secondment arrangement within a multinational group. Where a tax treaty includes a furnishing of services PE, the applicability of the OECD's principles in proposed paragraph 10 (and therefore of paragraphs 8.11 and 8.13 – 8.15 of the Commentary on Article 15) should be made clear. Specifically, it should be made clear whether the OECD takes the view that the same tests apply in determining, for the purpose of a furnishing of services PE, whether an enterprise is acting "*through employees or other personnel engaged by the enterprise*".

The Commentary should also provide guidance on the principles that are relevant in establishing when employees of a subsidiary can be deemed to be employees of the parent company. This is necessary in response to the September 2011 decision by the High Court of Delhi in *Rolls Royce plc v DIT*. In that case, notwithstanding the formal employment relationship, the actions of the employees of a subsidiary company which provided services in India to the parent company were characterised as the actions of the parent company in the UK, thus creating a PE.

In so deciding, the court confirmed that formal employees of a service provider may be treated as the actual employees of the principal. However, the case itself does not lay out principles of general application which assist in determining when a similar outcome would arise. It is submitted that such guidance should be provided in the Commentary in a manner that is consistent with the Commentary in proposed paragraph 10.

2. Article 5, paragraph (6) of the Model Tax Convention

a) Inclusion of examples of agents of independent status

The Commentary currently includes principles to be used in determining whether an agent is of independent status and therefore not constituting a PE of the principal.

It would be helpful if the Commentary also included examples of situations in which an agent would, and would not, be considered to be an agent of an independent status. This would assist in demonstrating the appropriate application of the principles laid out in the Commentary to Article 5(6).

We trust that the above comments are of assistance to the OECD. We look forward to reviewing future developments on this issue.

Please do not hesitate to contact me on +65 6216 3227 should you wish to discuss any aspect of our comments.

Yours faithfully

Steve Towers
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