SIEMENS

Siemens AG, CF T, Wittelsbacherplatz 2, 80333 Muenchen

Grace Perez-Navarro
Deputy Director, CTPA
OECD
2, rue André Pascal
75775 Paris

per e-mail: grace.perez-navarro@oecd.org

Name Dr. Christian Kaeser
Department CF T

Telephone +49 (89) 636-31591
Fax +49 (89) 636-33143
Mobile
E-mail Christian.kaeser@siemens.com

Our reference CK
Date February 7, 2012

Dear Ms. Perez-Navarro,

OECD Discussion Draft on the definition of "Permanent Establishment" in the OECD Model Tax Convention – Comments on the proposed changes

we highly appreciate the opportunity to comment on the discussion draft "Interpretation and application of article 5 (Permanent Establishment) of the OECD Model Tax Convention". We are grateful for the time and efforts which the authors have invested. The very clear structure of the discussion draft is extremely helpful to understand the issues at stake and the OECD's train of thought in the respective area.

Since the interpretation of Art. 5 of the OECD Model Convention has been the subject of both lively academic debate and disputes among practitioners for many years, we very much welcome more detailed guidance on the OECD level, and are pleased to hereinafter submit our comments on the discussion draft.

We would like to make a general remark on the developments around article 5 and 7 over the course of the last years: there seems to be some disconnect between the AOA which treats a permanent establishment as it was a legal entity for purposes of income determination whilst at the same time there apparently is a trend even within OECD to soften the requirements of a permanent establishment. We think that the AOA should require more certainty in the area of article 5 and an even higher threshold for creating a permanent establishment.

Sincerely yours,

sgd. Dr. Christian Kaeser

- Encls.-

OECD – Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention

Comments submitted by Siemens AG

2. Meaning of "at the disposal of" (paragraph 4.2 of the Commentary)

- The term "at the disposal of" adds clarity to the definition of permanent establishment. Only those fixed places are to be considered permanent establishments, which are in a specific way related to a person. Whether a fixed place is – or is not - at the disposal of the enterprise should easily be identifiable in the interest of legal certainty. Softening the requirements for this term means increasing uncertainty as well as broadening the scope of taxation by the source state.
  In recent years, we experienced increasing uncertainty in the interpretation of the criterion "at the disposal of". Two decisions of the German Federal Tax Court (Bundesfinanzhof) of 2004[1] and 2008[2] re certain services rendered at German airbases and the subsequent discussions on those in German literature reveal the problems as well as the level of uncertainty created by an interpretation of "at the disposal of" in a wider, commercial or functional sense. We therefore – in principle – appreciate the Working Party's endeavors to provide further guidance.

  The proposal for the new paragraph 4.2 leads us to the following comments.

  It starts (1st sentence) with the statement, that no formal legal right to use a particular place is required. While this principle was established years ago, it needs to be stressed, that it introduces uncertainty to the application of Art. 5 paragraph 1. Would the definition call for an established ("formal") legal right, the problems addressed by the further sentences would disappear – for the benefit of both the taxpayer and the countries concerned. From a taxpayers perspective, it would clearly be preferable if the existence of a "formal legal right" would be the only relevant criterion to establish the term "at the disposal of". The 3rd sentence of the new wording appears to support this view. We would, in the interest of clarity, expect the contracting states, if they see a need for this, to precisely define in their tax treaties certain instances as giving rise to a permanent establishment, where no "formal legal right" exists. This is exactly what happens, when clauses dealing with installation and construction PE's are being negotiated (along the lines of Art. 5 paragraph 3 of the Convention); it should be possible, to introduce specific other cases as permanent establishments, if there is a need for it. Broadening the interpretation of the fundamental definition in Art. 5 paragraph 1 of the Convention is not in our view an alternative to this.

  The new 2nd sentence implies, that – more than a formal legal right – the following two criteria are essential to establish the term "at the disposal of":

  > the extent of the presence of an enterprise at that location; sentence 4 translates this into a continuous and regular basis during an extended period of time at a location that

[1] 14.07.2004, Az. I R 106/03, BFH/NV 2005, 154
[2] 04.06.2008, Az. I R 30/07, BStBl. II 2008, 922

belongs to another enterprise or that is used by a number of enterprises.; sentence 5 tries to limit that again by stating, that an intermittent or incidental presence may not necessarily be considered a place of business.

and

the activities that it performs there. This aspect is not illustrated any further, so it is difficult to assume, what this could mean. – We learn from paragraph 14, what in the opinion of the Working Party may be a case relevant in this aspect (IT training by an IT consultant); but this thought does not find its way into the proposal for the Commentary. While that is understandable, the wording as suggested – again – creates ambiguity and uncertainty, in sharp contrast to the purpose of the Commentary.

- We do not think, that these newly introduced criteria help with the interpretation and application of Art. 5 paragraph 1 of the Convention, as they are too vague and by themselves necessitate interpretation.

Sentence 6, finally, is helpful in that it eliminates certain cases from being regarded as permanent establishment (see below, Item 3). In our view, the statements are correct, maybe obvious, but could be kept for the avoidance of doubt.

Regarding the example in paragraph 13 (Peter / Clientco) we are of the opinion, that under Art. 5 paragraph 1 of the Convention no permanent establishment should be assumed. Peter is a service provider. As such, he renders his services at the clients' premises, but is not allowed to use them for any other purpose than the courses for the client. The facilities are hence not at the disposal of Peter. He is not conducting his business through, but only at the fixed place. – If states entering into tax treaties consider this as a fact pattern which should give rise to a permanent establishment, then they should in our view agree on specifically phrased clauses to this effect as for example that of the alternative provision of a Service permanent establishment already provided by the commentary.

3. Can the premises of a (converted) local entity constitute a permanent establishment of a foreign enterprise under paragraph 1? (paragraph 4.2 of the Commentary)?

In response to this question, the Working Party makes a number of useful comments. The cases at hand indeed have to be assessed based on the criteria of (i) right to dispose of the subsidiaries premises, and (ii) whether or not it is the foreign parent's business which is being carried on through these premises. We agree with the suggested treatment of the CARCO case.
The contract manufacturer, being a taxable person in its own right and separate from the foreign entrepreneur, is not to be regarded as dissolving into this foreign entrepreneur. The contract manufacturer's premises are not at the disposal of the foreign entrepreneur either. The cost plus compensation of the contract manufacturer, even though this is paid by the foreign entrepreneur, does not imply, that the foreign entrepreneur acquires and eventually owns the assets of the contract manufacturer.
A functional analysis reveals that the contract manufacturers' business is not identical with that of the foreign entrepreneur. Anything else than respecting the legal entities and their respective businesses can only lead to confusion and serious risks of double taxation. The same holds true if the resident company fulfils other functions, such as a distributor, as can be seen from the

widespread and controversial discussions in the aftermath of the ITAT (Delhi) in the Case Rolls Royce[3].
We finally agree with the statement, that any prior business model or interim business restructuring needs to be disregarded when assessing whether or not a current setup constitutes a permanent establishment. Again, applying a step doctrine, a commercial perspective or any other approach to substitute the legal current facts, in our view is bound to increase uncertainty and tax risks for the tax payer and needs to be avoided.

On the proposed par. 4.2, 6th sentence, we are – again – of the view, that this is correct, and could be kept for the avoidance of doubt.

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

The discussion paper specifies that a revolving presence of a foreign enterprise may constitute a permanent establishment even if each individual stay is of fairly short period of time. This would constitute 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 given 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 producing a film must not be meant as for general application. Nevertheless creating such exceptions from the current well understood and straightforward general rule is very likely to create great legal uncertainty. We fear that some states could in general seek to assume a PE for much shorter periods. The condition of recurrence instead of any measure of duration is very subjective and difficult to monitor in a globally active company. We suggest deleting the proposed changes.

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

Where a general contractor subcontracts a part of the work to service providers, the periods those subcontractors spend on a construction site are included in the period during which the construction site or installation project runs, and hence attributed to the general contractor (paragraph 19 of the Commentary).
This principle shall now be extended to apply beyond construction projects. Furthermore, a permanent establishment is suggested to exist even when the general contractor is not on site himself but has outsourced “all aspects of a contract”.
We strongly disagree with the extension of the general rule. In our view the decisive issue for purposes of Art. 5 paragraph 1 is whether the activity outsourced to the subcontractor is the business activity of the general contractor, or the business activity of the subcontractor. We therefore suggest sticking to the principle, that a general contractor and a service provider each conduct their own business activities, which are to be assessed based on their own facts and circumstances. Reallocating certain attributes among multiple persons can only lead to confusion and double taxation. While the draft paragraph 10.1 has got some merit in that it would clarify the need for further criteria of Art. 5 paragraph 1 of the Model Convention (e.g. fixed place of business) to be fulfilled in a given case, we are very concerned about the implicit tendency to have relevant attributes allocated or shared among different taxable persons. We

[3] Delhi Income Tax Appellate Tribunal (ITAT) of 26.10.2007, Rolls Royce Plc v. Deputy Director of Income Tax, ITAT Nos. 1496 to 1501/DEL of 2007

clearly see the risk of the source country raising taxes from income that has not been generated by local presence of a general contractor, but by functions performed and risks carried outside of the source country.
Regarding the draft paragraph 19 we think that removing the need for the general contractor to be present at a site at least at some point in time means diluting the requirements for a permanent establishment in an inacceptable manner. Only where a person is in main part present at an offshore site in person or with his own personnel should he be considered as doing business there.

10. Meaning of "place of management" (paragraph 12 of the Commentary)

The example of the discussion paper raises two questions: The relationship between the examples, which are mentioned in Art. 5(2) and the general definition of permanent establishments in Art. 5(1) as well as the relationship between Art. 5 (1), (2) and the application of the "at the disposal" standard.

We very much support the clarification proposed by the OECD, which will be included in paragraph 12 of the Commentary. Only if one of the items of the list in Art. 5 (2) fulfills the requirements of Art. 5 (1) it should be regarded as a permanent establishment. Those requirements are not automatically fulfilled. It is correct and corresponds with the commonly accepted interpretation of this Article to further require the conditions contained in Art 5 (1).

The explanatory material is useful and we encourage the Working Party to include the statement that the provision of management services does not cause the management premises to be at the disposal of the enterprise receiving the benefit of the services. It is important to note, that this does not only apply to the administrative services referred to in the example at paragraph 59 of the discussion paper.

12. Must the activities referred to in paragraph 4 be of a preparatory or auxiliary nature? (paragraphs 21 and 23 of the Commentary)

This example also raises the relationship between specific examples and a general rule. The activities described in subparagraphs Art. 5 (4) (a) to (d) constitute exceptions to a fixed place of business PE described in Article 5 (1). The raised question is whether those are "automatic" exceptions or whether the preparatory or auxiliary condition of Art. 5 (4) (e) is to be fulfilled.
The examples specified in Art. 5 (4) (a) to (d) are meant to simplify the application of Art. 5. We therefore agree that if all the exceptions were made subject to the preparatory or auxiliary condition this would create (unnecessary) uncertainty to the Commentary. This condition is much more subjective and would therefore result in more disputes with the tax authorities.

Also from the point of view of a systematic interpretation of Art. 5 (4) an extension of the preparatory or auxiliary condition cannot satisfy. It would lead to making Art. 5 (4) (e) to a general rule to which the precedent subparagraphs (a) to (d) would have to comply although they are on the same systematic rank than subparagraph (e).

Although we agree in principle with the proposed amendments to paragraph 21 of the Commentary we suggest to delete the following text "involve activities which are so remote from

the actual realisation of profits by the enterprise that they" in paragraph 23 of the Commentary on Article 5. It is too subjective and creates uncertainty.

19. Meaning of "to conclude contracts in the name of the enterprise" (paragraph 32.1 of the Commentary)

Under Art. 5 paragraph 5 of the Convention a tax payer is deemed to have a permanent establishment in another country if, in this other country and under further conditions, a person is acting for it.

While par. 1 links the existence of a permanent establishment to a fixed place at the disposal of a non-resident person, par. 5 considers a person acting for the non-resident as a sufficiently strong enough link between this non-resident and the source country to justify a permanent establishment, too. From a legal perspective this concept is understandable, as, with the persons acting in the name of the non-resident, it is the non-resident itself who is legally bound by these actions. From that it follows, that it is this non-resident himself who is doing business in the source country. In doing so he is by himself using or benefiting from local resources in the source country, which provides for a justification for the taxation of local profits generated by and attributable to a permanent establishment.

To the contrary, if a non-resident just benefits from certain sales channels in the source country this cannot be regarded as a sufficient basis for the taxation of profits. The distinguishing factor, which separates a taxable from a non-taxable activity of the non-resident in the source state both in a practical and equitable manner must in our view be the legal quality of the acts undertaken by the non-resident. Only if he is legally bound by the resident persons should he be regarded as doing business in the source state; if he is not, then someone else is, who then should be the subject of the source state's taxation. In this regard, the decision of the French Conseil d'Etat in the Zimmer case[4] provided welcome guidance for the taxpayer.

For the taxpayer it would be highly risky if the tax authorities expanded the definition beyond its legal meaning so as to also cover economically similar arrangements. A broader, more economically driven interpretation of the rules in regard to certain distribution models would clearly come at the expense of double taxation. The Norwegian Dell case[5] went into this highly problematic direction but was finally resolved in line with the above mentioned Zimmer case by the Norwegian Supreme Court.[6]

The contracting states entering into a tax treaty strive to eliminate double taxation risks. They should hence be specific and precise in their agreement, such that ambiguous rules are avoided. If they see a need to regulate specific cases, which they regard as commercially comparable to the legal representation of a non-resident, then these states have got the ability to define and regulate such specific cases (e.g. a commissionaire structure); and this should be done in the interest of clarity. In our view this is preferable to developing the interpretation of existing clauses based on the commentary.

It is in this respect, that a further expansion of par. 32.1 as proposed by the Working Group is viewed critically. Rather than defining further instances, where an act not in the name, but (only) the economic interest of the non-resident is to be regarded as sufficient to conclude contracts within the meaning of Art. 5 par. 5 of the Convention, the Commentary should in our view reconsider the first sentence of 32.1 and adjust it to a stricter legal perspective.

[4] Supreme Administrative Court, 31.03.2010, Société Zimmer Limited v. Ministre de l'Économie, des Finances et de l'Industrie, Nos. 304715 and 308525

[5] Norwegian Court of Appeals of 02.03.2011, i Borgating langsmannsrett, Saksnr. 10-032855ASD-Borg/03

[6] 02.12.2011