

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

Neuilly-sur-Seine, 9 February 2012

**Subject : Public discussion draft “interpretation and application of Article 5  
(permanent establishment) of the OECD Model Tax Convention”**

Dear Ms Perez-Navarro,

CMS welcomes the efforts of the OECD Committee on Fiscal Affairs to further clarify the Commentary on the concept of permanent establishment. It is therefore with pleasure that we submit short comments on the OECD’s public discussion draft on interpretation and application of Article 5 of the OECD Model Convention.

As a preliminary and general remark, we wish that OECD Member Countries will be invited by the CFA to confirm, modify or delete their observations on the Commentary for any change to the text of the current Commentary to which they relate. We believe that this should be done even if the changes to the text of the current Commentary appear to be marginal or just a rewording of the previous text (see, for example, the observation made by Italy at paragraph No. 43 in relation to new wording of the proposed paragraph No. 12).

The following comments follow the order of the public discussion draft and deal with specific aspects only.

### **Can a farm be a permanent establishment? (proposed paragraph 3.1 of the Commentary)**

We fully agree with the principle stated in the first sentence according to which the existence of a PE does not depend upon “the determination of which provisions of the Convention apply to the profits derived by the enterprise”. However, the example contained in the following sentence is not fully clear when it uses the wording “apartment rental office”. The example moreover seems to imply that a PE might exist in the absence of a real business carried out through the PE.

### **“Meaning of “at the disposal of” (paragraph 4.2 of the Commentary)**

We fully agree with the proposed modifications of the Commentary on the meaning of “at the disposal of”.

We just notice in this respect that the concept of an “exclusive legal right” is a little bit ambiguous insofar as an “exclusive right” is sufficient to convey the meaning which is envisaged by the Commentary. “Legal right” might suggest that such a right could be granted through a statute only, which is not consistent with the idea that it could also derive from a contract. We therefore suggest that the expression “exclusive legal right” be replaced by “***exclusive right***”.

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

We agree with the proposed modification insofar as it states that “even though part of the business of an enterprise may be carried on at a location such as an individual’s home office, that should not lead to the automatic conclusion that that location is at the disposal of that enterprise simply because that location is at the disposal of an individual (e.g. an employee) who works for the enterprise”.

We however have doubts whether it is necessary to insert a new paragraph 4.9 in the Commentary providing for a specific example. Although this example is not deprived of relevance, one may wonder why this particular example has been selected, especially considering that the “background” described by the Working Group shows that a number of other possible situations may arise in practice. We therefore recommend either to delete this example (which seems to be the best option) or to insert additional examples in the Commentary.

We would also like to stress that the reservation made at the end of Paragraph 4.8 may lead some tax authorities to favor a broad interpretation of the concept of permanent establishment in situations where it is unable to prove that a dependent agent exists. By relying on such a broad interpretation, tax authorities might therefore circumvent the conditions which are ordinarily required to prove the existence of a permanent establishment.

We therefore suggest to add a final sentence to paragraph 4.8 of the Commentary in order to state that “***only in exceptional circumstances should a home office be considered as being at the disposal of the enterprise under Article 5***”.

### **Time requirement for the existence of a permanent establishment (paragraph 6 of the Commentary)**

We are not fully convinced by the need to modify paragraphs 6.1 et seq as suggested in the public discussion draft.

We notice, first of all, that the examples provided in paragraphs 6.1 and 6.2 are very specific and might not be of considerable help when it comes to solving concrete issues pertaining to the concept of permanent establishment.

Second, we observe that there is a discrepancy between the way the situation is described in the new paragraph 6.1 and the way it is presented in the background (§ 34 et seq.). The background presentation indeed states that Frans produces small glass sculptures in his spare time, which shows that the example might be of little practical relevance. Besides, the background presentation adds that “this is the only time and place where Frans sells his sculptures”, which is also an essential feature of the fact pattern which is not inserted in the proposed modification of paragraph 6.1 of the Commentary. We therefore believe that the example should either be deleted or be presented in the Commentary in a complete way.

Third, we take the view that, according to the spirit of the OECD model, the mere fact to perform an activity for a very limited period of time for several years in a row should not be enough to give birth to a permanent establishment in the state where these activities are carried out. Indeed, it is very hard in practice to determine the conditions which should be fulfilled for such an activity to trigger a permanent establishment. The recurrent nature of the activities is also very difficult to establish: not only does it appear after several years only, but it may be interrupted for various reasons, thereby giving rise to potential litigation with the tax authorities.

In our view, the OECD should rather insist on the fact that activities of a recurrent nature should be deemed as permanent establishments in the source state only where this is provided by the relevant tax treaty between the source and the residence state or where exceptional circumstances exist.

More generally, we would like to stress that the existence of clear time requirements for permanent establishments is essential in order to ensure legal safety for businesses.

### **Presence of foreign enterprise’s personnel in the host country (paragraphs 10 of the Commentary)**

We support the proposed new paragraph 10 of the Commentary.

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

We support the conclusions reached by the new paragraph 10.1 of the Commentary.

However, for the sake of clarity, we respectfully suggest that this paragraph be partially rephrased by :

-deleting the last phrase of paragraph 10.1 providing with the example ;

-replacing the third sentence of the paragraph by : “In the context of paragraph 1, that will require that these subcontractors perform the work of the enterprise at a fixed place of business that is at the disposal of the enterprise **and through which the subcontractors perform such work**”.

### **Application of paragraph 3 to joint venture and partnership activities (paragraphs 10 and 19 of the Commentary)**

We agree that this issue is a very relevant one in practice and that the proposed modifications of the Commentary are more than welcome.

We wonder whether the paragraphs 10.3 and 10.4 could not be partially rephrased in order to:

-clarify what the exact assumption is in paragraph 10.4 where it states that the enterprise “takes the form of a fiscally transparent partnership”: does this transparent character apply in the source state, in the residence state or in both states? We are not fully sure what the Working Group had in mind in this respect.

-better clarify the different phases of the reasoning: where a partnership is deemed to exist, the permanent establishment is that of the partnership itself ; however, where it is deemed to be transparent, the tax treaties apply between the source state and the residence states of the partners.

### **Meaning of “place of management” (paragraph 12 of the Commentary)**

We welcome the clarification effort made in order to change the wording of paragraph 12 of the Commentary.

However, the proposed changes do not seem to address in a complete way the problem described in paragraph 59 of the discussion draft, namely whether remaining

headquarters services in the parent company's state may qualify as a permanent establishment of the subsidiary.

In our opinion, such support services should not be deemed to be a "place of management" insofar as they do not have a direct relationship with the generation of profitable income of the business.

Although we are aware that this observation relates to the Model itself rather than to the Commentary, we would like to attract the OECD's attention to the risk that an overly broad interpretation of the concept of "place of management" might end up distorting the concept of permanent establishment in a significant way.

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

We support the new paragraph 22 of the Commentary on Article 5.

For the sake of clarity, we suggested that the last sentence of the proposed change be drafted as follows : "... would not cover, for example, immovable property and data ***if they are not considered as inventory under domestic law of the state where they are located*** (...)".

### **Meaning of "to conclude contracts in the name of the enterprise"**

We are not fully sure why paragraph 32.1 has been modified, considering the diversity of approaches which is described in the background, as presented by the Working Group.

Should the Commentary be changed, we take the view that it should provide for a complete presentation of possible approaches in a variety of jurisdictions. Although we understand that the OECD does not intend to support a particular domestic approach and that entering into many details is not appropriate in the Commentary, we suggest to add at least one sentence in paragraph 32.1 : "***In some other countries, an opposite position prevails***".

We also suggest to replace the expression "would be bound", in the proposed changes, by the expression "would be ***legally*** bound".

### **Is paragraph 5 restricted to situations where sales are concluded? (paragraph 33 of the Commentary)**

We support the proposed changes and suggest, for the sake of clarity, to complete the last sentence of paragraph 33 in the following way : "the paragraph would cover, for example, a situation where a person has and habitually exercises an authority to

conclude leasing contracts or contracts for services, ***where such contracts relate to the business proper of the enterprise***".

We trust that the above comments are of assistance to the OECD and we are at your disposal to discuss any aspect of our comments.

Yours faithfully,

Daniel GUTMANN

Partner  
CMS Bureau Francis Lefebvre

1-3, villa Emile Bergerat  
92522 Neuilly-sur-Seine Cedex, France  
Tel : +33 1 47 38 42 09  
Fax : +33 1 47 38 55 55  
[daniel.gutmann@cms-bfl.com](mailto:daniel.gutmann@cms-bfl.com)

Carlo ROMANO

Partner  
CMS Adonnino Ascoli & Cavasola  
Scamoni

Via Agostino Depretis, 86, III piano  
00184 Roma, Italia  
Tel : +39 06 47815305/306  
Fax : +39 06 47823139  
[carlo.romano@cms-aacs.com](mailto:carlo.romano@cms-aacs.com)