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CONFEDERATION OF SWEDISH ENTERPRISE

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Position Paper: Confederation of Swedish Enterprise – Comments on the OECD Discussion Draft entitled "Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention 12 October 2011 – 10 February 2012"

Dear Grace,

The Confederation of Swedish Enterprise is pleased to provide comments on the OECD Discussion Draft entitled "Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention 12 October 2011 – 10 February 2012".

The Confederation of Swedish Enterprise welcomes the initiative by the OECD to provide further guidance and clarification in relation to the concept of Permanent Establishment. This is an area which often results in double taxation and all efforts to provide additional clarity to the OECD Model Tax Convention is naturally of interest to business.

We are pleased that the Discussion Draft contains a number of improvements to the Commentary of Article 5. To mention a few, the clarification in the new paragraph 4.2 that the use of a contract manufacturer does not lead to a permanent establishment for the enterprise (principal) is very helpful. So is the clarification in the new paragraphs 4.8 and 4.9 regarding when a home office of an individual (e.g. an employee) can constitute a PE for the enterprise. Another important improvement is the clarification in paragraph 10 that individuals employed by an enterprise who are seconded to a company in another State do not by themselves constitute a PE of the enterprise.

However, there are also some proposals in the Draft that raise concern and thus warrant further consideration.

Overall, the Confederation of Swedish Enterprise supports the comments made by BIAC but would also like to provide some additional comments on a few issues.

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

The concept "at the disposal of" is no doubt an important and critical element in determining when a "place of business" is at hand. The current guidance in the Commentary to Article 5 provides little guidance in this respect, leaving business with legal uncertainty in investment decisions. Physical presence at a fixed place as opposed to legal responsibility for what occurs at a fixed place or some sort of more theoretical right to be present at a fixed place does give rise to uncertainty.

Consequently, we fully support the efforts made by the OECD to provide further clarification regarding the meaning of the phrase "at the disposal of".

In the proposed paragraph 4.2 in the Draft Report, two new examples are introduced to determine whether an enterprise has premises at its disposal in such a way that it may constitute a "place of business through which the business of that enterprise is wholly or partly carried on". The first example refers to a situation where "an enterprise has an exclusive legal right to use a particular location which is used only for carrying on that enterprise's own business activities". This situation seems quite straight forward since the language indicates that the enterprise owns or leases the property. That would in turn mean that the enterprise has control of the premises and thus is able to exclude others from those premises. Consequently, we agree that such a situation would constitute a fixed place of business for the enterprise.

The second example in paragraph 4.2 for determining when an enterprise also would be considered to have premises at its disposal deals with a situation where the enterprise "performs business activities on a continuous and regular basis during an extended period of time at a location that belongs to another enterprise or that is used by a number of enterprises". This situation cause greater concern than the first one, since the question of whether the enterprise has control of the premises does not seem to be addressed at all.

As we see it, the proposed language regarding the second situation is problematic and may open up for interpretations that were not initially intended. When reading the second example in paragraph 4.2 in conjunction with the proposed new provision in paragraph 10.1, stating that an enterprise may carry on its business through subcontractors, it implies that an enterprise that carries on its business through a subcontractor is considered to have premises at its disposal on the mere fact that the business activities have been performed on a continuous and regular basis.

Such a general statement would, in our view, be incorrect. As a general rule, a subcontractor, being a separate legal entity, must be considered to perform its own business under a contract with the general contractor. Whether or not premises used by the subcontractor would be at the disposal of the general contractor would have to be determined based upon the facts and circumstances of each separate case.

The second sentence in the new paragraph 10.1 stating that a permanent establishment only will exist if the other conditions in Article 5 are met does not seem to provide any further guidance. Furthermore, the scenario described seems to be in contrast with the intention of paragraph 10.1 which clearly suggests that for a fixed place of business to be at the disposal of an enterprise, other criteria need to be met than the mere fact that the work at these premises is performed by a subcontractor.

Examples could surely be used in the Commentary for clarification, but it could also be useful to try to elaborate on the rationale behind expanding the concept of a PE in situations where there is in fact no physical presence by the taxpayer at a location to which the taxpayer has exclusive or legal right of access.

Furthermore, given the general wording of the second example in paragraph 4.2 in combination with the fact that the question of control is not addressed, there is an obvious risk that any independent consultant providing services, in a case similar to the one described in paragraph 13 in the Draft, would be considered to have a PE even in cases where the facts clearly indicate that he does not have any premises at his disposal.

Should this be the interpretation, it would certainly be a step towards a more general application of the ”Service-PE” principle, than what is the case under the current Commentary. That would mean that many cases that currently fall outside the scope of Article 5 (cases where there is no ”place of business” as the enterprise does not have any place at its disposal) suddenly would constitute a PE in accordance with Article 5.1.

Alternative provisions of services are dealt with in paragraphs 42.11- 42.48 of the Commentary. The conclusion to be drawn from paragraph 42.24 must be that unless a specific service PE provision is included in a treaty, then the normal standards of Article 5 shall apply.

Consequently, we believe that service PE provisions should be dealt with between States on a bilateral basis through explicit provisions in a tax treaty and not incorporated through a back door into the OECD Commentaries.

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

The current guidance on when short duration business and recurrent activities could constitute a PE is not very clear. This is also explicitly acknowledged in paragraph 6 of the Commentary which basically states that it is sometimes difficult to determine when the nature of a business is such that a very short period of time may constitute a PE. From a business perspective this is very unsatisfactory.

To suggest that a business activity which exists only for a short period of time is to be considered permanent is in itself in fact a contradiction in terms. All the more reason to be clear on the time frame required. The examples in the new paragraph

6.1 and 6.2 unfortunately provide little guidance beyond the specific situations in the examples themselves and may in fact be causing more concern than they are adding value.

The two examples proposed in the Draft refer to "short duration business" and "recurrent activities". Both examples deal with situations where it clearly can be questioned whether the activities carried out could be considered to have any degree of permanency. As for the example on "short duration business" it becomes rather obvious that the example in practice will lead to the conclusion that four months will constitute a PE whilst it remains very unclear what the conclusion should be if the activities go on for two months, one month or three weeks under otherwise identical circumstances. It is generally difficult to see why a prescribed time frame would cause such concern among administrations. The certainty such a time frame would provide should definitely outweigh any negative consequences that could possibly be presented.

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

The proposed new paragraph 10.1

The fact that an enterprise may engage subcontractors to perform all or parts of a project for which the enterprise is responsible, does not mean that such subcontractors carry on the business of the enterprise. As stated above (under paragraph 4.2), subcontractors that are separate legal entities must be considered to carry on their own business. Consequently, as a general principle, the activities of a subcontractor do not constitute a permanent establishment for the main contractor. As recognized in the last sentence of paragraph 19 of the Commentary to Article 5, the subcontractors may of course have permanent establishments of their own.

Based on the above, we object to the proposal in paragraph 10.1 that "An enterprise may also carry out its business through subcontractors, acting alone or together with employees of the enterprise". Consequently, we also object to the conclusion that a subcontractor may constitute a permanent establishment for the enterprise (other than in cases where such subcontractor is a dependent agent to the enterprise in accordance with Article 5.5).

Furthermore, the view expressed in proposed paragraph 10.1 would have odd implications, as the same business (with the same personnel, location, equipment etc.) potentially could constitute a permanent establishment for more than one enterprise.

The proposed wording of paragraph 19

We object to the addition of "all or" in the second sentence of paragraph 19. In cases where a main contractor subcontracts parts of a project, the main contractor would normally have to have some physical presence at the location in order to perform the activities which have not been subcontracted. In cases where a main contractor

subcontracts all parts of a contract no such presence is required. To our understanding, the current wording of paragraph 19 (i.e. ”[…] subcontracts parts of […]”) primarily aims at preventing schemes where a main contractor itself carries out as much of a project as possible within the 12 month period and subcontracts the remaining parts of the project, in order to avoid having a permanent establishment under Article 5(3). Paragraph 19 makes clear that in such cases the period spent on the project by the subcontractors shall be considered to be time spent on the project by the main contractor.

Furthermore, the current wording of paragraph 19 only refers to the period spent on a project by a subcontractor. The proposed new paragraph 10.1 would change the current interpretation of Article 5 as it would not only allocate to the general contractor the period spent by a subcontractor on a project, but also the business activities performed by such subcontractors. In our view, that would mean a clear extension of the PE concept since such a wider interpretation would not only be relevant for Article 5(3) but also for Article 5(1).

To say the least, we find the proposals in the Draft Report regarding subcontractors to be very troublesome. It elaborates on language developed specifically for building sites or construction or installation projects (where there is a time frame). As the proposals appear to widen the PE scope not only in relation to building sites etc., but also in relation to other activities, the consequences could be far reaching and result in a dramatic increase of PEs.

As we see it, the current paragraph 10 of the Commentary offers no support for the conclusion that an independent subcontractor could constitute a PE for the main contractor merely by performing his own business activities. Creating the suggested link between paragraph 10 and paragraph 19 will mean that what is now a well-defined and limited exception for building sites, construction- or installation projects will become a general rule.

There is also the question of the rationale behind these amendments. Considering the possible implication for business with additional uncertainty and the risk of double taxation, is there a need for expanding the PE concept to cover these situations? The subcontractors in question will most likely be taxed either as residents or because they themselves will have a PE. What is the rationale behind identifying a PE for the general contractor? With these amendments it will be extremely important to ensure that this new subcontractor PE in Article 5 is compatible with the guidance for attributing profits to PEs under Article 7.

Should these proposals be adopted corresponding guidance under Article 7 would be necessary in order to avoid numerous cases of double taxation. The profits to be allocated to such a PE cannot be the profits taxed with the subcontractor and it cannot be the profits realized by the general contractor unless the general contractor is allowed to deduct all costs relevant to the income. Such costs would for example include the compensation provided to the subcontractor for his services.

It is difficult to foresee the full consequences of the proposed amendments. However, it is not difficult to foresee that the impact these changes would have on business

would not be positive. Should these proposal be incorporated into the Commentaries we fear that there will be a dramatic increase in the cases of double taxation.

Consequently, we urge the OECD to reconsider its proposal in this respect.

On behalf of the Confederation of Swedish Enterprise

February 9, 2012

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