Interpretation and application of Article 5
(Permanent Establishment) of the OECD Model Tax Convention
Public discussion draft
Response by IFA Grupo Mexicano, A.C.

Attention: Grace Perez-Navarro

Dear Madame,

Below are the comments prepared by IFA Mexican branch (IFA Grupo Mexicano, A.C.) in connection with the abovementioned public discussion draft. For such purposes, we have divided them per topic as analyzed in the discussion draft.

In addition to our comments, in general we agree with the Group in the sense that there are a lot of practical application issues in connection with the term permanent establishment and the need to address them and in certain cases modify the applicable Commentaries. We greatly appreciate the effort of the Group in the preparation of this discussion draft, understanding that it is impossible to address all cases/issues in the document or to include all the applicable examples.

6. Time requirement for the existence of a permanent establishment

Considering that concerns have been expressed about the uncertainty regarding the period of time required for a location to be considered a permanent establishment, we agree with the comments made by BIAC in the note prepared in 2005 and inserted in this public discussion draft in the sense that a minimum period of time for a permanent establishment to be considered to be created is needed to be included. For these purposes, we also agree that the periods of time established in article 15 (183 days) and paragraph 3 of article 5 of the Model Convention are good references that can be used. This, even though the Group decided not to make reference to this minimum period of time in the amendments to the Commentaries and in turn proposed examples to the two exceptions that were already included in paragraph 6 of the Commentaries to Article 5 regarding the creation of permanent establishments even if they existed for a very short period of time.

As all particular elements and facts have to be considered when defining if a permanent establishment is created, including the permanency requirement, we consider that the two illustrations included in paragraphs 6.1 and 6.2 are too broad and may be difficult to apply to real cases (too hypothetical), so even with those examples a gray area for certain cases will continue to exist in defining if a permanent establishment is created or not.

16. Carrying on various activities listed alternatively in subparagraphs 4 a) and b)

The issue analyzed here by the Group is to what extent the specific exceptions in subparagraphs 4 a) and b) apply if various activities listed alternatively in these subparagraphs are carried out at the same location and if these activities, taken

together, go beyond the preparatory or auxiliary threshold so as to preclude the application of paragraph f).

As the preclusion of the application of subparagraph 4 f) that is mentioned in the previous paragraph is not analyzed or described in this discussion draft, it would be important to include its analysis and conclusions in order to complete this point.

17. Negotiation of import contracts as an activity of a preparatory or auxiliary activity

The Group proposes to include in the Commentaries the clarification that when an office in one country is actively involved in the negotiation of the important terms in sale of goods (i.e. type, quality or quantity) to buyers in that country, such activities cannot be deemed as "preparatory and auxiliary" notwithstanding they do not have the authority to conclude contracts.

We consider that this clarification is correct as an activity that relates to part of the main activities performed by the enterprise (in this case, actively participating in the negotiation process of the sale of the goods) should not be considered as of a "preparatory or auxiliary" nature.

However, we consider that it is relevant to clarify that a permanent establishment is not deemed to be created when the active participation is not performed on a regular basis. Additionally, practical issues should be taken into considerations when attributing profits to a permanent establishment related to the aspects commented above.

19. Meaning of "to conclude contracts in the name of the enterprise"

The Group concluded to add to Commentary 32.1 the clarification related to the fact that such power to conclude contracts would involve not only direct representation but also indirect representation (under commissionaire or agency agreements). These agreements are concluded with third parties by persons who do not disclose that are acting "on behalf" of their principal. From a Mexican perspective, this situation of the indirect representation is established in the Commercial Code as a commissionaire arrangement with undisclosed principal ("comitente oculto" in Spanish language).

20. Is paragraph 5 restricted to situations where sales are concluded?

The Group is considering that the word "contracts" included in paragraph 5 should not only refer to sales contracts but also to leasing and services contracts.

In this sense, Commentary 32.1 states that the authority to conclude contracts will be irrelevant if it refers to hiring employees or for internal operations only. The question that we raise relates to the meaning of "internal operations", i.e. does not "internal operations" relate to all other contracts that are not related to the sale of goods?

Now, if the change is aimed to clarify that if the main business of the enterprise is not related to sales but to render services or leasing, then the following wording should be considered:

The type of contracts referred to in paragraph 5 are not restricted, however, to contracts of sales of goods: the paragraph would cover, for example, a situation where a person habitually exercises an authority to conclude leasing contracts or contracts for services whenever those activities constitute the business purpose of the enterprise.

21. Does paragraph 6 apply only to agents who do not conclude contracts in the name of their principal?

Due to the fact that the English and French versions of the model do not appear to correspond, the Group concluded that a mere clarification of the Commentary was not sufficient. We consider that a clarification in the wording of the Model should be done as soon as possible as this represents an important interpretation issue.

On the other hand, the title of this section and the question that was intended to be analyzed therein was whether paragraph 6 apply only to agents who do not conclude contracts in the name of their principal, but no comments or analysis was included in the discussion draft in that regard. Therefore, we think that it would have been important to include such comments and analysis.

23. Activities of fund managers

The issue relates to what, in the case of transparent capital venture funds, should be considered as “enterprise” and “permanent establishment”. For example, in the case of dependent agents, whether he would have the authority to conclude contracts in the name of the “enterprise” (being the term enterprise under discussion in this case).

The Group concluded that this is very factual and is not restricted to venture capital funds; so they decided that further analysis of the terms “enterprise” and “permanent establishment” in the case of partnerships should be performed.

We suggest the possibility to analyze and discuss the role (activities) that the regular types of income that a fund obtains (e.g. trading activities, interest earned, exchange gain, capital gains, dividends, derivative transactions), as these activities should not be considered as entrepreneurial and thus no permanent establishment should be deemed to be created.

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Should you have any question or comment in connection with the foregoing, please do not hesitate to contact us.

Sincerely,