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FROM	Alexander Bosman[*] / Kees van Raad[**] / Ton Stevens[***]
REFERENCE	10876708-v1
ENCLOSURE	1
DATE	10 February 2012
RE	Comments on proposed changes to the Commentary on Article 5 (Permanent Establishment) of the OECD Model Tax Convention

Dear Ms Perez-Navarro,

In response to the invitation of the Committee on Fiscal Affairs to interested parties to provide comments on the public discussion draft "Interpretation and application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention" (the "**PE Draft**"), please find in this letter the comments on the PE Draft on behalf of Loyens & Loeff N.V. ("**Loyens & Loeff**", "**we**" or derivative terms). More information about Loyens & Loeff can be found in Enclosure 1.

Loyens & Loeff appreciates the work done by the Committee on Fiscal Affairs, through a working group ("**WG**") composed of delegates to Working Party 1 on Tax Conventions and Related Questions, in analyzing various issues related to the definition of permanent establishment. We have examined with great interest the resulting additions and changes to the Commentary on Article 5 of the OECD Model Tax Convention (the "**OECD Model**") which are proposed in the PE Draft, and we welcome the opportunity to submit comments on that draft.

As the interests of our various clients are far from identical, we have refrained from discussing the PE Draft with them. The comments we provide in this letter are therefore only our own comments as tax professionals.

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Our comments to the PE Draft are divided in two categories, i.e. general comments and specific comments on a selection of the proposed additions and changes to the Commentary.

1. General comments

We understand that the issues discussed in the PE Draft are the result of various projects which were carried out by the Committee on Fiscal Affairs over time, as well as comments provided by delegates and the OECD Business and Industry Advisory Committee (BIAC), and we recognize the practical importance of the solutions proposed in the PE Draft. However, we would also have welcomed a more comprehensive view on the effectiveness of the concept of permanent establishment ("**PE**") on a more fundamental level.

A prominent issue in tax treaty law is the choice of criterion to delimit the taxing authority of source countries in respect of business profits. The concept of PE is one of the leading and most longstanding of such criteria. It defines the minimum connection/threshold required for a state to tax business profits of a non-resident taxpayer. The question could be raised whether the current PE concept, taking into account the refinements made over the years to the PE definition in Article 5 of the OECD Model as well as the (ever expanding) explanations in the OECD Commentaries, still suffices to deal with the challenges posed to international business in a globalized economy.

Without attempting to be complete, these challenges include the development of new business models (the continuing rise of e-commerce), increased digital communication, outsourcing of business activities, the increased mobility of people, functions and business activities, and international hiring out of labour. In this context, EU developments with regard to a common consolidated corporate tax base may also be relevant. Some of these issues have been dealt with in recent updates to the OECD Commentaries as well as in the current PE Draft, but the ramifications of these developments for international business may warrant a fundamental reconsideration of the question in which circumstances states may tax cross-border business profits. In our view, this would ideally include a re-examination of the required minimum physical, geographical and temporal *nexus* to a state.

We express the wish that the OECD will address this fundamental issue in the near future, and we would be honoured to provide contributions in this field.

2. Specific comments

This section contains our comments on particular changes and additions to the Commentary which are proposed in the PE Draft.[1]

2.1. Chapter 2 - Meaning of "at the disposal of"

- It is proposed in section 11 to add a new paragraph 4.2 to the Commentary that clarifies the term "at the disposal of". The suggested new Commentary employs the terms "continuous and regular" and "intermittent or incidental" (in an apparent contrast). These terms leave a fairly wide margin of interpretation, which could lead to questions on the scope of these terms. We would like to have a better understanding of these terms. In particular, we would appreciate a discussion or illustration of the circumstances in which activities are too intermittent or incidental to conclude that a PE is present.

- Does "and" in "continuous and regular" (as used in the proposed paragraph 4.2) suggest a cumulative requirement (which is difficult to understand: can something that is continuous at the same time be regular?), or should it be read as "and/or"? And what does "regular" in this context mean: if "periodical" we would prefer the use of that term; and if something else, what exactly?

- The proposed new paragraph 4.2 includes an example to illustrate to what extent a supplier of goods or services, like a contract manufacturer, can create a PE (see also sections 17 and 18). The proposed Commentary states that "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." It seems very farfetched to assume the existence of a PE merely (i.e. without any further facts) on the basis of the use of goods that are obtained through contract manufacturing by another party. It would be helpful, however, if the facts and circumstances were added that would indeed make the contract manufacturer's plant a PE of the other contracting party.

- The new paragraph 4.2 refers to paragraph 42 of the Commentary. Paragraph 42 deals with services between members of multinational groups. This raises the question whether the example of contract manufacturing in the proposed new paragraph 4.2 applies equally outside the context of (multinational) groups.

- We would welcome the addition to the Commentary of (a conclusion on) the example presented in section 13 (i.e. a consultant working at a client's premises).

[1] All references to the Commentary are to the Commentary on Article 5, unless indicated otherwise. References to sections are to the paragraph numbers used in the PE Draft. References to paragraphs are to the paragraphs in the Commentary, both current and proposed.

- According to section 15, the painter example of paragraph 4.5 of the Commentary was discussed. The PE Draft is silent on the conclusions of this discussion, or how the painter examples in paragraphs 4.5 and 5.3 of the Commentary relate to the suggested new Commentary. Could this be clarified?

2.2. Section 3. Premises of converted local entity

- We would welcome the addition to the Commentary of the CARCO example presented in section 17.

2.3. Chapter 6. Time requirement

- It is proposed in section 33 to add various new paragraphs to the Commentary, including two examples ("renting a stand" and "catering"). These examples are in our view somewhat limited in their scope. We would welcome more fundamental guidance on the application of the time requirement.

- The example in proposed paragraph 6.2 raises the question from which moment a PE may be present. Would this be from the first activity (possibly retroactively), or somewhere during the course of the recurring activities? Based on the "rule of thumb" minimum period of six months in paragraph 6.1, which is clearly supported by the WG, we suggest that a time threshold of six months on an aggregate basis would be a useful practical guideline for the purpose of recognizing a PE in case of recurring activities. We would welcome the WG's views on this.

2.4. Chapter 7. Presence of foreign enterprise's personnel

- According to section 44, an intra-group cost-plus service charge could in certain circumstances have the "unfortunate consequence" that services rendered by a company's employee would result in a PE of that company. We would welcome more guidance on the circumstances in which intra-group (service fee) charges would increase the PE risk, also in light of the analysis in paragraph 8.13-8.15 of the Commentary on Article 15 of the OECD Model regarding "economic" employment.

2.5. Chapter 8. Main contractor subcontracting all aspects contract

- The new paragraph 10.1 of the Commentary which is proposed in section 48 clarifies that in case of subcontracting there is only a PE if all the conditions of Article 5(1) are met, i.e. a location should be "at the disposal of the enterprise for reasons other than the mere fact that (…) subcontractors perform (…) work at that location". In addition to the hotel example in proposed new paragraph 10.1, we would welcome the WG's guidance on which other reasons could be relevant this context.

- According to the proposed addition to paragraph 19 of the Commentary, a site can be considered at the disposal of the general contractor during the time spent on that site by any subcontractor where (1) the general contractor has overall responsibility for the site and (2) the site is made available to the general contractor for purposes of carrying on its construction business. We would welcome a clarification of the circumstances in which a site can be considered to be made available to the general contractor for purposes of carrying on its construction business. Would this require the actual presence of (a representative of) the general contractor at the site (compare section 49) or is potential access to the site sufficient?

2.6. Chapter 9. Application Article 5(3) to joint venture/partnership

- The final sentence of the proposed paragraph 10.4 (in section 54) refers to "paragraph 19.1 below". Should this reference not be to (new) paragraph 19.2?

2.7. Chapter 10. Meaning of "place of management"

- It is proposed in section 60 to clarify paragraph 12 of the Commentary to the effect that the examples in Article 5(2) should be read in the context of the general definition of Article 5(1). The examples in Article 5(2) therefore constitute a PE only if the conditions of Article 5(1) are met. While it is subject to doubt whether this follows from the text of Article 5(1) and (2), we agree to this interpretation.

2.8. Chapter 12. Preparatory/auxiliary activities

- According to section 77, the WG was concerned that the sentence in paragraph 23 of the Commentary could be misinterpreted as suggesting that R&D is as a general rule a preparatory or auxiliary activity. However, the WG decided that no changes should be made to the Commentary, but that this warning should be included in the PE Draft. If this is indeed the view of the OECD, then we suggest that it is included in the Commentary and not solely in the PE Draft.

2.9. Chapter 14. Development property

- It is proposed in section 85 to clarify in paragraph 22 of the Commentary that the terms "goods" and "merchandise" in Article 5(4)(a) and (b) refer to tangible property and do not cover, *e.g.*, immovable property and data. In our view, this is a rather broad interpretation of the terms "goods" and "merchandise", which may be difficult to reconcile with the interpretation of those terms in accordance with Article 3(2) of the OECD Model and/or the general rules of treaty interpretation of the Vienna Convention on the Law of Treaties.

- It can be questioned whether it is justified to make a distinction in the proposed addition to paragraph 22 between data in digital form and tangible products that include data (such as CDs and DVDs).

2.10. Chapter 19. Meaning of "conclude contracts in the name of an enterprise"

- We understand that the WG was not able to reach a common view on the *Zimmer* and *Dell* cases referred to in section 111. The question is whether the recent decision of the Norwegian Supreme Court in the *Dell* case (2 December 2011) could be a reason for the WG to revisit its discussions.

Respectfully submitted,

Yours sincerely,
Loyens & Loeff N.V.

Alexander Bosman / Kees van Raad / Ton Stevens

LOYENS & LOEFF

Enclosure 1 – About Loyens & Loeff

Profile

Loyens & Loeff is an independent full-service law firm specialised in providing legal and tax advice to enterprises, financial organisations and governments. The intensive cooperation between attorneys, tax lawyers and civil law notaries places us in a unique position in our home market, the Benelux. Internationally, Loyens & Loeff is a reputable adviser on tax law, corporate law, financial and capital markets, cross-border financing, private equity, real estate, the energy sector, European law, regulatory law, VAT, employment taxes and employment law. The collaboration between the various specialists within a single firm works to the client's advantage, as issues are tackled from different angles, creating synergy and increasing efficiency.

International focus

Worldwide, Loyens & Loeff has about 1,500 employees, including more than 800 legal and tax experts in six Benelux offices and twelve branches in the major international financial centres. When providing international advice, Loyens & Loeff maintains close relationships with leading law firms and tax advisers in Europe, the Middle East, the United States and the Far East. In this way, Loyens & Loeff offers top-level advice worldwide and is capable of effectively structuring and supervising both domestic and international matters.

Pragmatic solutions

Loyens & Loeff's culture is characterised by a strong sense of independence, entrepreneurship, providing high-quality services and involvement. The principles of quality, transparency and short-line communication form the foundation for an informal and inspiring culture. This culture stimulates the search for pragmatic solutions to complex legal and tax issues. Loyens & Loeff pays particular attention to education and training and to creating an exciting and challenging work environment. This enables Loyens & Loeff to attract young talent and to guarantee the quality of services.