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Comments on Public Discussion Draft: Interpretation and application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention

Dear Ms Perez-Navarro,

Thank you for the opportunity you have given us to comment on the "*discussion draft on proposed changes to the Commentary on Article 5 (Permanent Establishment) of the OECD Model Tax Convention*" dated 12 October 2011. We have read the proposed changes with interest and are pleased to give our thoughts on such a major point as the interpretation and application of the definition of permanent establishment.

We greatly appreciate the interpretation efforts made by the OECD Committee on Fiscal Affairs to update the Commentary on such a complex issue as the identification of permanent establishments, which requires specific facts and circumstances to be ascertained.

Nevertheless, in order to further clarify the proposed changes, we suggest that it would be important to provide additional examples of the existence of a permanent establishment to include, for example, corporate reorganisations involving entities in different jurisdictions, or transformation of commissionaires to distributors, or of limited distributors to full-fledged distributors.

In addition we would like urge that greater emphasis be given to the importance of complying with the interpretations in the Commentary. As you are aware paragraph 33.1 provides that the mere fact that a person contributed to, or participated in negotiations, in a State between the enterprise and the client is not sufficient *per se* to conclude that such person exercised in the State an authority to conclude contracts in the name of the enterprise. The OECD has stated that a permanent establishment is deemed to exist when the agent negotiates all the elements of a contract, whether or not the principal's name is mentioned. As you know, however, Italy added an Observation to the Commentary to the effect that Italian court decisions on the matter should not be disregarded, although this opinion is not universally shared. In this Observation, Italy stated – rather ambiguously– that the stance taken by domestic judges (especially in the well known Philip Morris case) cannot be ignored when interpreting the existence of a permanent establishment in Italy of a non-resident enterprise, thus giving rise to several interpretative uncertainties.

Therefore, in our view, the Commentary should in any event explicitly state the importance for individual OECD Countries to agree on a common conduct, *inter alia* to harmonise the different interpretations of the notion of "permanent

establishment". The different conduct adopted by the individual OECD Countries (and Italy in particular, in this specific matter) causes greater uncertainty – to the disadvantage, in such difficult times, of the Italian operations of multinational groups – in a particularly sensitive and complex matter such as the identification of a permanent establishment.

In particular, we suggest you consider such additional proposals for amendments, or to further clarify the following points.

Point 2 – Meaning of "at the disposal of" (Paragraph 4.2 of the Commentary)

Following a number of disputes on the meaning of "at the disposal of", the OECD Working Group proposes a number of changes to paragraph 4.2 of the Commentary in order to clarify its meaning and, in particular, the cases in which a place of business can be considered as a permanent establishment of an enterprise.

Two main concepts are included in the proposed new wording of the paragraph:

- The presence of the enterprise at the location in terms of timing and legal title to use the premises;
- The type of activities performed.

We deem it advisable to further clarify the following concepts, included in the new wording of the paragraph:

- The wording "This will not be the case, however, where the enterprise's presence at a location is so intermittent or incidental that the location cannot be considered a place of business of the enterprise" is not totally clear, as it does not definitively clarify those cases where the presence is not so continuous to give rise to a permanent establishment. In our opinion, the Working Group should clearly define the cases in which a presence is "so intermittent or incidental", with the inclusion in the paragraph of a clear timing reference;
- Reference is made in the new paragraph to supplier and contract manufacturer cases, in which no permanent establishment of the company that receives or processes the goods exists. It would be advisable to also include in the examples the commissionaire case, for which a permanent establishment of the principal does not exist if the "fixed place of business" requirement is not met, with a cross-reference to the other statements dealing with commissionaires already contained in the Commentary.

In addition:

- New paragraph 4.2 should be amended (or a new example should be added to paragraph 4.4) to make it clear that the "at the disposal of" condition is not met in a situation where a company provides services to a customer that are produced at the company's premises by its own employees, and those services are charged to the customer at a full cost-plus price. In other words, the Commentary should clarify that the mere fact that the premises costs borne by the company vis-à-vis a third party are then charged to the customers via the cost-plus mechanism cannot per *se* result in those premises being regarded as "at the disposal of" the customer.

- New paragraph 4.2 should be amended (or a new example should be added to paragraph 4.4) to make it clear that the "at the disposal of" condition is not met in a situation where a company provides services to a customer that are produced at the company's premises by its own employees, and that company is acting as a dependent agent of the customer. In other words, the Commentary should clarify that the existence of a "dependent agent permanent establishment" of the customer in the company's country would not result in the material assets of the company being regarded as "at the disposal of" the customer.

Point 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)

We agree with the addition of the penultimate sentence in paragraph 4.2.

Point 4 – Home office as a PE (proposed new paragraphs 4.8 and 4.9)

In relation to proposed new paragraphs 4.8 and 4.9:

- Paragraph. 4.8: We suggest distinguishing between an activity carried out at home by an employee, or by a self-employed person on behalf of the enterprise. In the case of employee it should be established whether the carrying out of a business activity at home is incidental, or a regular and continuous part of employment by making reference to the employment agreement. In the case of a professional reference should be made to the contract with the enterprise and the presence of an exclusivity clause (i.e. the professional can only work for such enterprise). In both cases the home office may be considered "at disposal of" the enterprise only if given the nature of the activity performed by the individual paragraph 1 of the Model Convention to art. 5 is applicable (i.e. the home office is deemed to be a place of business through which the

business of an enterprise is wholly or partly carried on.). Also cross reference should be made to paragraphs 5 and 6 of art. 5 of the Model Convention.

- Paragraph 4.9: Regarding the example we suggest: (i) clearly distinguishing the activity performed by a self-employed person (e.g. consultant) and an employee; (ii) clarifying that a home office activity performed by an individual can constitute a location at disposal of the enterprise only if the individual is acting on behalf of such enterprise and not in the ordinary course of her self-employed/business activity; and (iii) clarifying the example of the cross-frontier worker as it is misleading since such an employee would normally work at the enterprise premises (otherwise she would not be a real cross-frontier worker).

Point 7 - Presence of foreign enterprise's personnel in the host country

The Working Group analyzed the cases of "secondments" among multinational companies that could give rise to permanent establishment issues.
In particular, the following amendments to paragraph 10 of the Commentary have been proposed:

- Individuals employed by an enterprise carry on business activities of another enterprise (to which they are seconded): in this case the employer should not be considered to have a permanent establishment in the country in which its employees are seconded;
- However, in order to ascertain if the seconded employees actually perform the business activity of the employer, reference is made to paragraph 8.13 to 8.15 of the Commentary on article 15.

Regarding the proposed amendments, we have the following comment:

- In our opinion, reference to the cases considered in paragraph 8 of the Commentary to article 15 is not totally appropriate. The purpose of paragraph 8 is actually to prevent "abuses through adoption of the practice known as international hiring-out of labour" that concept is quite different from the permanent establishment issue, covered by article 5 of the Model Tax Convention. In our opinion, it would be advisable to ascertain the benefit of the activities performed by seconded employees by reference to the "substance" criteria already contained in the Commentary to article 5.

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

New paragraph 19 states that for a permanent establishment to exist, the overall responsibility for the works must lie with the main contractor. In our view, it would be helpful to elaborate on the meaning of "overall responsibility" and on the activities which give rise to such responsibility.

Point 10 – Meaning of place of management (paragraph 12 of the Commentary)

We are in agreement with the changes to paragraph 12 of the Commentary, even if the meaning of "*place of management*" is not obvious. Perhaps a more explicative amendment should be made here.

We do not think that the following sentence in point 65 is very clear: "*Whilst an enterprise can have different places of management for the purposes of subparagraph 2 a) of Article 5, an entity such as a company can have only one place of effective management for the purposes of paragraph 3 of Article 4*".

It might be helpful to reiterate, in the comment to article 5, the relationship between the phrases, "*place of management*" and "*place of effective management*". Paragraphs 23 and 24 of the commentary to article 4 use the two phrases almost interchangeably, while in paragraph 65 there appears to be a difference between an "*enterprise*" which can have more than one place of management and an "*entity – such as a company*" – which can only have one "*place of effective management*".

It might be a good idea to coordinate the various paragraphs and provide clarification in the comments to article 5 (also in light of the fact that Italy made an observation on paragraphs 24 and 24.1 of the commentary to article 4, stating that in order to establish the place of effective management, the place where the activity is principally carried out is also relevant).

Paragraph 65 seems to lead to the conclusion that for an "entity" (such as a company) point 2 a) of article 5 would not apply, as this would have only one place of effective management which determines the company's residency (article 4). If this interpretation is indeed correct, it would be best that it be clearly stated.

Point 13 – "Relationship between delivery and the sale of goods in subparagraph 4*a*) (paragraphs 22 and 27.1 of the Commentary)"

Paragraph 22 of the Commentary states that a place maintained for delivery, but also used for sale, is not deemed to be included among the exceptions of paragraphs (4a) and (4b) of article 5.

Based on our experience, we believe it would be helpful to clarify how the receipt, the analysis and dispatch to the head office of returns is characterised with respect to the exceptions listed under article 5(4).

Point 14 – "Does a development property constitute a PE? (paragraph 22 of the Commentary)"

The new Paragraph 22 clarifies that in paragraphs 4a) and 4b) the words "goods" and "merchandise" solely refer to tangible assets which may be stored, displayed and delivered.
This definition does not include property and data, although it may include tangible assets which contain data, such as CDs and DVDs. Therefore, we ask how assets not clearly characterised as either movable or immovable (such as for instance a photovoltaic farm) can be considered.

Yours sincerely,

Massimo Cremona
Ignazio La Candia