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

Reference: Draft regarding the interpretation and application of Art. 5 of the OECD Model Tax Convention

Dear Ms Perez-Navarro,

In the following I would like to comment on the public discussion draft regarding the interpretation and application of Art. 5 of the OECD Model Tax Convention. My annotations refer to the consolidated version of paragraphs 1 to 35 of the Commentary on Art. 5 as amended by the proposals of Working Party 1.

Ad 3.1 (Determination of a permanent establishment (PE) is independent from determination of provisions which apply to the profits thereof)

The amendment proposal is misleading. The example for a PE mentioned therein (i. e. a farm exploited by a resident of the other state and an apartment rental office) says that such PE could be relevant for instance for the application of Art 11 para 4 and 5. In such a case Art 11 para 4 would in my opinion **not** be applicable as Art 11 para 4 refers explicitly to a person who carries on "business" in the other state and says that in such case the provisions of Art 7 shall apply. There is no reference to Art 6 in Art 11 et seq. which would justify assuming a "power of attraction" of e.g. rental income in relation to income in the meaning of Art 11 et seq.. This result is, in my opinion, compulsory as Art 6 lacks provisions on the determination of profits other than from immovable property (as specified in Art 6 para. 2). By contrast, Art 7 deals with different income types and tries to determine what belongs to a separate business unit which forms a PE within an enterprise. In addition, it would, in my opinion, be rather difficult to determine whether income in the meaning of Art 11 et seq. is "effectively connected" to income from e. g. an apartment building as it has no further business purpose than renting apartments which can be done almost on a stand- alone basis.

Ad 4.7 (Example of a painter, who for two years, spends three days in a week in a large office building of his main client)

I believe that this example should be deleted from the commentary as it reaches too far. Primo, it is unclear whether the painter is self-employed or an employee. Secundo, it is open

whether the indication of two years is of essence for the conclusion that it is regarded as a PE. Further, it is unclear whether the painter has a location at his disposal in the office building. It seems likely that he has not as he does his work according to the instructions of the client and is working at different places in the building. He has no right to be present at the office building beyond his contractual obligations and does not, in fact, use that location for other (own) business purposes. The commentary contradicts in my opinion at this point the newly inserted wording in annot. 4.2 sentence 6. The painter is in the office building mainly in the interest of his client and because of the nature of his work.

The commentary states that the presence of the painter in the office building "where he is performing the most important functions of his business (i.e. painting))" constitutes a PE whilst annot. 5.3. says that no PE is assumed if the painter works for different clients subsequently in the same building (apparently for a similar period of time). The criterion which seems to be decisive is that the work is done under a single contract. This, however, is no criterion for a PE. How would the conclusion be if the office manager of said building (which belongs e. g. to a group of proprietors) regularly retained the painter for painting work to be done in the building? I think that the result should be that the painter has no PE at the building premises. According to the commentary I would rather think that the opposite is true.

In addition, the criterion of the location where "the most important functions" are performed is misleading, because painting is but one of the functions a self-employed painter has. A function which is just as important as painting is e.g. the acquisition of clients, book-keeping, organization of business and employees, purchase of materials etc. If we assume for a moment that the example is modified and the painter would already have own business premises, and thus a PE, in the other state, nobody would assume that he has a second PE at the large office building he is working for in the example. It seems clear that "the most important functions" are fulfilled at his office premises and not at the place he is fulfilling his contractual obligations towards the client.

The example mentioned in annot. 5.4 (consultant moving between offices in a building while training employees) should not lead to a PE either because while said consultant is allowed under his contract with the bank to move in the building this does not give him necessarily the right to use office space for his own purposes and at his own discretion. He has to follow the instructions of the bank and respect the necessities of the project. To the extent that the consultant has no office space at his exclusive disposal which he can use at his own discretion in my opinion no PE can be assumed. Otherwise, the meaning of the term PE becomes dangerously vague.

Ad 6.1 (Example relating to activities of a recurrent nature)

I would suggest replacing the example by another one which has more practical impact. It is not helpful to choose a period of 15 years in order to illustrate activities of a recurrent nature. In addition, after 15 years the majority of tax claims will have become statute-barred and tax files are usually destroyed after 10 years. There are in my opinion two ways which could help to solve the problem. The first option would be to treat the case like the example in annot. 6.2. (opening a restaurant in the other state for only 4 months) or to choose a shorter period for reference, e.g. activities one or two years. An example could be a person, resident in State A, who sells self-made pottery every first weekend of a month at a farmers´ market in State B. Or, alternatively, an orchid grower and resident of state C who sells his plants at a biannual flower show in state D. Is there a frequency which is of essence for a PE?

Ad 10.1 (Enterprise doing business in another state through subcontractors)

The new wording of annotation 10.1 seems not to be in line with the general requirements of a PE as aid down in annotation 2. Annotation 2 says that normally "persons who, in one way or another, are dependant on the enterprise (personnel) conduct business of the enterprise in the state in which the fixed place is situated". This seems to exclude that a PE could exist when subcontractors are "acting alone" as annotation 10.1 says. In addition, one can hardly imagine that a fixed place of business is at the disposal of an enterprise and no personnel is at the site of such a PE (with perhaps an exemption for automatic equipment as described in Art 10.2.) A subcontractor will fulfil his own contractual obligations and, thus, acts independently in his own name and on his own account. Therefore, his activities cannot be taken into account when the requirements of a PE are examined at the level of the general contractor. This principle is also reflected in the distinction between a dependant and an independent agent in Art 5 para 5 of the OECD-Modell Convention. Otherwise the situation may occur that the subcontractor sets up a PE for himself and – automatically – for the general contractor as well.

In addition, the example which is to be inserted in this context is not realistic. In practice, either the entire hotel is leased to a contractor or it is managed by the enterprise itself whereby certain services can of course be outsourced. In the later case there will be a necessity for own personnel on site for mere organisational reasons. The example in its proposed form seems to have a background in business restructuring cases and/or transfer pricing issues but is unlikely to occur between unrelated parties.

Ad 19 (a site is to be considered to be at the disposal of the general contractor during the time spent on that site by any subcontractor)

The sentence which is proposed to be inserted should be deleted. A site can only be considered to be at the disposal of a general contractor as long as he has control of it. The period of time subcontractors spend on site is normally limited by the period the general contractor has control of it. However, cases may exist where the subcontractor stays with the consent of e. g. the owner of the site longer than the general contractor controls the construction site. Such an additional period of time can not be included in the period the general contractor stays on site because the subcontractor does not act for the general contractor. Otherwise, the subcontractor is treated for treaty purposes like personnel of the general contractor which would obviously contradict the principles of the OECD Model Convention.

In case I can be of further help please do not hesitate to contact me.

Yours sincerely,

Prof. Dr. Eleonore Ronge