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Düsseldorf, 17th February, 2012
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Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention

Dear Ms. Perez-Navarro,

The Institute of Public Auditors in Germany, Incorporated Association (Institut der Wirtschaftsprüfer in Deutschland e.V./IDW), is pleased to provide you with its comments on the proposed additions and changes to the Interpretation and Application of Article 5 of OECD Model Tax Convention concerning permanent establishment.

General remarks

In general, the amendments and changes proposed in the Commentary on Article 5 of OECD Model Tax Convention are aimed at broadening the scope of application of Article 5 OECD Model Tax Convention. Some amendments are not compatitive with the criteria for the constitution of a permanent establishment. They also undermine traditional interpretation principles and may therefore lead to double taxation. In our opinion certain key assumptions supposed by the Working Party should be reviewed and we would also like to express our concern about the practical implications of the proposed amendments as follows:

Meaning of "at the disposal of" (paragraph 4.2 of the Commentary)

The Working Party intends to replace paragraph 4.2 of the Commentary on Article 5. A location shall be considered to be at the disposal of the enterprise where an enterprise has an exclusive legal right to use a particular location used

only for carrying on that enterprise's own business activities. Where an enterprise does not have a right to be present at a location and does not use that location itself, that location shall not be deemed to be at the disposal of the enterprise. An example is given to outline these principles. The example (marginal number 13) deals with a consultant working at a client's premises for a long period of time. The consultant "is allowed to use 10 various training rooms" and "is given a security card allowing him unrestricted access to the buildings", but he is only allowed to utilize rooms for preparing his courses "when these rooms are not in use". Thus the consultant has - in accordance with the example of a painter in paragraph 4.7 (formerly paragraph 4.5) - neither the legal power of disposition nor the effective authority to dispose on these rooms. Consequently the consultant cannot have a permanent establishment, because there is no fixed place of his business and he does not have the legal or effective power to exclude a third party.

Therefore we propose the sixth sentence of paragraph 4.2 be reworded as follows: "Where an enterprise does not have a definitive right to be present at a location and, in fact, does not use that location itself, that location is not at the disposal of the enterprise; ...".

Home office as a permanent establishment (proposed new paragraphs 4.8 and 4.9)

We also do not support the proposed new paragraphs 4.8 and 4.9. Whether a home office is used on a regular and continuous basis for carrying on business activities for an enterprise and it is clear from the facts and circumstances that the enterprise has required the individual to work from home are not crucial for the constitution of a permanent establishment. Since the employees home is not at the employers disposal, a home office does not constitiute a permanent establishment. Only when the employer bears the rental and other costs of the home office could a home office be considered to be at the disposal of the enterprise.

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

With reference to the second sentence of Paragraph 6 of the Commentary, we share your concerns about the existing uncertainty. We therefore, on the one hand, support your suggestion to use an additional minimum time period for which an activity has to be performed in a continuous manner before the creation of a permanent establishment is deemed. But, on the other hand, we do not believe a time limit alone is sufficient to determine a permanent establishment. Furthermore, for the existence of a permanent establishment a

fixed place of business has to exist and the location has to qualify as a place of business where the business of that enterprise is wholly or partly carried on. We also disagree with the conclusions drawn in the example concerning recurrent activities in the renumbered Paragraph 6.1.

A stand held each year for a few weeks at a commercial fair for several consecutive years does not necessarily constitute a permanent establishment. Only in rare circumstances are these activities of a recurrent nature such that a permanent establishment is created. In respect of the recurrent nature of the activities, it is not sufficient that independent short-term activities are repeated anually. There has to be a causal nexus between the specific activities, e.g. the stand is reserved in advance for many years. Moreover, the time requirement has to be fullfilled within a limited time slot. It is not sufficient for the – generally accepted – minimum time period of six months to be met within a very long time frame – in the example given within six successive years. It is also not clear whether a permanent establishment would be created or not were the stand to be rented intermittently. If an individual resident of State A rents a stand at a commercial fair for four years for a period of five weeks each year, the time requirement is not met. If this resident does not rent the stand at the commercial fair in the subsquent year but for two years thereafter, it is not clear whether the time requirement is fulfilled (and, if so, at which point of time) or not.

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

The insertion of paragraph 10.1 and the amendments to paragraph 19 only make sense in the case that the subcontractor and also the enterprise have the authority to dispose. Consequently the hotel (as described in paragraph 10.1) will be a permanent establishment for the enterprise because the enterprise rents out the hotel's rooms. Provided that the rooms are rented out by the subcontractor and the enterprise has no chance to take command of the hotel's rooms, the hotel does not constitute a permanent establishment for the enterprise. This should be effective in the same way as in the case for a site as mentioned in paragraph 19. It is not sufficient to consider that the site is at the disposal of the general contractor during the time spent on that site by any subcontractor where the general contractor has the overall responsibility for the site and the site is made available to that general contractor for the purposes of carrying on its construction activities. If the construction activities are carried into execution only through subcontractors, the site does not constitute a permanent establishment of the general contractor. Neither the responsibility for the site nor the theoretical availability over the site are adequate criteria. Whether a permanent establishment exists or not is a matter of fact that has to be

considered isolated from the formal or rather abstract opportunity that the site is made available to the general contractor. The existence of a permanent establishment depends, in principle, on the extent of presence at the site and the work done. In that case the subcontractor may have a permanent establishment due to carrying on the construction business at the site. In contrast, the general constructor that does not continously observe or attend the site consequently does not have a permanent establishment. Between the general constructor and the subcontractor that is acting as contract manufacturer a contractual relationship exists which has to be dealt with in respect of evaluating the transfer price.

Meaning of "to conclude contracts in the name of the enterprise" (paragraph 32.1 of the Commentary)

The Working Group proposes replacing paragraph 32.1 to clarify the meaning of "to conclude contracts in the name of the enterprise". The additional, explanatory sentence points out that an enterprise can be bound in some countries and in certain cases by a contract concluded with a third party by a person acting on behalf of the enterprise even if that person did not formally disclose that he or she was acting for the enterprise and the name of the enterprise was not referred to in the contract. This description seems to be inexact and imprecise in as much as it does not deal with the different legal traditions. From our point of view it is necessary to distinguish between common and civil law jurisdictions.

In jurisdictions where a commission agent (commissionaire) acts on his or her own behalf and does not legally bind his or her principal, who is also not referred to in the contract, only the commissionaire and his client enter into legal relations. Therefore the enterprise (= the principal) is bound neither legally nor economically. Since such a commission agent does not act on behalf of the enterprise that agent does not constitute a permanent establishment of the enterprise. Only in those cases where the commission agent announces that he or she is acting on behalf of a particular enterprise may a permanent establishment be deemed in accordance with Article 5 Sec. 5 OECD Model Tax Convention. This interpretation is in line with the legal tradition in continental Europe.

In contrast an undisclosed agent under common law is permitted to conclude a contract without referring to the name of the enterprise; i.e. legally binding the enterprise. The undisclosed agent's contractual partner has a direct legal recourse against the enterprise. In such circumstances the enterprise is bound legally and economically. Thus an undisclosed agent may be deemed to be a permanent establishment of the enterprise.

Consequently we suggest amending paragraph 32.1 along the lines previously suggested by Great Britain to paragraph 45 of the interpretation and application

of the OECD Model Tax Convention so as to distinguish precisely between a commissionaire and an undisclosed agent, and their respective significance in determining whether an enterprise is deemed to have a permanent establishment depending on their very different status under common law and civil law.

Hence, a commissionaire can by no means constitute permanent establishment of the enterprise. This interpretation would reflect the original intention behind paragraph 32.1 which was to cover with the specific circumstances of an undisclosed agent.

We would be pleased to answer any questions you may have or discuss any aspect of this letter.

Best regards,

Hamannt

Rindermann, RA StB
Technical Director Taxes and Law