22 February 2012
Taxand

OECD
Grace Perez-Navarro
Deputy Director
CTPA
grace.perez-navarro@oecd.org

Dear Grace,

Re: Taxand Responds to the OECD Discussion Draft on the Definition of "Permanent Establishment" in the OECD Model Tax Convention

Further to the publication of the OECD's discussion draft, "Interpretation And Application Of Article 5 (Permanent Establishment) Of The OECD Model Tax Convention" ("**OECD PE Discussion Paper**"), Taxand is honoured to provide combined feedback from around the world.

First of all, we would like to salute the OECD Committee of Fiscal Affairs' efforts for its continual improvement to the efficiency of the Model Tax Convention which is an essential tool for coordinating international taxation in the business community. More particularly, the meaning of "permanent establishment" has such significant importance in the Model Tax Convention, from the perspective of both Article 7 and Article 15, that the efforts of your organization to provide further guidance on the term are welcomed immensely.

The following reflects Taxand's global view in response to the OECD PE discussion paper. In general the feedback we received was positive and encouraging. We have summarized our feedback below by the Issue identified in the OECD PE Discussion Paper.

It should be noted that with respect to Issues #10, 12, 14, 15, 16, 19, 22, 24 and 25, Taxand is in complete agreement with the OECD's proposed changes and no further comments have been provided.[1]

[1] The OECD Model Tax Convention and its commentary will be referred to throughout this submission as the "**Model**" and the "**Commentary**", respectively. Furthermore, the term "permanent establishment" will be referred to throughout this submission as "PE", and the Business and Industry Advisory Committee will be referred to as "BIAC".

Groupement d'intérêt économique - RCS : C 68
1B, Heienhaff - L – 1736 Senningerberg (Luxembourg)
Banque et Caisse d'Epargne de l'Etat, Luxembourg
IBAN LU49 0019 2855 1871 6000, BIC : BCEELULL
VAT identification : LU 220 135 38

Taxand Comments on the OECD PE Discussion Paper

Issue #1: Can a farm be a permanent establishment? (proposed paragraph 3.1 of the Commentary)

Taxand welcomes the recommendations made by the OECD Working Group, with the following observation:

There is a possibility for tax advisors and tax administrations to overlook the reference to "may" constitute a PE. We would therefore recommend emphasizing that the three basic elements of the PE general rule must still be met, particularly that a business must be carried on wholly or partially through the fixed place of business.

It is not clear to us why the example refers to an "apartment rental office" as opposed to simply an "apartment building". In this context, we would have thought the more common scenario was where a non-resident owned multiple rental units in a country that might, due to the degree of services provided to tenants therein, constitute a business and thus a possible PE. This seems to suggest that a non-resident would need to have an apartment rental office in the source country to potentially have a PE.

In addition, it should be specified that the analysis should depend on how active the owner is involved in the production from the farm. If it is only rental income without management, it should not be a PE.

Finally, it is also important to emphasize the main purpose of Article 5, which is to provide a definition of the term “permanent establishment” which is used in other articles of the Model. Therefore, we recommend that clarification be made that Article 5 does not deal with the taxing right of any income earned through the PE.

Issue #2: Meaning of — “at the disposal of” (paragraph 4.2 of the Commentary)

Taxand welcomes the recommendations made by the OECD Working Group, with the following observation:

The recommended changes regarding Issue 2, notably new paragraph 4.2, will help address current problems faced by taxpayers where tax authorities are attacking certain structures and activities that should not result in a PE determination. However, we would like to emphasize that the example “Consultant working at the client’s premises” in paragraph 13 of Issue 2 is an oft recurring issue. To this day, the determination of whether a consultant working at the client’s premises is difficult and the criteria are muddied and confusing. Accordingly, we agree with the comments in paragraph 14 and believe that language, which consolidates these comments along with the example in paragraph 13, should be included in

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the Commentary as such language would clarify the issue and help prevent disputes or problematic court decisions from occurring.

An additional clarification that could be incorporated in the Commentary, as suggested also by the BIAC to the OECD, is that a place cannot be "deemed" as being at the disposal of a foreign entity/main contractor in a project when the latter subcontracts its (locally performed) work entirely to local contractors, merely because the responsibility for the performance of the entire works/services lies with the foreign main contractor. In other words, the civil law responsibility does not in itself lead to the creation of a PE on the basis of deeming that in such cases the place of provision of the services under the contract is at the disposal of the foreign contractor assuming that the latter more likely than not supervises the work done by being present at such place (see additional concerns under Issue #8 below).

It would be helpful if the OECD Working Group adds illustrations to the Commentary on what constitutes "intermittent or incidental presence" at a particular location. For example, a right to enter a particular location (*e.g.*, a warehouse) for inspecting stocks or verifying proper storage of goods, should not be regarded as the place being "at the disposal" of the foreign enterprise.

We suggest also that at the end of paragraph 4.2 of the Commentary, it be added that "There will also not be a PE where the enterprise has a presence at a location, such as a representation office, but no activity of the enterprise is developed through this representation office, other than those of a representation nature."

Although the proposed revisions to the Commentary go some way to clarify the concept of "at the disposal of", it is stated that an enterprise can have a PE at a location that belongs to another enterprise if it performs business activities there on a "continuous and regular basis during an extended period of time". "Continuous and regular" is a subjective term and it is not clear how this should be interpreted. We suggest that the term is amended or clarified in the Commentary. We also think that more examples should be included in the Commentary to clarify the meaning of "so intermittent and incidental" and "continuous and regular".

Issue #3: Can the premises of a (converted) local entity constitute a PE of a foreign enterprise under paragraph 1? (paragraph 4.2 of the Commentary)

Taxand welcomes the recommendations made by the OECD Working Group, with the following observations:

The "Contract manufacturing" example in paragraph 17 is one that is occasionally treated by tax authorities as creating a PE for the parent. One argument sometimes raised by tax authorities is that, since the subsidiary is often economically dependent on the parent in such a situation, the tax authority may treat the subsidiary as being an agent of the parent company. In this regard, paragraph 20 states that the OECD Working Group agreed that

Groupement d'intérêt économique - RCS : C 68
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there could be no agency-PE issue in such a case because the subsidiary clearly did not exercise any authority to conclude contracts in the name of its parent. While we agree with this analysis and appreciate the recommended changes to new paragraph 4.2 and paragraph 10, we believe it is necessary to explicitly mention this conclusion (*i.e.*, no agency-PE issue) in the Commentary as, unfortunately, tax authorities have reassessed taxpayers in situations which mirrored the example based on an agency argument. We are of the opinion that simply mentioning this conclusion in the discussion draft is not sufficient to prevent or deter tax authorities from making such incorrect assessments in the future.

Another similar concern arises from operative structures in which personnel from the local subsidiaries are functionally dependent in the day to day work of management employed by the foreign principal. Under these situations, even though the local employees are not legally bound with the foreign entity (principal), de facto, they are bound and report in their job to personnel from the said entity. In this situation, it has sometimes been concluded by tax authorities that, depending on the facts and circumstances, it could be considered that the premises of the local entity constitute a PE of the foreign principal, since the local employees working on them are functionally dependent of the management of the foreign entity, thus indirectly carrying out their business activity for the foreign company. In this regard, the last sentence of the new paragraph 4.2 could perhaps also clarify that the operation and organization of a multinational entity, under which local employees report to management of the foreign headquarters that have been assigned to work at the subsidiary should not, in and by itself, result in a conclusion that the premises of the subsidiary is “at the disposal” of the foreign enterprise for its own business.

The Commentary could expressly state the fact that the local entity was previously a distributor of the products it now manufactures does not prejudice or affect in any manner the existence of a PE as the relevant restructuring that may have led to the new business activity/functions of the local entity is viewed separately within its proper tax framework.

Furthermore, we suggest that references to “contract manufacturing” are also extended to “toll manufacturing”.

Issue #4: Home office as a PE (proposed new paragraphs 4.8 and 4.9)

Taxand generally agrees with new paragraphs 4.8 and 4.9 and we believe they will go a long way in eliminating certain confusion with the issue of determining whether the use of a home office by an employee will create a PE. However, as this topic is frequently of relevance in practice, the proposed wording will lead to difficulties in applying these rules.

In the Tax Court of Canada decision of *Knights of Columbus v. The Queen*, 2008 TCC 307, the issue of a fixed place of business PE was to be determined by considering whether the business of the parent was being carried on through this fixed place of business (*i.e.*, the subsidiary’s office). The Court concluded the following:

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> For the [agents'] residences to be considered fixed places of business of the [enterprise], the [enterprise] must have a right of disposition over these premises. A right of disposition is not a right of the [enterprise] to sell an agents' house out from under him. The [enterprise] might be viewed as having the agents' premises at its disposal, for example, if the [enterprise] paid for all expenses in connection with the premises, required that the agents have that home office and stipulate what it must contain, and further required that clients were to be met at the home office and in fact the [enterprise's] members were met there.

Taxand recommends that the OECD Working Group consider adding additional factors to paragraph 4.8 such as those mentioned by the Court in *Knights of Columbus* as we believe that the current drafting of paragraph 4.8 does not provide a stringent enough test and has a lot of ambiguity. In addition, even though the proposed Commentary suggests that the enterprise must "require" the employee to work from home, this is such an important factor that further examples should be added in the Commentary to clarify various situations. For example, what should happen in a situation where an employee is provided with an office but chooses to work from home on a regular basis of his/her own accord. This could be done with the implicit consent of the employer. Guidance on this and other scenarios is recommended.

We are also of the view that the highlighted portion in the following text needs to be clarified:

Paragraph 4.8:

> "Where, however, 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 (e.g. by not providing an office to an employee in circumstances where the nature of employment clearly requires an office), the home office may be considered to be at the disposal of the enterprise."

The highlighted text may lead to an interpretation that a PE will arise only if an employee is required to work from home where the nature of employment clearly mandates an office. However, an employer could require or permit an employee to work regularly from home, even when the nature of activities does not require an office. It is not clear whether the OECD intends to exclude other space in the home situations, other than offices, from being treated as at the disposal of the foreign enterprise employer, and if so, what is OECD's justification for this.

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1B, Heienhaff - L – 1736 Senningerberg (Luxembourg)
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Finally, we are not in agreement with the text highlighted below:

Paragraph 4.9:

> "It should be noted, however, that since the vast majority of employees reside in a State where the employer has at its disposal one or more places of business to which these employees report, the question of whether or not a home office constitutes a location at the disposal of an enterprise will rarely be a practical issue. Also, the activities carried on at a home office will often be merely auxiliary and will therefore fall within the exception of subparagraph e) of paragraph 4."

Given the increased use of communications technology and the mobility of employees, the presumption that there may not, in practice, be situations where employees work from home in a state where an office at the disposal of the employer is also located may not be correct. This situation is not infrequent and should, therefore, be addressed in the Commentary. Also, it is common that the activities carried out from home will be more than merely auxiliary in nature. The Commentary should therefore not denigrate the importance of this issue of great uncertainty.

Issue #5: Shops on ships operated in international traffic (proposed paragraph 5.5 of the Commentary)

While we agree with the OECD Working Group's recommendations as it pertains to the general PE rule, we have concerns regarding the observation pointed out in paragraph 31 of the background that a deemed PE under Article 5(5) can exist to the extent that contracts would normally be concluded with customers by the personnel of the restaurant or shop. If personnel concluding contracts with customers will generally result in a deemed PE coming into existence under Article 5(5), this would result in a PE being formed in each and every case that a ship navigates within territorial waters, or even in a situation where personnel habitually conclude contracts in trade fairs for a limited duration in a year in another State. Also, this would seem to suggest that the example in proposed paragraph 6.1 is moot as well as any "enterprise" that has a person habitually concluding contracts will have a deemed PE. We would recommend that further clarification is needed in the Commentary.

Issue #6 - Time requirement for the existence of a PE (paragraph 6 of the Commentary)

Taxand welcomes the additional clarification of the "time requirement" and many found the new example in paragraph 6.2 extremely helpful. However, we found the example pertaining to "recurrent" business activity in paragraph 6.1 ineffective because adding only an individual time example (*e.g.*, 15 years) adds very little clarification to the matter. We are also of the view that further guidance is needed to show when the test should begin. For example, as

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1B, Heienhaff - L – 1736 Senningerberg (Luxembourg)
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per the illustration provided in paragraph 6.1, an individual resident in State R could constitute a PE in State S on account of renting a stand for a period of five weeks for 15 consecutive years. Such an approach could lead to a difficulty in examining the existence of a PE in the initial years, if there is no visibility or certainty regarding the likelihood of recurrence of the participation in future years. In such a case, if the recurrence is judged after several years have passed based on actual participation, it would result in a PE being held to be in existence even in earlier years which would lead to enormous compliance issues. For instance, will a PE be determined in the second, third or fourth year? Once one reaches a conclusion (say in year 4) that a PE is established on account of regular participation for all the years, what happens to the 3 past years? Unless the intent to participate regularly in the future is evident in a particular year, it should not lead to a conclusion that a PE comes into existence in that year. Regardless, the uncertainty on this matter should be clarified.

Also, in light of the background material in paragraph 35 and particularly the example of Frans the fireman, it is not apparent how much weight should be given to the fact that the host country is the only place that Frans sells his sculptures. In other words, if this is a relevant factor, why not refer to it in the paragraph 6.1 example?

We also recommend that the Commentary still needs to go one step further and establish a clear 6 month test. For example, as it stands right now, the Commentary states:

> "Whilst the practices followed by Member countries have not been consistent... experience has shown that permanent establishments normally have not been considered to exist in situations where a business had been carried on in a country through a place of business that was maintained for less than six months."

While we recognize that the inclusion of a definitive 6 month rule in Article 5 of the Model is an issue not consistent with some of the scenarios intended to be caught under the general PE rule (see examples in proposed paragraphs 6.1 and 6.2), consideration could still be given to establishing more definitive guidance in the Commentary. Having clear cut 6 month definitive language in the Commentary will help enterprises operating internationally achieve a greater degree of tax certainty regarding their PE issues. In other words, since there is no predetermined rule for the amount of time that may give rise to a PE and the Commentary continues to state the rule of minimum time required as a general practice, controversial interpretation will continue to arise. In light of this, we suggest that the Commentary could put more emphasis to the 6 month rule of thumb (*i.e.*, suggest that such minimum time period is a general interpretative rule and not merely a general practice, as has been suggested in the case of a deemed PE arising out of services under paragraphs 42.11 - 42.48).

We would also like to point out that the example in paragraph 6.1 could benefit from further guidance in a situation, for example, where an enterprise manufactures and sells products to

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1B, Heienhaff - L – 1736 Senningerberg (Luxembourg)
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VAT identification : LU 220 135 38

customers across Europe from a premise in its home state, but regularly attends an international trade fair based in another State where the product is marketed and sales are made. As noted in point 2 above, if the enterprise is considered to be based at the fair on a continuous and regular basis, then a PE could be deemed to arise in situations where a deemed agent PE has not already arisen. Consideration could be given to amending the Commentary to clarify whether the trade fair example should only apply where the enterprise attends the fair as a distinct business and not as part of a larger business activity. We also, again, would like to point out the comments we made in Issue #5 regarding deemed PEs under Article 5(5) if sales are habitually being concluded at the trade fair.

Issue #7 - Presence of foreign enterprise's personnel in the host country (paragraphs 10 of the Commentary)

Taxand agrees that the proposed amendments to paragraphs 10 and 10.2 of the Commentary are helpful. In addition, it was observed that the proposed words "of the enterprise" in the fourth sentence of paragraph 10 is an extremely significant clarification. However, that proposed amendment is so subtle that it is possible that tax authorities may not pick up on its importance. For example, certain tax administration auditors have, on occasion, relied on the current wording of paragraph 10 to support its claim regarding a PE determination for a non-resident enterprise. That is, where a subsidiary is so economically dependent and under the control of its non-resident parent company (*e.g.*, certain captive service providers and toll manufacturers could fit this scenario), certain tax administrations, at least at the audit level, have considered the subsidiary to be an agent of its parent company. Regardless that the so-called agent (note: the agency argument is usually highly questionable) does not conclude contracts on behalf of its parent company (*i.e.*, there is no deemed agent PE), the tax administrations have been known to interpret current paragraph 10 of the Commentary as support that the parent company has a PE even though the parent company employees are not present at the subsidiary's facilities (*i.e.*, no "space at the disposal" argument). The proposed amendment should prevent tax administrations from misinterpreting paragraph 10 of the Commentary. However, given the subtlety of the change, consideration should be given to adding a sentence in paragraph 10 to clarify that this paragraph of the Commentary is not intended to imply that, in and by itself, dependent agent subsidiaries that do not conclude contracts on behalf of their parent company will create a PE for its parent company.

Issue #8 - Main contractor who subcontracts all aspects of a contract (paragraphs 10 and 19 of the Commentary)

We are not clear on the treaty policy objectives behind these clarifications and we have concerns that this approach is creating more confusion on PE matters in general. We do not necessarily disagree with the proposed changes to the Commentary, but believe that the proposed changes, as they stand, are not sufficient, on their own, to provide the necessary guidance to the international tax community on this highly contentious issue. For example,

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1B, Heienhaff - L – 1736 Senningerberg (Luxembourg)
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the OECD Working Group is, arguably, creating a concept of a PE, using the Commentary rather than the Model itself, that is just beyond any reasonable interpretation of the phrase "permanent establishment" or “fixed place of business” and the generally understood “physical presence” and “nexus” requirement generally related to these terms in the Model. To illustrate, based on proposed paragraph 10.1, it would be possible for a non-resident to have a PE in a state with absolutely no physical presence in the state by its employees or dependent agents, simply based on the fact that the non-resident, as the general contractor, will be considered to have "space available to it" at the facility of the ultimate customer in order to perform its services under the general contract. This, arguably, seems to be stretching the concept of PE too far and seems to have been done, in part, to i) justify the long standing position expressed in paragraph 19 of the Commentary on recognizing time spent by subcontractors at a construction site (“construction site subcontractor rule") and ii) bring consistency between the construction site subcontractor rule and the general PE rule. However, one would have assumed that in 99% of construction site scenarios, the general contractor would have some presence at the construction site. Presence at a customer's site by a general contractor may not be necessary in more routine service contracts that have been subcontracted out to local entities. We are less concerned with the “no physical presence” scenario if at least the non-resident enterprise owns or leases an actual fixed place of business that customers clearly identify as the enterprise’s place of business in the host state (*e.g.*, like the hotel example). At least there is some significant physical connection in the host state by way of a property that is identified by customers as being the non-resident entity’s place of business in that host state.

As alluded to above, the OECD Working Group appears to be creating a policy issue when one considers how the Model handles captive service provider and toll manufacturer situations (particularly in light of the proposals described in Issues #2, #3 and #4). For example, let’s consider the situation where a resident of State R enters into a contract to manufacture a widget for $1,000,000 to a customer in State S, and then creates a subsidiary in State S to carry out the entire manufacturing of the widget and deliver the final product to the customer in State S. If the transaction is made at an arm's length transfer price and the resident of State R still earns a net profit of $50,000, why isn't the Model concerned about protecting source state taxation rights on all or a portion of that $50,000 profit? On the other hand, let’s assume the resident of State R enters into a service contract for $1,000,000 that requires services to be performed at the customer’s facilities in State S. The resident of State R subcontracts the entire contract to its subsidiary in State S and, after applying proper transfer pricing rules, still earns a $50,000 profit. All or a portion of that profit may now be taxable in State S under proposed paragraph 10.1. Where is the consistency here from the perspective of tax treaty policy? In both situations, there is zero presence in State S by the non-resident entity and its employees. Transfer pricing protects the source state to ensure the proper profits are reported in its jurisdiction with respect to the functions, assets and risks utilized by each entity in that State. We recognize that the subsidiary's facilities may not constitute “space at the disposal" of the non-resident parent company whereas, in the service scenario, there may be "space at the disposal" of the general contractor. However, in the

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absence of any actual physical presence in the host country by the non-resident entity, and transfer pricing regimes protecting source country taxation rights in both scenarios, why would the OECD want to protect source country taxing rights for a small "spread" in just certain scenarios? It would appear that these policy issues are driven by a concept (*i.e.*, space at the disposal) that is not always consistent with one's understanding of a "fixed place of business". This policy issue could also be extended to where independent agents are appointed to habitually conclude sales. Again, the substantive income earning activities of an enterprise have been, for all intent and purpose, subcontracted to an independent party. Yet Article 5(5) does not apply to deem this to be a PE.

We are also of the view that the phrase "other that the mere fact that these subcontractors perform such work at that location" in proposed paragraph 10.1 is confusing and needs clarification. Also, the hotel example isn't that practical or helpful, particularly when the issue was one where the non-resident enterprise subcontracts all aspects of a contract. In the hotel example, the non-resident in fact owns the hotel, so it would appear quite reasonable that the subcontract of certain operations, along with ownership of an actual fixed place of business will constitute a PE, even in the absence of physical presence in the host state by personnel of the non-resident enterprise.

Taxand is generally confused as to the reasoning of the OECD Working Group behind the proposed changes and the treaty policy objectives behind these changes (although we presume these changes are intended to be "clarifying" in nature). Some of the confusion stems from the hotel example as it seems to contradict the alternative provision found at paragraph 42.23 of the Commentary. The alternative provision provides in part that, in order for the contractor in State R to have a PE in State S, the services must be performed by an individual present and performing these services in State S. In addition, the services performed by an individual on behalf of one enterprise shall not be considered to be performed by another enterprise through that individual unless that other enterprise supervises, directs or controls the manner in which these services are performed by the individual. Therefore, in the context of the hotel example, the enterprise would only have a PE in State S if it was supervising, directing or controlling the manner in which the services are performed by the subcontractor. It is not clear to us how "supervising, directing or controlling" ties in with whether the space of the ultimate customer is legally at the disposal of the non-resident enterprise (*i.e.*, general contractor).

The confusion is apparent in the international tax community as, for example, the Canada Revenue Agency ("CRA") has publicly stated that, with respect to Article V(9) of the Canada-United States Treaty which is essentially a modified version of the alternative provision in the Commentary, where an enterprise of the United States subcontracts an entire contract, for which the services are to be performed in Canada, to a local subcontractor (*i.e.*, a subcontractor in Canada), this will not create a PE even if the services are performed for an aggregate of 183 days or more over any twelve month period. The CRA announcements on this would seem to be consistent with the comments made in paragraph 42.43 of the

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VAT identification : LU 220 135 38

Commentary regarding the alternate provision. Accordingly, again from a treaty policy perspective, why would certain subcontract arrangements offend the general PE rule but not the deemed service PE rule?

As stated above, we would generally agree with the hotel example in proposed paragraph 10.1 given that the enterprise owns the hotel (*i.e.*, the fixed place of business) which is recognized as the enterprise's place of business. However, given that the ownership or lease of the fixed place of business by the enterprise is such an important nexus for the host state, we believe that a second example should be provided for clarification. Accordingly, we would recommend that an example along the lines of paragraph 47 (*i.e.*, the catering contract to offshore platforms) be used. The catering contract represents the typical service "subcontract" situation that requires OECD guidance and, because one must rely on the "space at the disposal" concept, it is a situation that needs clarification.

Issue#9 - Application of paragraph 3 to joint venture and partnership activities (paragraphs 10 and 19 of the Commentary)

Taxand is in agreement with the proposed changes to paragraphs 10 and 19 of the Commentary on Article 5. However, we felt that it should be clarified that Paragraph 10.4 applies in the same manner as expressly suggested in paragraph 19.2. In other words, that the creation of a PE of the partnership is considered by reference to the tax treaty of each partner with the state of the potential PE on a "pro-rata" basis so that for one part it may be deemed to have a PE and for another not. This is expressly provided in the case of construction projects where different minimum project durations might be found in different partner treaties, yet it could be also that in other cases different treaties the position may not be so clear.

Issue #11: Additional work on a construction site (proposed new paragraph 19.1 of the Commentary)

Taxand generally welcomes the recommendations made by the OECD Working Group, with the following observations:

It has been observed that some tax administrations have the tendency to take the view that, the closer the inspection/repair is made to the delivery of the work, the more it could be considered to relate to the work period. In other words, the activation of the guarantee and repair almost immediately after the delivery of the work could be considered as connected to the work itself or as being, in practice, a lack of acceptance of the work/extension of the work, depending on the circumstances. In light of this, perhaps the word "acceptance" would be more appropriate from the word "delivery" as to the time of completion of the project.

Moreover, perhaps consideration can be given to an additional example could be added to reflect not only the case of the guarantee but also the case of a separate contract made with

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the same contractor many times for this purpose (*e.g.*, a contract for maintenance and operations activated immediately after the construction that will require the presence of employees of the contractor on site but for different reasons/under a different relationship). This example is a typical case of extended presence of the personnel of the foreign contractor following completion of the construction project and under a new relationship which should be viewed separately from the construction project itself.

Issue #13: Relationship between delivery and the sale of goods in subparagraph 4 a) (paragraphs 22 and 27.1 of the Commentary)

While we agree with the OECD Working Group's recommendations, we feel that the issue of what is considered to be "organizationally separate" is not adequately explained in the suggested draft. We would therefore suggest clarifying as to whether places of business can be said to be segregated organizationally only when they are housed in separate entities, or whether a functional separation within the same entity would satisfy the "organizationally separate" criteria.

Issue #17 - Negotiation of import contracts as an activity of a preparatory or auxiliary activity (paragraphs 24 and 25 of the Commentary)

Taxand is generally in agreement with the proposed changes to paragraphs 24 to 24.2 of the Commentary on Article 5. While we are agreed that the conclusion of contracts was not a necessary element when conditions of paragraph 1 of Article 5 were to be taken into consideration, it was felt that some more guidance may be required with respect to what constituted "active part in the negotiation of important parts of contracts" since this term could be subject to multiple interpretations.

Issue #18: Fragmentation of activities (paragraphs 27.1 of the Commentary)

Taxand generally welcomes the recommendations at the end of Issue #18. However, it has been suggested that that the fragmentation of an enterprise's activity, in the framework of a business restructuring, may also concern situations in which:

a) The fragmented activities are carried out by the same "converted" (stripped) local enterprise in different places of business; or

b) The fragmented activities are not considered auxiliary, however, such activities do not constitute, in and by itself, a PE of the principal (foreign entity) because the activities are not carried out by the foreign entity through a fixed place of business in the other state, or because the local (stripped) entity, even though it acts as a dependent agent, does not have the authority to conclude contracts in the name of the principal. In other words, paragraph 27.1 seems to address situations of a fragmentation of activities only referring to the exceptions of Article 5(4). However, it has been suggested that the same conclusion should

Groupement d'intérêt économique - RCS : C 68
1B, Heienhaff - L – 1736 Senningerberg (Luxembourg)
Banque et Caisse d'Epargne de l'Etat, Luxembourg
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be reached regarding activities that, although not considered auxiliary, do not constitute a PE in its own right. The combination of said activities under the same stripped (converted) local company should not *per se* trigger the existence of the PE. We recognize this seems to be the purpose of Issue #3 and the proposed last sentence in paragraph 4.2, however, for clarity, reference could be added in paragraph 27.1 (see comments under Issue #20).

Issue #20 - **Is paragraph 5 restricted to situations where sales are concluded? (paragraph 33 of the Commentary)**

Taxand is in agreement with the proposed changes to paragraph 33 of the Commentary on Article 5. Even though this particular issue has been raised by the Joint Working Group on Business Restructuring in the context of a scenario involving a restructuring of a full-fledged distributor into a commissionaire or other sales agent, the issue is one that needed clarification in a broader sense (see the second scenario described below). However, there are three suggestions that have been raised by Taxand that we would like the OECD to take under consideration:

1) First, it may be useful to clarify that concluding leasing contracts or other contracts for services would mean concluding contracts for such leasing or services to be rendered by the enterprise to its customers.

2) Second, it has been observed that there have been situations where tax authorities of a host state and their respective audit teams have invested much time and effort to support a deemed PE determination on the basis that the contracts for services were concluded in that host state, only to have all or substantially all of the tax assessment reversed by the Appeals division or the competent authorities (under the Mutual Agreement Procedure) because the tax auditors had ignored the fact that there is not a force of attraction principle in the particular treaty. For example, consider the situation where an enterprise of State R sends an employee to State S to negotiate and conclude a contract for services with a Client pursuant to which the enterprise will send several employees to Client's facilities in State S to perform said services. Let's also assume that the enterprise does not have a PE in State S in its own right as a result of either not having space at its disposal or simply the duration of the contract was not more than a few months. In the absence of a force of attraction provision in the relevant treaty, State S will only be able to tax the profits of the enterprise which are attributable to the efforts of the employee who concluded the contract with the Client. The vast majority of the profits will be attributable to the services performed by the other employees of the enterprise at the Client's facility. It has therefore been recommended that paragraph 33 be amended to remind the reader that, while contracts for services fall under the umbrella of paragraph 5, in the absence of a force of attraction provision, the attribution of income principles in Article 7 of the Model prevail and a state cannot attribute all the profits arising from that contract to the deemed agency PE. In other words, the profits to be attributed to a PE created by an

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employee concluding a contract for services will not include the profits which are attributable to the actual services performed at the client's facility. This is often overlooked by tax authorities because in the case of concluding sales contracts, the key income earning activities is the concluding of a sales contract, therefore a large portion of the profits often are attributable to the deemed agency PE. Now that the OECD is clarifying its application to service contracts, and almost red-flagging the issue to tax authorities, this attribution of income issue should be emphasized in the Commentary.

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

Taxand is disappointed that no satisfactory solution is provided. This should be addressed by the OECD Working Group as quickly as possible.

In addition, we suggest that the term used in paragraph 6 of Article 5 should be only "any agent of an independent status" and that the Commentary should clarify that the type of agent intended to be covered in paragraph 6 is subject to the difference of legal concepts of agent of various countries.

Issue #23 – Activities of Fund Managers

The OECD working group does not recommend performing any change in the commentaries as it considers that the issue is essentially dependent on facts and circumstances. We consider however that in the current regulatory context of the UCITS 4 and AIFM Directives and the related management company passport, one should make sure, in order to maximise legal certainty for the tax payer, that where an investment fund decides to have its management company located in a different jurisdiction, it will not become taxable on all or part of its activity in the country in which the management company is located. Otherwise, the possibility to have a management company managing investment funds in several jurisdictions will never be able to become reality as it will be possible from a regulatory point of view but not from a tax point of view. Thus, one should introduce a clarification according to which the fact that an investment fund has its management company in another jurisdiction does not as such create a PE of the fund in the country of the management company. This would be on the basis that there is no commercial income and generally an independent agent. In order to solve this issue, Luxembourg has already provided in its internal law a provision according to which "UCIs which are established outside the territory of Luxembourg are exempt from corporate income tax, local business tax and wealth tax in Luxembourg when they have their central administration within the territory of Luxembourg". Indeed, even though this issue may in most cases be a tax residence issue, it could also become a PE issue.

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Taxand's Take

As mentioned in the introduction, Taxand welcomes the proposed changes presented in the OECD PE Discussion Paper. We believe that these changes clarify the application and interpretation of certain OECD principles and guidelines for a number of contentious issues within the international tax community. These proposed changes, once implemented, should lead to the resolution of many outstanding cases and save much time and resources for taxpayers and tax authorities alike.

However, Taxand is of the view that there is still a need for further guidance on the issuance of "space at the disposal" in the context of both office in the home scenarios and sub-contract scenarios. We recognize that it is difficult to provide certainty or detailed guidance in the Commentary to every possible fact situation, but any additional clarification of these two common areas of PE exposure would be of great benefit to the international tax community.

We appreciate this opportunity to provide comments to the OECD Committee of Fiscal Affairs and would be pleased to discuss this further and / or to participate in any further discussion on these matters.

More information on how to contact us and about Taxand is provided as Appendix I. Taxand is wholly committed to supporting the OECD Committee of Fiscal Affairs and we look forward to contributing to further debate.

Yours sincerely,

Taxand

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APPENDIX I

CONTACT DETAILS

Jim Wilson
Taxand Canada
T. +1 613 786 0196
E. jim.wilson@gowlings.com

ABOUT TAXAND

Taxand provides high quality, integrated tax advice worldwide. Our tax professionals, nearly 400 tax partners and over 2,000 tax advisors in nearly 50 countries - grasp both the fine points of tax and the broader strategic implications, helping you mitigate risk, manage your tax burden and drive the performance of your business.

We're passionate about tax. We collaborate and share knowledge, capitalising on our collective expertise to provide you with high quality, tailored advice that helps relieve the pressures associated with making complex tax decisions.

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