

Paris, 31 January 2013

Subject: BIAC response to the OECD Model Tax Convention: Revised Proposals Concerning the Interpretation and Application of Article 5 (Permanent Establishment)

Dear Pascal,

BIAC thanks Working Party 1 ("WP1") of the OECD Committee on Fiscal Affairs (CFA) for the opportunity to provide comments on the Revised Proposals Concerning the Interpretation and Application of Article 5 (Permanent Establishment or "PE") of the OECD Model Tax Convention (the "Discussion Draft"), as follow below:

Introduction

1. We note that you have requested comments that focus on the drafting of the recommendations rather than on their substance. In this regard, we have attempted to offer drafting suggestions on specific issues but we also note that such drafting suggestions often relate to substantive concerns. We hope to have the opportunity to work with WP1 to further improve the guidance.
2. Before commenting on specific issues, we have set out below a number of general concerns that BIAC members have identified during their review that relate to several issues considered in the Discussion Draft.

Widening interpretations

3. As we understand it, the fundamental purpose of this project is to clarify issues of interpretation of the Commentary on Article 5; changes to the Article itself are not within scope. BIAC is concerned that some of these interpretative changes, however, will have the effect of fundamentally changing the operation of Article 5. If such changes are desired, they ought to be made to the Article itself rather than through reinterpreting long-standing principles. Renegotiating bilateral treaties is difficult and time consuming, but the alternative of changing the meaning of the treaty through shifting the interpretation of the existing provisions undermines long-standing international practice, and will increase uncertainty for both governments and businesses in the application of those treaties.
4. Business is concerned that a lack of clear language, definitions, or 'bright line' tests will not assist in reducing double taxation and will discourage the cross border trade and investment that is part of the OECD's core mission. Guidance also ought to facilitate the resolution of

disputes under the Mutual Agreement Procedures in addition to determining taxing rights. A lack of clarity and an openness to multiple interpretations do not contribute to this goal.

5. We are concerned that – without this being clearly articulated – the OECD and some of its member governments are suspicious of the way in which business considers taxation in relation to investment decisions. It appears from previous discussions and public consultations that WP1 is concerned that businesses will always seek to go right up to but not beyond any ‘bright line’. In our experience, business is not generally done in this way, and avoiding clear definitions due to these concerns, which likely relate to a minority of business practices, may be damaging to cross border trade. For example, business may want to put a ‘toe in the water’ in a country in order to determine whether opportunities justify an investment. If the PE standard is not clear, then business may be reluctant to do this because of the significant accounting and regulatory burdens associated with establishing a PE in a jurisdiction. Thus, lack of clarity over the PE standard may discourage foreign direct investment.
6. Further, the lack of clarity puts business in a difficult position with respect to its tax filing obligations and the possible imposition of interest and penalties. Generally, if no tax return is filed (because the taxpayer believes there is no PE), then the statute of limitations does not run and the tax authorities could assert a tax liability with interest and penalties at any time. All of this leads to caution on the part of business in deciding whether to make an initial investment or commence initial commercial activities in a jurisdiction. Therefore, the deliberate avoidance of ‘bright lines’ is not in the interest of countries or business.

Response to Comments at Consultations

7. BIAC would also like to express its concern at what it perceives as the lack of response from WP1 on suggestions that have previously been made by business.
8. BIAC submitted a significant number of comments in response to the OECD’s October 2011 Discussion Draft. These suggestions were made based on our members’ experience of PE discussions and disagreements with and between OECD member and non-member governments.
9. Business fully understands and appreciates the value of clarity and the true cost of ambiguity when considering taxation and investment decisions. BIAC’s comments are always offered bearing this in mind.
10. Business understands that WP1 may have legitimate concerns about the use of PEs in certain circumstances – although it would prefer for those concerns to be more clearly articulated. However, changing a general rule to catch a minority of specific problems seems neither sensible nor proportionate. It would be much better to come up with specific rules for specific circumstances. Some of these concerns arising from new ways of doing business might be better dealt with under the BEPS project.
11. We have re-visited our previous suggestions and are concerned with the lack of response, particularly on key issues. We stand by our previous comments and encourage the OECD to revisit them. Where we feel the issues are most critical, we have provided additional input in this letter to better explain our material concerns and suggestions.

12. Guidance will be most effective, and will promote certainty and cross-border trade and investment if the opinions of business and governments are articulated, understood and debated before guidance is adopted.

A lack of consensus

13. As noted above, several comments made in this document relate to the ambiguity of the proposed guidance. This should be of concern not just to business but also to governments, considering that improving clarity is the fundamental objective of this project.
14. BIAAC understands that the Discussion Draft is not clear on several issues because there is a lack of consensus among WP1 representatives. As we have stated in previous comments on earlier Discussion Drafts, reservations from WP1 representatives can cause problems in Competent Authority contexts, as one country or the other may take the position that it is not bound by the provisions of a treaty to which it has made a reservation. As a policy, BIAAC recommends to the OECD that in principle, reservations should be resisted, as they do not facilitate dispute resolution nor provide principles which non OECD countries can apply in a consistent manner.
15. However, if WP1 cannot reach consensus on certain issues, we believe it would be helpful to state clearly which representatives have expressed dissenting views and what those views are. Such an approach, although not ideal, would be preferable to new vague guidance with the resulting increased risk of dispute. This should be helpful to countries entering into treaty negotiations as well as taxpayers since the dissenters' observations will allow countries with different views to identify and potentially resolve those differences in the context of negotiations rather than leaving the issues to be identified and resolved (or not) through the competent authority process.
16. BIAAC would be pleased to engage openly with WP1 on these most difficult of issues in the hope of achieving greater clarity.

Key comments

Issue 2: Meaning of "at the disposal of" (paragraph 4.2 of the Commentary)

"Meaning of Effective Power to Use"

17. The revised Discussion Draft adds that whether a location may be considered to be at the disposal of a foreign enterprise depends in part on the foreign enterprise "having the effective power to use that location." It appears that WP1 intended to respond to commenters' requests that the Commentary be revised to require a foreign enterprise to have more than a mere presence (or a presumed ability to be present) at the location. We are concerned, however, that the proposed "effective power to use" standard does not adequately communicate this intent. If a foreign enterprise is in fact present at a particular location, it seems that it is thereby "effective" in being there. Accordingly, we ask WP1 to consider the following alternatives. Per our comments on the October 2011 Discussion Draft, we continue to believe that the concept of "control" would provide the clearest guidance to taxpayers. Thus, the language in paragraph 4.2 would read "having control over that location."

Alternatively, WP1 may consider using other formulations that require more than mere physical presence at a particular location, such as “having the effective power to determine how and when the location will be used by the enterprise in the conduct of its business” or “having command over.” Indeed, the formulation should be consistent with the other standards set forth in the existing Commentary (e.g., paragraph 4 refers to a foreign enterprise having certain premises “at its constant disposal”). Whatever the appropriate formulation, it is important to distinguish the test for a fixed place of business PE under Article 5(1) from the optional deemed services PE standard that applies by its terms only if included in the applicable treaty (Commentary paragraph. 42.21).

Mere Presence (or Presumed Ability to be Present)

18. The “effective power to use” is one factor, among others (e.g., “the extent of the presence” of a foreign enterprise’s employees at a location), in determining whether a place is at the disposal of a foreign enterprise in such a way that it may constitute a “place of business through which the business of [that] enterprise is wholly or partly carried on.”
19. However, the various factors used in revised paragraph 4.2 unfortunately lack the clarity necessary to provide taxpayers the guidance they need, especially on an issue as fundamental as the existence of a PE. For example, revised paragraph 4.2 explains that whether a PE exists depends on, among other factors, “the extent of the presence of the enterprise,” and if an enterprise performs its business activities at a particular location “on a continuous basis during an extended period of time.” The “extent of the presence” formulation suffers from a lack of clarity. Does “the extent of the presence” refer to the length of time that an enterprise is present at a particular location, or to the number of employees it has there at any given time, or to other considerations, or to a combination of factors? Likewise, does “extended period of time” refer to the six-month or greater period set forth in paragraph 6 of the Commentary (explaining that “experience has shown that permanent establishments normally have not been considered to exist in situations where a business had been carried out in a country through a place of business that was maintained for less than six months”). If so, then we suggest that a cross-reference to paragraph 6 be inserted in paragraph 4.2. As discussed above, BIAAC is concerned that the lack of guidance with ‘bright lines’ has the unfortunate consequence of discouraging investment, resulting in protracted and needless expensive controversies.
20. Along similar lines, we remain very concerned that the proposed standards could be read as coming close to erasing the distinction between the existence of a fixed place of business PE under Article 5(1) and the alternative provision for a services PE, especially if, as appears to be the case under the proposed standards, presence combined with the passage of time without more is all that is required to constitute a PE under Article 5(1). Courts have required a more demanding standard for finding that a taxpayer has a fixed place of business at a third party’s premises under treaties. For example, Canada’s Federal Court of Appeal in *The Queen v. William A. Dudley* (2000) held, under facts very similar to the example involving Peter in paragraph 13 of the Revised Discussion Draft, that a “fixed base” (analogous to a fixed place of business PE) did not exist, despite the presence of the taxpayer at the client’s location for a total of 340 days over two years. The Dudley Court noted that the taxpayer’s access to the client’s premises was determined exclusively by the client, that the taxpayer could not do

work there for anyone other than that client, that the taxpayer had no space in the premises that was exclusively his, and that the taxpayer was not identified to other clients as working at the client's location and could not be found by them there. When Canada and the United States subsequently amended their income tax convention to include a services PE provision, the U.S. Senate Foreign Relations Committee said that amounted to a reversal of the result of the Dudney decision. The Oxford English Dictionary defines "at one's disposal" to mean "available for one to use whenever or however one wishes". If the Commentary is amended in such a way as to deprive the concept of "disposal" of any of that notion of freedom to determine the time and manner of use, that will subvert the common meaning of the existing Commentary language and potentially amount to a stealth introduction of the services PE alternative into Article 5(1) itself.

Contract Manufacturing Arrangements

21. The revised Discussion Draft helpfully retains language from the original Discussion Draft confirming 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."
22. As explained in paragraph 18 of the revised Discussion Draft, WP1 intended the conclusion that no PE exists under the CARCO example set forth in paragraph 17 to "be reflected in the changes to paragraph 4.2 (relating to the meaning of "at the disposal of"). The CARCO example clearly involves a consignment or toll manufacturing arrangement pursuant to which the foreign enterprise maintains ownership of the raw materials, work-in-process, and final product through the manufacturing process.
23. Thus, in order to more clearly reflect the WP1 conclusion, paragraph 4.2 should be revised by adding "or a consignment or toll manufacturer" after "supplier or contract-manufacturer" to clarify that the same conclusion applies equally to a consignment or toll manufacturing arrangement.

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

24. We are disappointed that the Working Group has not accepted BIAC's repeated recommendation for the adoption of a more definite minimum time threshold for the establishment of a PE. It appears that the lack of a more definitive statement in this regard is due to an inability to achieve consensus among the delegates. BIAC believes that this inability to achieve consensus or the deliberate avoidance of 'bright lines' is not in the interest of countries. BIAC is aware that some countries are concerned that drawing 'bright lines' with respect to the minimum time required to have a PE will encourage taxpayers to go right up to that line and then leave in order to avoid being subject to tax. Business is not generally conducted in that way. It is far more likely that a company will avoid engaging in a country when it is unclear when the company will become subject to tax. This lack of clarity is therefore likely to discourage and delay foreign direct investment. We urge WP1, when it reviews the Discussion Draft, to continue to work on this issue. It would be helpful if the wording with respect to the 6 month minimum time period could be made more definitive.

We suggest that a new last sentence be added to paragraph 6 of the Commentary as follows (proposed new text italicised in bold and underlined):

Based on these member country practices, generally, a place of business that does not exist for more than 6 months will not be considered fixed and therefore will not constitute a permanent establishment except in the case of the two limited exceptions described in paragraphs 6.1 and 6.2.

25. It is our understanding based on the public discussion that the examples in paragraphs 6.1 and 6.2 are intended to be read narrowly and therefore it would be useful to make that clear in the Commentary. A sentence along the lines suggested above would be helpful in that regard.
26. We reiterate our previous comments as to the problems experienced by the business community with respect to the PE concept when dealing with business activities of a short duration. As mentioned before, we object strongly to the assertion that a PE could be found based on either of the exceptions proposed in the Discussion Draft. However, given that our suggestions have been rejected, we appreciate that the Working Group has attempted to limit the application of the PE concept to short-term activities by way of the addition of more specific examples to the Commentary.

Recurrent activities

27. BIAC appreciates the narrowing of this exception that seems evident from the inclusion of a new more limited example, statements at the public consultation, and the deletion of the example pertaining to selling at a commercial fair. We are concerned, however, that the substantive language of paragraph 6.1 has not been narrowed. Therefore, some countries might take the position that it is still possible to conclude there is a PE based on the recurrent short-term presence at a location, without regard to the reason for which the presence is short-term. There are a couple of ways this ambiguity could be eliminated. One way would be to revise the first sentence along the lines of the following (proposed revisions italicised in bold and underlined):

*One exception to this general practice has been where the activities were of a recurrent nature; in such cases, **if the reason the activities are recurrent rather than continuous relates to the nature of the location at which the activities are performed**, then each period of time during which the place is used needs to be considered in combination with the number of times during which that place is used (which may extend over a number of years).*

28. BIAC believes this formulation makes clear that the nature of the location, rather than the nature of the business, is the reason for the application of this exception. That is, the enterprise would be carrying on drilling operations in country S year round except that the seasonal conditions prevent them from engaging in that activity. Including the suggested language would also clarify the application of the exception to other common situations. For instance, in the case of an MNE, marketing personnel may meet every year at a company headquarters. Although this is a recurrent activity, the nature of the location has no effect on the way the business is conducted and therefore these activities should not be captured by this test. Further, in our view these more common examples would not trigger a PE because the headquarters are not at the disposal of the marketing personnel and the activities

performed at the headquarters should be considered preparatory and auxiliary. - Nevertheless, clarifying the language in paragraph 6.1 would eliminate any doubt on this issue.

29. Another way of reducing the ambiguity would be to include examples of cases in which recurrent activities do not result in the creation of a PE. These examples could include the example from the prior Discussion Draft, the example of marketing personnel meeting at headquarters discussed above, and an example of a consultant who travels annually to meet with a client for two weeks at the client's place of business and to review the client's activities and provide advice.
30. If the recurrent activities exception does apply and a PE is deemed to exist, it is unclear at what point in time the recurrent activity will constitute a PE. It seems logical that that point would be when the total amount of time spent by the enterprise of State R in State S exceeds the six month general threshold (or whichever general time threshold is in place in State S). BIAC strongly supports this interpretation because of the difficulties associated with retrospective PEs. The facts of the example in the revised Discussion Draft provide that the enterprise expects the operations to continue for a period of five years. In such a case, where the taxpayer expects from the outset to be in State S for such a period, treating the taxpayer as having a PE from the outset is less troubling. In the absence of evidence of such an intention (e.g., a contract signed by the enterprise that indicates the duration of the activities), a PE based on recurrent activities should be constituted on a prospective basis from the date when the relevant time threshold is passed to avoid difficult compliance issues. BIAC understands that the Commentary is not clear because there is no consensus among the countries concerning this issue. However, it is unfair to taxpayers to find a PE retrospectively and then impose penalties, if the standard is not clear. At a minimum the Commentary should urge countries to clearly set forth their positions in their bilateral agreements, so that taxpayers can understand their tax filing obligations.

One Shot Projects

31. BIAC reiterates its previous comments concerning the inappropriateness of treating any short-term business as a PE. We believe it is crucial that the exception be limited to its stated purpose: to permit source country taxation where activities constituting that business are carried on exclusively in the source country. In order to make that clear, the portion of the example illustrating when a PE would not be found to exist should be revised as follows (proposed revisions italicised in bold and underlined):

*This would not be the situation, however, where a company resident of State R which operates various catering facilities in State R would operate a cafeteria in State S during a four **month production of a documentary week international sports event**. In that case, the company's business, which is permanently carried on in State R, is only temporarily carried on in State S.*

32. If this exception is not limited to the unique and self-contained business, then it would dramatically undercut the general PE rule. We agree that non-resident caterers that operate their business in a state during a sporting event of limited duration (such as the Olympics) or other short term event should not have PEs in that state, assuming that they operate their

business outside that state as well. Because of the importance of this distinction, it is important to maintain both the parts of the example illustrating both the unique and self-contained nature of the business and the business that is part of a larger multinational enterprise. The absence of any kind of minimum time limit, even in the case of a unique, self-contained business, continues to be of concern to the business community.

Issue 7: Presence of foreign enterprise's personnel in the host country (paragraph 10 of the Commentary)

33. It is disappointing that none of BIAAC's proposed amendments/clarifications appear to have been included within the revised text. Specifically the use of the term "secondment" without definition may lead to an inconsistent application of the term.
34. In addition, BIAAC strongly believes that paragraph 10 of the Commentary should be revised to include a new last sentence concerning cross border reporting lines (proposed new text italicised in bold and underlined):

It should be noted that cross border reporting lines will not, in and of themselves, create a secondment of the reporting employee to the company to which the employee reports.

35. BIAAC assumes that this is in fact the intention of the current draft and therefore such an amendment should be quite straightforward, however, should this not be the intention this should be clearly articulated along with the reasons as to why.
36. The examples intended to illustrate the application of paragraphs 8.13 to 8.15 of the Commentary to Article 15 and their application to the determination of whether a PE exists are not detailed enough. In particular, the second example, discussed in paragraphs 41 and 42 of the Discussion Draft, does not indicate how the issue of whether RCO is considered to be the employer of the hotel managers ought to be resolved. One approach to providing more clarity on this issue would be to expand the second example to include additional facts concerning the employment relationship that are enumerated in paragraph 8.14 of Article 15 Commentary. Perhaps there could be two examples, one in which RCO is considered to be the employer and one in which RCO is not considered to be the employer. At a minimum, the Commentary should encourage treaty partners to be clear on this point in their bilateral negotiations.

Issue 8: Main contractor who subcontracts all aspects of a contract (proposed paragraph 10.1 of the Commentary)

37. We remain of the view that the proposed paragraph 10.1 is deeply troubling as a matter of principle. In providing that the business of an enterprise can be carried on by a third party, without limitation as to whether the third party is in any sense dependent on the enterprise, the paragraph represents a material extension of the PE rule. There is, however, no guidance or commentary on why it has been necessary to extend the fixed place of business rule in this way, nor is there any clarity on the intended scope and operation of the rule. Further, the general statement in the first sentence of proposed paragraph 10.1 "An enterprise may also carry on its business through sub-contractors, acting alone or together with employees of the enterprise" seems evidently at odds with other statements made in the Commentary. For

example, in existing paragraph 42 there is the statement "Indeed, the fact that a company's own activities at a given location may provide an economic benefit to the business of another company does not mean that the latter company carries on its business through that location...". Even in relation to the services PE discussion (and notwithstanding the lower threshold test that applies for a services PE) the same conflict emerges. In paragraph 42.23, for example, the comments in the last sentence of the paragraph indicate that, absent circumstances involving specific direction and control, services performed by an individual on behalf of an enterprise are not to be regarded as performed by the enterprise. We assume it cannot have been the intention of the OECD to create a conflict with this existing guidance.

38. In the absence of any principled explanation of the proposed paragraph, we cannot support its inclusion in the amendments to the Commentary to Article 5. If the OECD does wish to pursue the change it would seem necessary, as a minimum, to provide some guidance on the circumstances in which the business of a third party may be considered to represent the business of another company and also to address any inconsistencies with existing statements in the Commentary. The WP1 should also clarify how to apply the concept of premises being "at the disposal" of an enterprise when WP1 considers that the business of the enterprise is being conducted by a third party (especially, for example, an independent third party) at the third party's premises. Finally, if WP1 wishes to retain the current language in the Discussion Draft without further clarification, the OECD should, as a matter of urgency, clarify how the Authorised OECD Approach to the attribution of profits to permanent establishments applies to situations where a permanent establishment is found to exist under Article 5(1) because of activities carried on by a third party for the benefit of a foreign enterprise.

Issue 19: Meaning of "to conclude contracts in the name of the enterprise" (paragraph 32.1 of the Commentary)

39. Issue 19 clearly posed the question for which guidance was sought under Article 5(5), namely whether the phrase "to conclude contracts in the name of the enterprise" refers only to cases where the principal is legally bound vis-à-vis the third party, under agency law, by reason of the contract concluded by the agent, or whether it is sufficient that the foreign principal is economically bound by the contracts concluded by the person acting for it in order for a PE to exist. We were, of course, quite disappointed to hear during the public consultation that the WP1 delegates were unable to reach a consensus on that question, particularly in light of the history of Article 5(5) and its Commentary and the well-reasoned opinions issued by various countries' Supreme Courts in recent years which have concluded the standard requires the principal to be legally bound. We continue to believe that the OECD, by making no improvement to the Discussion Draft, would be squandering a precious opportunity to provide valuable guidance through the Commentary on an issue that cries out for resolution, especially when one considers the number of controversies that continue to fester now, and are likely to arise in the future, on this question. We are particularly disappointed by the apparent truth that consensus was so far from being attainable that the OECD could not even express a preferred view on this question, allowing dissenting members to record their disagreements through observations. While not ideal, that approach would have been preferable to a complete lack of consensus on the issue raised.

40. We were nevertheless heartened to hear at the public consultation that the language which was proposed to be added to paragraph 32.1 of the Commentary was simply intended to shed light on the historic basis for the sentence, now present as the first sentence of paragraph 32.1 but originally added to paragraph 32 of the Commentary in 1994, which reads: “Also, the phrase authority to conclude contracts in the name of the enterprise’ does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise.” The history of the introduction of that sentence in 1994 is irrefutable – the sentence was intended to address a concern raised by the United Kingdom, a common law country, concerning the possibility that a literal application of the Article 5(5) words “contracting in the name of” would cause a UK agent who did not reveal his principal but did enter into a contract which legally bound the principal not to be recognized as creating a PE.¹
41. Thus, the sentence added in 1994 was specifically intended to confirm that an agent acting on behalf of an undisclosed principal who legally bound that principal would create a PE under Article 5(5); it had no connection with situations involving agents contracting in their own names where those agents did not legally bind their principals.² This history was fully noted and understood by the Rapporteur Public in the Conseil d’Etat’s Zimmer case in France and contributed to the decision in that case which held that a commissionnaire would not create an Article 5(5) PE where it did not legally bind the party it represented. The same history was cited and understood by the Supreme Court of Norway in its Dell decision, which similarly held that a commissionnaire acting for an undisclosed principal would not create an Article 5(5) PE without legally binding the principal.
42. We were likewise heartened to hear from the Secretariat at the public consultation that there was surprise that the language proposed to be added to paragraph 32.1 of the Commentary under the October 2011 Discussion Draft – “For example, in some countries an enterprise would be bound, in certain cases, by a contract concluded with a third party by a person acting on behalf of the enterprise even if the person did not formally disclose that it was acting for the enterprise and the name of the enterprise was not referred to in the contract” -- could be interpreted as applicable to situations where an agent may have bound its undisclosed principal economically but not legally.
43. Given the acknowledgement that the new sentence, as drafted, had apparently been misunderstood by some readers to support the “economically bound” approach, we were especially disappointed that WP1 did not take the opportunity presented by the revised Discussion Draft to improve on the ambiguous drafting to more clearly reflect the intention underlying the new language, namely to provide an illustration which would better explain the historic basis for the language in the first sentence of paragraph 32.1 regarding contracts “which are binding on the enterprise”.

¹ This concern was described in the May 1993 article by John Avery-Jones et al., “Agents as Permanent Establishments under the OECD Model Tax Convention”, *European Taxation*, page 161, as having been the source of an observation entered by the UK on the Commentary on Article 5 in 1992.

² The introduction of the sentence resulted in the UK’s withdrawal of its observation on the Article 5 Commentary in 1994.

44. The history of the first sentence of Article 32.1, and its origins in the OECD's desire in 1994 to confirm the potential creation of an Article 5(5) PE in the case of an undisclosed agent who legally binds his principal, are objective facts which cannot be denied. It would be contrary to known fact and regrettably productive of unjustified new confusion to introduce into the Commentary language which incorrectly left the impression with some readers that the first sentence of Article 32.1 was intended to address anything other than situations where an undisclosed agent legally bound his principal.
45. For this reason, we strongly recommend that the new language proposed for inclusion in paragraph 32.1 be redrafted to eliminate any possible interpretation that the first sentence of paragraph 32.1 was intended to address situations involving agents who did not legally bind their principals. The simplest and most straightforward way of doing that would be to add the word "legally" before "bound" in the proposed new language. Alternatively, the new sentence could be redrafted to refer more clearly to the historic concern which led to the introduction of the first sentence of Article 32.1. For example, the new sentence could be redrafted along the following lines: "This clarification confirms that a person acting on behalf of an enterprise may create a PE for that enterprise under paragraph 5, where the person concludes contracts with third parties which under applicable law bind the enterprise vis-à-vis the third parties, even if the person does not formally disclose that it is acting for the enterprise and the name of the enterprise is not referred to in the contracts."
46. If WP1 cannot agree to improve the drafting of the proposed addition in accordance with either of the recommendations above, we respectfully urge WP1 to omit the proposed addition from the final package of changes to the Commentary. We believe that the proposed addition, as currently drafted, has the risk of creating greater confusion than if no change were made to paragraph 32.1. The fact that the acknowledged misinterpretation of the proposed addition was identified in the course of the public consultation and was not addressed in the revised Discussion Draft exacerbates the potential confusion.
47. The purpose of this project is to clarify issues of interpretation under Article 5 that were identified. If the resulting changes fail to bring greater clarity and actually create greater confusion, they undermine the very objective the OECD set out to achieve and bring discredit to the Commentary itself. That would indeed be a lamentable outcome, particularly when WP1 resigned itself to the fairly unambitious task of illustrating the historic genesis of existing Commentary language.
48. We are also disappointed that WP1 has declined to provide guidance on three additional scenarios raised by BIAC (involving multiple approvals or nonexistent or highly circumscribed negotiating authority) on the grounds that the cases are factual and that the Commentary ostensibly already provides adequate guidance to deal with them. We respectfully disagree with the latter conclusion and submit that it is untenable in the face of the business views expressed in the public consultation on that point.
49. We suggest that WP1 could better fulfil its mandate on this project by attempting to address these issues through proposed enhancements to the Commentary. BIAC would be glad to engage in a dialogue with the OECD on these issues. If WP1 decides not to pursue that route, we strongly urge that its final report omit the third through sixth sentences of paragraph 112

of the Discussion Draft. Those sentences include some loose commentary on the scenarios raised without any indication of whether that commentary reflects a consensus view of WP1, nor any opportunity for countries to make their individual views known through observations or otherwise. If there are consensus conclusions which can be formalized into Commentary on Article 5, then the OECD should consider adopting such enhancements to the Commentary; otherwise, loose remarks on scenarios which are not being addressed in actual Commentary language should not be included in the final report.

Other comments

Issue 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)

50. The earlier Discussion Draft provided that “no distinction should be made based in the application and interpretation of Article 5 based on whether or not the facts and arrangements relevant to the determination of a PE resulted from a business restructuring.” (Paragraph 19 of the first Discussion Draft.) BIAC suggested that Commentary itself should be clear on this point. The OECD proposes to include an entirely new paragraph 3.1 that would make this clear. We appreciate the OECD proposing to clarify this point and support inclusion of this new paragraph.

51. Paragraph 17 of both versions of the Discussion Draft provides as follows:

Two relevant questions are whether these premises are at the disposal of the foreign enterprise and whether it is the business of the foreign enterprise (and not only the business of the local entity) that is wholly or partly carried on in these premises.

52. BIAC continues to believe that whether the premises of the premises of SUBCAR are actually at the disposal of CARCO would be made clearer by actually including the entire example (which paragraph 18 indicates WP1 agrees does not constitute a PE) and not just the abbreviated version that is contained in paragraph 4.2. The additional detail in the longer example helps flesh out the level of involvement that CARCO is permitted to have without having a PE and therefore would be helpful to include.

Issue 10: Meaning of Place of Management (paragraph 12 of the Commentary)

53. BIAAC supports the proposed changes to the Commentary on this issue. The new Discussion Draft (copied below) makes minor clarifying changes we believe constitute improvements. The background material contains an example (paragraph 58) and an explanation (paragraph 60) that make clear that centralizing administrative functions does not create a PE because the place where these functions are performed is not “at the disposal” of the entity on whose behalf they are performed. We believe it would be useful to make a minor change to paragraph 12 of the Commentary that would clarify this issue further (proposed new text italicised in bold and underlined).

*This paragraph contains a list, by no means exhaustive, of examples of places of business, each of which can be regarded as constituting a permanent establishment under paragraph 1 provided that it meets the requirements of that paragraph. As these examples are to be read in the context of the general definition given in paragraph 1, the terms listed, “a place of management”, “a branch”, “an office”, etc. must be interpreted in such a way that such places of business constitute permanent establishments only if they meet the requirements of paragraph 1 (**e.g., the premises are at the disposal of the entity on whose behalf the services are provided**) and are not places of business to which paragraph 4 applies.*

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

54. BIAAC supports the proposed changes to this paragraph of the Commentary. For the many reasons discussed during the public consultation, we appreciate that the OECD has not proposed to adopt the standard of “delivery and the acceptance by the client”.

Issue 12: Must the activities referred to in paragraph 4 be of a preparatory or auxiliary nature? (paragraphs 21 and 23 of the Commentary)

55. BIAAC commends the OECD for making clear the listed activities constitute “automatic exceptions” to the fixed place of business PE described in Article 5(1). The revised version of paragraphs 21 and 23 of the Commentary makes clarifying changes that we believe represent improvements to the earlier draft.

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

56. BIAAC agrees with the proposed changes on this issue and believes the minor clarifying changes to paragraph 27.1 are improvements to the draft language.

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

57. BIAAC supports the clarification provided by paragraph 24.2 of the draft Commentary. However, we propose that a new sentence should be added at the end of this paragraph to confirm that it relates to the application of the paragraph 1 rules, rather than being an extension of the deemed PE rules contained within paragraph 5 (proposed new text italicised in bold and underlined):

24.2 Similarly, where an enterprise that sells goods worldwide establishes an office in one State, and the employees working at that office take an active part in the negotiation of important parts of contracts for the sale of goods to buyers in that State (e.g. by participating in decisions related to the type, quality or quantity of products covered by these contracts) even if they do not exercise an authority to conclude contracts in the name of their employer, such activities will usually constitute an essential part of the business operations of the enterprise and should not be regarded as having a preparatory or auxiliary character within the meaning of subparagraph e) of paragraph 4. If the conditions of paragraph 1 are met, such an office will therefore constitute a permanent establishment. **However, an enterprise will not be taken to have established an office in one State 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.**

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

58. BIAC suggests adding language to paragraph 33 to clarify that a toll manufacturer that purchases materials on behalf of a foreign enterprise/principal (e.g., by accepting a purchase order) is not the type of contract referred to in paragraph 5 because such purchases do not relate to the "business proper" of the principal. An enterprise that engaged in purchasing activities directly would not be considered to have a PE under paragraph 4(d) of Article 5. Thus, purchasing activities of a toll manufacturer should not cause the enterprise to have a PE. Accordingly, BIAC requests that WP1 add the following language at the end of revised paragraph 33 of the Commentary (proposed new text italicised in bold and underlined):

Similarly, a toll manufacturer that concludes contracts for materials that are needed to manufacture the goods for a principal enterprise in another country is not the type of contract to which paragraph 5 applies because such contracts do not relate to the business proper of the principal (see paragraph 4(d) of Article 5).

Again, we thank you for the opportunity to comment on this draft. We would reiterate again, however, the importance for both taxpayers and governments of providing clarity in this area to reduce the potential for uncertainty and dispute. If it would be useful, BIAC representatives would be pleased to meet with representatives of the WP1 to assist in furthering the attempt to clarify the concept of "Permanent Establishment" in treaty situations based on the experience of business.

Sincerely,



Will Morris

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Mr. Pascal Saint-Amans,
Director of the OECD Centre for Tax Policy and Administration (CTPA)

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