



ICC comments on “Revised proposals concerning the interpretation and application of Article 5 (Permanent Establishment)”

ICC is – and has been throughout its long existence – a steadfast rallying point for those who believe, like our founders, that strengthening commercial ties among nations is not only good for business but good for global living standards and good for peace.

The ICC Commission on Taxation therefore thanks OECD for the opportunity to contribute some thoughts about the revised discussion draft on permanent establishment.

A. General remarks

The requirements for qualification as a permanent establishment have been steadily lowered through various revisions of the OECD Commentary on the Model Tax Convention. Furthermore, the definition of permanent establishment has become increasingly broader, a trend that seems to have been perpetuated by the existing draft content of the Commentary for the 2014 update of the OECD Model Tax Convention. What is at issue here essentially involves an “expansion” of the definition of the term permanent establishment (e.g. through what are referred to as service permanent establishments and agency permanent establishments).

Although the clarifications that have been included in the draft of the Commentary on Article 5 are intended to provide more legal certainty in practice and are as such welcome, the proposed changes at the same time tend to blur the definition of permanent establishment. Consequently, business increasingly finds itself in a less than acceptable situation since, when confronted with ambiguous cases, we are hardly able to make reliable statements as regards the question of the existence of a permanent establishment and the myriad fiscal implications. In our view, the tendency towards a more and more flexible definition of what constitutes permanent establishment contravenes the implementation of the Authorized OECD Approach into Article 7 of the OECD Model Tax Convention 2010. Where for reasons of profit allocation the permanent establishment has at present reached a status of being almost as functionally separated as corporations, the planned changes to the Commentary on Article 5 at the same time seem to add momentum in the opposite direction.

The implementation of the Authorized OECD Approach requires both tax practitioners and companies with cross-border operations to furnish detailed valuation and documentation of inter-company transactions at an accelerated pace. However, the planned changes to the Commentary on Article 5 often fail to provide clear guidelines on whether the creation/existence of a permanent establishment will make such efforts likely to incur or not. Against this background, we think that strengthening permanent establishments in terms of profit allocation should also be underpinned by a clear and restrictive definition of what permanent establishment actually is.



We fear that an ever wider definition of permanent establishment and continuing ambiguities will harm commercial ties between countries. There is a high risk for businesses of omitting inadvertently to treat commercial activities as permanent establishments. This can have severe consequences varying from country to country. Beside all the tax consequences (payroll tax etc.) criminal proceedings may be triggered quasi-automatically.

B. Specifics

I. Expansion of the meaning of ‘at the disposal of’

Major changes planned in the Commentary on Article 5 of the Model Tax Convention will concern the meaning of “at the disposal of”, which is fundamental to the understanding of a definition of permanent establishment. The working party seems to be essentially of the opinion that a place of business is clearly at the disposal of an enterprise if the enterprise has an exclusive legal right to use the premises – for example, in the form of a rental agreement or lease. Nevertheless, a permanent establishment will also be considered to exist when an entrepreneur uses the premises of another entrepreneur on a continuous and regular basis over an extended period of time or premises that are used in such a manner by several entrepreneurs. Seen the other way around, a permanent establishment cannot be assumed to exist if an entrepreneur is present on such premises irregularly or only occasionally. Finally, such premises can therefore not be considered to represent a fictitious place of business. According to the draft, the same will apply if an entrepreneur has no right to use premises as he sees fit and in fact maintains no presence on such premises.

Such cases, however, in practice lead to tremendous difficulties not only with regard to income taxation but also to payroll and value added tax issues.

The revised discussion draft adds that whether a location may be considered to be at the disposal of an enterprise depends on the foreign enterprise ‘having the effective power to use that location’.

The proposed examples provided in para. 4.2 on Article 5 as amended by the Working Party to illustrate whether an enterprise has the effective power to use a certain location do not provide sufficient clarification. In each example a situation is described which is rather clearly based on the practice of the Member Countries.¹

An example should be included which provides facts respectively illustrates the ‘thin borderline’ when an enterprise has the effective power to use a location and when not. The meaning of the Commentary must become clearer and the language used must be understandable to the typical reader versed in international tax principles. The example should make clear that “at the disposal of” requires a qualified access. The qualifying moment should be the foreign enterprise’s ability to decide oneself about when, how, and to which business purpose to access the client’s premises.

¹ The first example provides a case where an enterprise has an exclusive legal right to use a particular location. The second example describes a situation where an enterprise is allowed to use a specific location that belongs to another enterprise and performs its business activities at that location on a continuous basis during an extended period of time.



C. Time requirement

We agree with the elimination of the commercial fair example. However, we still doubt that the drilling example provides sufficient clarity. It is e.g. unclear, if all installations disappear entirely during the non-drilling period.

However, the drilling example does not provide a reliable minimum time threshold. To make it all depend on ever-changing facts and circumstances is poison for international economic activities. The missing certainty will trigger additional costs and therefore inhibit growth and job creation.

The current wording of the Commentary does not specify any 'own' recommendation of the OECD. It is all left to 'best practice' of the Member Countries. Para. 6 of the Commentary mentions that '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'. This statement reflects the general practice executed by the Member Countries but does not provide a recommendation of the OECD itself. If at all, the statement indicates that the OECD shares the same view. OECD should provide here an 'own' clear statement that this practice should be maintained.

D. Subcontractor

With regard to the involvement of subcontractors the wording of the future commentary must make clear, under which circumstances the enterprise (general contractor) has the effective power to use a location where subcontractors perform work for the enterprise. Para. 10.1 distinguishes two cases. Firstly, where only parts of aspects of a contract are subcontracted and secondly, where all aspects of a contract are subcontracted.

In case only parts of aspects are subcontracted, whether a location is at the disposal of the enterprise (general contractor) will be determined on the basis of the general rule according to para. 4.2 of the commentary on Article 5.

In cases where the enterprise subcontracts all aspects of the contract to a subcontractor, para. 10.1 provides that the enterprise 'clearly has the effective power to use that site, e.g. because the enterprise owns or has legal possession of the location and controls access to and use of the location'.

Unfortunately the draft still doesn't elaborate on this statement.

E. Attribution of time spent by the subcontractor vs. activities

Furthermore, the wording of para. 48 of the discussion draft is not coherent with the wording of para. 19 of the commentary. Para. 19 deals with the attribution of time spent by the subcontractor to the general contractor, whereas para. 48 of the discussion draft states that the working party concluded that the implication of para. 19 was that the activities of the subcontractor were allocated to the main contractor.

Hence, it would be desirable, if this case could be cleared. From the wording of para. 19.1 in connection with para. 10.1 of the Commentary only the time spent by the subcontractor must be considered as time spent of the general contractor.



F. Subcontracting all aspects of a contract in the context of the AOA

The attribution of time spent is now extended to cases where all aspects of a contract are subcontracted. The commentary on Article 5 does not provide any comment or reference to the AOA. According to the AOA no profit could be attributed to a PE in the absence of the enterprise's personnel (significant people function).

It would be desirable, if a statement or reference could be included in the commentary how the AOA is treated in cases where all aspects of a contract are subcontracted.

G. Questions of doubt regarding agency permanent establishments (draft para. 106 et seqq. of the draft)

The nature of an agency permanent establishment as defined in Article 5 para. 5 of the Model Tax Convention hinges on the "authority" of the agent to execute contracts "in the name of the enterprise" in a contracting state with the additional condition that this authority is "habitually exercised". In this regard the proposed Commentary stipulates that the reference to "authority to conclude contracts on behalf of an enterprise" is by no means intended to restrict application exclusively to agents literally executing agreements that are binding upon the enterprise. Instead, Article 5 para. 5 of the Model Tax Convention is intended to apply equally to agents who enter into agreements that are binding upon an enterprise even if they are not actually signed in the name of that enterprise. There is some disagreement as to whether the opposite holds, i.e. whether commission agents who conclude contracts in their own name also fall under Article 5 para. 5 of the Model Tax Convention. The national courts have not yet shown a common stance in respect of the question as to whether possession of "authority" requires a valid (direct) legal relationship with a third party or whether an economic (indirect) commitment of a principal by its agent would suffice².

The draft makes reference to the peculiarities of civil or commercial law of various OECD member countries according to which an enterprise may under certain circumstances be bound by an agreement entered into with a third party by an agent not in the name of the enterprise, but in its own name and on behalf of the enterprise. This would also apply if the third party does not formally disclose the name of the enterprise (para. 32.1 of the Commentary).

Finally, it will in the future likely remain necessary to take into account the views of the contracting states for the purposes of construction of the term "authority" pursuant to Article 3 para. 2 of the Model Tax Convention with regard to consignment structures. In a number of national laws a commission agent can still not be assumed to have an agency permanent establishment. This point of view also reflects the judgment of the French Conseil d'État ("Zimmer" case) and the recent decision of Norway's highest court, the Norges Høyesterett, ("Dell Computers" case) to the effect that a consignment agent acting in his own name cannot be considered a dependent agent due to a lack of authority. Both rulings follow the same line of reasoning, i.e. the construction of the term agency permanent establishment does not depend on economic ramifications, but on the legal structure of the business relationships involved. As a result, an agency permanent establishment cannot exist in cases in which the consignment agent cannot bind the principal vis-à-vis customers.

²Judgment of the French Conseil d'État of March 31, 2010, "*Zimmer*" and the decision of the Norwegian Borgarting Lagmannsrett of March 2, 2011, "*Dell Computers*".



The current version of the Commentary does not make reference to such specifics of national commercial law. We would therefore appreciate seeing in the final version of the revised Commentary on Article 5 some form of qualifying remark in order to illustrate that such distinctions need to be taken into consideration in certain cases.

ICC appreciates the opportunity to present its views on the “Revised Proposals concerning the interpretation and Application of Article 5 (Permanent Establishment)”. We would be thankful for keeping in mind that any lack of certainty with regard to the existence or non-existence of a permanent establishment will be detrimental to business creating jobs and prosperity. We remain at your disposal for any further discussion.

Theo Keijzer
Chairman

Commission on Taxation

International Chamber of Commerce

