

PUBLIC COMMENTS RECEIVED ON THE DISCUSSION DRAFT ON THE ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS – PART I (GENERAL CONSIDERATIONS)¹

The Chartered Institute of Taxation

Comments on the Discussion Draft on the “Attribution of Profit to a Permanent Establishment Involved in Electronic Commerce Transactions”

1. This paper sets out the comments of the Chartered Institute of Taxation on the draft paper issued by the OECD’s Taxation Advisory Group on the taxation of business profits.

2. In this document the Taxation of Business Profits TAG faithfully applies the working hypothesis developed in the discussion draft produced by the Committee on Fiscal Affairs to a case study in which the PE consists only of a computer server with no human involvement and in so doing successfully establishes that it would be very rare for there to be any case for attributing more than an insignificant level of profit to such a PE (see e.g. paragraphs 105 and 140).

3. In demonstrating this, the TAG (intentionally or unintentionally) also shows the high degree of artificiality required in treating a computer server as a PE at all. Most double taxation agreements provide that: the term “permanent establishment” shall be deemed not to include:

the use of facilities solely for the purpose of storage, **display** or delivery of goods or merchandise belonging to the enterprise;

the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of **collecting information**, for the enterprise;

the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other **activity of a preparatory or auxiliary character**;

the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs *a*) to *e*), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character

(our emphasis).

4. The display of information relating to products on a web site clearly falls within “display”.

1. Please note that comments received on the “Discussion Draft on the Attribution of Profit to a Permanent Establishment Involved in Electronic Commerce Transactions” are *also* included in this document, as these comments may also be of interest when examining Part I of the Discussion Draft on the Attribution of Profit to a Permanent Establishment.

5. The taking of orders and the transmission of that information to the home base for decisions is, in our view, merely collecting information, even (or indeed especially) when done by a computer rather than by a person. Variation 1 assumes that a computer can bring an enterprise into contractual arrangements with a customer, in the same way as an agent can. This assumption is untested, as far as we are aware, and is highly contentious. We comment further on this point below.

6. Examples illustrating the artificiality required in treating a computer server as a PE can be found in paragraph 55 in the discussion of whether to attribute assumption of credit risk to the server; the possible attribution of inventory to the server in paragraph 63; the question as to whether a server could ever increase the value of marketing intangible provided by the head office (paragraph 80); the irrelevance of the question of transfer of hardware or the use of hardware as between head office and PE when the PE itself consists of the hardware and has no personnel to which any such transfer could even notionally be made (paragraph 89).

7. This comment applies not only to Variations 1, 2 and 3 of the case study (the human involvement in Variation 3 being there in only a supporting ancillary role) but also to all cases of servers functioning without human involvement. Even the use by one party (A) of a server provided by an independent internet service provider (B) would not generate the conditions for a PE as properly understood: the value added by B's server comes not from the server but from the expertise, research and development and other input provided by B. If B is based in a country other than that in which its server is based, there is no case for treating the server either as a PE of A's or of B's.

8. The argument in favour of not treating a server as a PE is reinforced by Variation 4 which is different from the others precisely because of the human involvement from the outset.

9. The bizarre result of the application of the OECD's working hypothesis so as to attribute PE status to a server alone is underlined by the extreme artificiality of applying a logical argument to a situation to which it cannot sensibly apply. In the concluding paragraphs (139 – 144) it is apparent to the reader that even the authors of the discussion paper had themselves begun to suspect this.

10. The paper does at least conclude that little value should be attributed to the automated functions of a server. However, the examples simply illustrate the traditional functional analysis without clarifying the particular problems associated with e-commerce and transfer pricing as identified at the Ottawa conference in 1998.

11. In the circumstances, we recommend that further debate on this matter should be deferred until the general rules about attribution of profits to PEs have reached a more advanced stage and the transfer pricing issues involved in e-commerce are addressed.