**PUBLIC COMMENTS RECEIVED ON THE DISCUSSION DRAFT ON THE ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS –
PART II (SPECIAL CONSIDERATIONS FOR APPLYING THE
WORKING HYPOTHESIS TO PERMANENT ESTABLISHMENTS OF BANKS)**

Canadian Bankers Association

Summary Account of Meeting between Canadian Bankers Association and the Department of Finance/Canadian Custom and Revenue Agency – June 21, 2001

Foreword

1. Officials of the Department of Finance and of the Canadian Custom and Revenue Agency met with representatives of the Canadian Bankers Association (CBA) in Toronto on June 21, 2001 to discuss the content of the *Discussion Draft on the Attribution of Profits to Permanent Establishment*, solicit the views of the CBA on the draft and invite the CBA or its members to make a written submission to the OECD.

2. Representatives of the CBA indicated at the meeting that the Association would not submit written comments to the OECD on the Discussion Draft but would be agreeable to having the Canadian delegation to Working Party No. 6 submit a summary account of the meeting, so that the views of the CBA can be recorded in writing with the OECD.

3. The remainder of this note sets out the **views of the CBA** on the Discussion Draft as expressed at the aforementioned meeting, devoid of any commentary or analysis on the part of the Canadian delegation.

Account of the Meeting – Position of the Canadian Bankers Association

General Comments

4. Financial institutions are complex organisations that are organised in various forms including branches and subsidiaries but operate as consolidated groups. Whatever rules are developed to attribute profits to permanent establishments (PEs) involved in a banking business, such rules need room to be adjusted to the particular facts on a reasonable basis within the spirit of the rules. Flexibility and reliance on the accounts of the banks are key.

5. It is important that all jurisdictions apply the rules in a similar fashion, so as to minimise the potential for double taxation.

6. There is a positive advantage in systems that are simple to administer and audit. This practical dimension should be reflected in all aspects of the guidance being developed to attribute profits to PEs.

7. As a general statement, the nature of the framework proposed in the OECD Discussion Draft (“the Draft”) and the departure that it represents from the current Commentary suggest that it could not be

implemented only by a change in the Commentary. The language of Article 7 of the Model Convention would need to be modified which, in turn, would require a renegotiation of existing treaties.

Functional Analysis and Asset Allocation

8. It is inappropriate to allocate assets among parts of a banking enterprise based on a functional analysis. Assets should not be attributed to a given location because functions related to the acquisition and/or management of the assets are performed in that location. The opposite approach should be followed. The starting point should be the location where the assets are booked. The profits attributable to the assets, including the risks assumed associated with the assets, should be attributable to the location where the asset was acquired (e.g., the PE). To the extent that expertise from another location (e.g., the head office) is drawn upon in the course of acquiring or managing the assets (and associated risks), then such functions should be remunerated under the arm's length principle. This is not to say that one cannot recognise that an asset (and the underlying risks) may actually be transferred from one part of the bank to another. In this case, the profits attributable to the assets would follow the assets. Finally, splitting assets for the purpose of attributing profits is a near-impossible task that should be avoided.

Credit Rating

9. The recognition that the PE should be regarded as having the same credit rating as the bank to which it belongs is appropriate and reflects reality, despite the fact that it may not be consistent with the separate entity approach under the Working Hypothesis.

Capital Allocation

10. Any capital allocation methodology has inherent problems in them. The BIS ratio proposed in the Draft is not a practical approach to allocate capital to the PE, in particular since banks allocate capital on the basis of consolidated groups (subsidiaries and branches). The allocation methods used by banks do not require allocating capital to a given asset in a given entity. Banks use the consolidation method for reporting to the regulatory authorities, and thus for the allocation of capital.

Interest Cost Adjustment

11. To the extent that there is a net shortfall or excess of liabilities on the branch's books after the allocation of capital is performed, the branch's interest costs should be adjusted by allocating a fully loaded wholesale cost of funds (for the functional currency of the PE, with a term to match the enterprise matching philosophy) to such excess or shortfall.

Transfer of Assets

12. Transfers of assets to and from the branch should be priced in accordance with the arm's length principle, that is, on the basis of the fair market value of similar assets at the time of the transfer. The products would be transferred at fair market value, which would include a profit factor.

Services

13. Costs, other than interest costs, associated with “dealings” between the PE and the rest of the enterprise, should be recognised on a “fully loaded” cost basis (that is, taking into account the direct costs as well as indirect costs, such as overhead), with no profit mark up. The current approach in the Commentary is preferable and more practicable than the approach proposed in the Draft in the context of a single entity. Most of the intra-company services are not services provided to third parties and finding comparables may be difficult. The “direct and indirect” approach of the current Commentary has the advantage of avoiding making a distinction between “service” and “stewardship” costs. Since there are very few services that the banks provide to external parties, all the services to internal branches should be charged at fully loaded cost.

Hedging

14. Banks utilise hedging to reduce risk. There would be normal internal hedging within the bank, as well as external hedging. The fair market value would be used on all hedging contracts, whether internal or external.