



Business and Industry Advisory Committee to the **OECD**

Comité Consultatif Economique et Industriel Auprès de l' **OCDE**

BIAC Comment to the OECD CFA WP1 on Article 5: PE Definition

Attachment: Proposed changes to Article 5

May 4, 2005

Dear Jeffrey:

BIAC expresses its appreciation for the opportunity to have participated in the consultation with members of Working Party 1 and the Secretariat on February 23, 2005, in Paris. At that meeting, BIAC delegates voiced the strong concerns felt by our membership over the impact of the 2003 amendments to the OECD Model Tax Convention Commentary, which addressed the matter of the definition of permanent establishment, as set forth in Article 5 of the OECD Model Tax Convention (the Model).

After reflecting further on the various issues discussed during the consultation, we decided to prepare this letter to you to suggest certain specific changes to the Commentary on Article 5 in order to provide that portion of the Commentary with greater clarity, less ambiguity and greater consistency with the Model's fundamental goal of establishing reasonable and practical treaty standards for the taxation of business profits of a non-resident enterprise. It should be stressed that, although the thrust of this letter is relatively narrow, focusing only on certain key aspects of the PE definition, BIAC has a keen interest in all PE issues under consideration by OECD, as evidenced by our heavy involvement in the ongoing "attribution" project.

BIAC remains greatly concerned that certain of the recent modifications to the Model Commentary, either separately or in concert, will lead to conflicting claims over the taxation of business profits that should be taxed by the source country in the hands of a non-resident enterprise. These conflicting, and possibly competing, claims are likely to lead to double taxation. In particular, we view the 2003 update to the Commentary as unnecessarily, and perhaps unintentionally, expanding the scope of what may be deemed to constitute a permanent establishment. Reducing the OECD Model Convention permanent establishment

threshold, whatever the motivation, will harm the flow of trade and investment among OECD countries, as well as, undoubtedly, between OECD member and non member states.

Accordingly, we would propose revisions to the specific language in paragraphs 4 through 4.5 and 6 through 6.1 of the Commentary to Article 5 to remove the uncertainty that the 2003 update creates and to confirm for taxpayers and tax administrators alike that the traditionally accepted definition of permanent establishment is still controlling. These suggested revisions address our strong concerns about the 2003 update, and they are based on our long-standing view that Article 5 should set forth standards that will limit taxation of business profits of a non-resident enterprise to those situations in which the non-resident enterprise has established a clear and sufficient connection to the source jurisdiction to justify the imposition of income tax.

Proposed Revision to Paragraphs 4 through 4.5

In order for a place of business to be “used for carrying on the business of the enterprise,” the enterprise must be able to carry on its business at that place. The Commentary notes: “A place of business may also exist where no premises are available or required for the carrying on of the business of the enterprise and it simply has a certain amount of space at its disposal.”

To eliminate the ambiguity about when space is “at the disposal” of an enterprise, we propose the following changes to Paragraphs 4 through 4.6.

In the first sentence of Paragraph 4, we propose inserting the word “habitually” between “premises facilities or installations” and “used for carrying on the business of the enterprise.”

In Paragraph 4.2 we propose inserting the following sentence immediately after the first sentence of Paragraph 4.2:

“Rather, the enterprise must:

- Have a physical presence in the country;
- Have the ability to make use of the premises to conduct its business to the extent, at a time and for the duration that it chooses to carry on its business at that location, provided that such usage is consistent with the enterprise’s business.”

Consistent with our suggested change to paragraph 4.2, we would revise paragraph 4.3 by inserting the following sentence immediately after the first sentence:

“The employee has the right to unlimited and exclusive use of the office for the duration of the period of his or her assignment to the location.”

We urge you to eliminate paragraph 4.5. This example seems to us both misleading and inconsistent with the Commentary of which it is, supposedly, illustrative. The painter does not have premises or space “at his disposal.” Rather, he is allowed to be present on the premises of another person in order to carry out one particular aspect of his enterprise’s business. It appears to us that the degree of access afforded the painter (a pass to the building, evening access, etc.) has no bearing on whether this place should rise to the level of constituting a permanent establishment. Nor is it evident why, for such an enterprise, the “space” within which the enterprise is permitted to carry out one specific aspect is particularly relevant (compare an inside and an outside painter).

As a general matter, although we favour addressing difficult cases, the particular example of the painter does not advance the reader’s understanding of when such an activity should be considered to pass the threshold for attracting local taxation.

We would, therefore, suggest substituting the following example, which is both much more common and more illustrative: “A fourth example is that of an auditor, an employee of a non-resident accounting firm, who visits at the office of a client of his/her firm, on an ad-hoc basis (sometimes several weeks at a time), in connection of the annual audit of the client over a period of 12 months. The auditor is given an office that he/she will primarily use to perform the business of the employer with respect to this particular client. In that case, the presence of the auditor will not constitute a permanent establishment, because the accounting enterprise does not have the ability to make use of the client’s premises to conduct its business at that location to the extent that it chooses to carry on its business at that location.”

Please see previously submitted Comments of the Business and Industry Advisory Committee to the OECD with respect to the OECD Model Tax Convention as Revised by the 2002 Update, September 15, 2003, at p.4.

Proposed Revisions to Paragraphs 6 and 6.1

We note that the first sentences in paragraph 6, the fourth sentence in paragraph 6 (without the parenthetical), and the first sentence in paragraph 6.1 are the only sentences in those paragraphs that actually describe the degree of permanency that we associate with the concept of permanent establishment. We, therefore, propose deleting the second and third sentence in paragraph 6, the parenthetical in the fourth sentence of paragraph 6, the portion of paragraph 6 that follows the fourth sentence, and the second sentence in paragraph 6.1. In addition, we propose deleting the word “normally” from the third sentence.

BIAC strongly supports the idea that a mere six months of intended or actual business operations in a jurisdiction should **not** be sufficient to cause a business enterprise to be deemed to have a permanent establishment in such jurisdiction. We believe that the Article and related Commentary should continue to function solely on a facts and circumstances basis for business operations in excess of six months.

BIAC also believes that a tax authority should not be able to amalgamate business operations each of which is conducted for “only very short periods of time” into operations deemed to have a degree of permanency. Permanency by its nature requires ongoing, continuous, not temporary, operations. For example, recurrent, temporary operations, such as those of the auditor in the proposed example set forth on page 4, should not result in a finding of permanency. Accordingly, we strongly disagree with the conclusion in the second sentence of paragraph 6.1.

Finally, BIAC believes that aspects of an enterprise’s business, other than its intended and actual business activities within a jurisdiction, should not affect the determination of whether the enterprise’s operations in such jurisdiction constitute a permanent establishment. An enterprise’s business operations, if any, carried on outside of a jurisdiction, should not determine whether the enterprise has a permanent establishment within such jurisdiction.

Future BIAC Submissions on PE

In our effort to have this paper reach WP1 while the consultation of 23 February 2005 is still somewhat fresh, BIAC has decided to submit further comments at a later date on two other matters discussed during the session. One such topic relates to cross border service

providers, particularly in the information technology industry. The Commentary on Article 5, to which we suggest language amendments in the preceding section of this letter, can severely impact taxpayers in this industry. We intend to submit a paper as soon as feasible with an appropriate illustrative case and a discussion of the proper interrelationship between Articles 5 and 9 (which, incidentally, requires a thorough discussion here as well as in the area of attribution of profits to a PE).

We also briefly touched upon, during the consultation, the topic of dependent agent. This is a subject of grave concern to our membership, as the principle is being overused to create PEs under various scenarios, particularly some of those scenarios discussed at the OECD January 2005 restructuring roundtable. We would like to develop, in conjunction with OECD, appropriate language for the Commentary on Article 5, Paragraph 5, which will limit the application of the dependent agency approach to the situations when it truly is intended to apply.

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We trust that the foregoing language suggestions will be seriously considered as possible revisions to the Model Commentary, and we will endeavour to provide our additional submissions as soon as possible. Again, as always, we thank you for the opportunity to have a frank and candid exchange of views.

Yours very truly,

A handwritten signature in black ink, appearing to read 'Richard M. Hammer', written in a cursive style.

Richard M. Hammer
Chair, BIAC Committee on Taxation and Fiscal Affairs

Mr. Jeffrey Owens
Director
OECD Centre for Tax Policy and Administration