

12 April 2004

PROPOSED CLARIFICATION OF THE PERMANENT ESTABLISHMENT DEFINITION

PUBLIC DISCUSSION DRAFT

Working Party No. 1 on Tax Conventions and Related Questions¹ has been invited, by its delegates and representatives of the business community, to expressly include in the Commentary to the OECD Model Tax Convention some widely-accepted interpretations related to the permanent establishment concept. The proposals included in this draft are therefore intended to clarify some basic aspects of that concept.

The Working Party wishes to stress that, although it has had substantial discussions on the proposals below, these proposals have not been approved and might be amended to be consistent with other work on issues related to Article 5 and the work of Working Party No. 6 on attribution of profits when these are completed.

Comments on the proposals below should be sent **before 30 June 2004** to:

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¹ That working party is the sub-group of the OECD Committee on Fiscal Affairs which is responsible for updating the OECD Model Tax Convention.

PROPOSED CLARIFICATION OF THE PERMANENT ESTABLISHMENTS DEFINITION

Public discussion draft

1. Working Party No. 1 on Tax Conventions and Related Questions has been invited, by its delegates and representatives of the business community, to expressly include in the Commentary to the OECD Model Tax Convention some widely-accepted interpretations related to the permanent establishment concept. The proposals below are therefore intended to clarify some basic aspects of that concept.

The permanent establishment definition is applicable to one specific enterprise

2. The Working Party wishes to clarify that when applying the permanent establishment definition, one must look at a specific enterprise and not at a group of entities as a whole. It therefore suggests the following change:

*Replace paragraphs 41 and 42 of the Commentary on Article 5 by the following (changes to the existing Commentary appear in **bold italics** for additions and ~~strikethrough~~ for deletions)*

“41. A parent company may, however, be found, under the rules of paragraphs 1 or 5 of the Article, to have a permanent establishment in a State where a subsidiary has a place of business. Thus, any space or premises belonging to the subsidiary that is at the disposal of the parent company (see paragraphs 4, 5 and 6 above) and that constitutes a fixed place of business through which the parent carries on its own business will constitute a permanent establishment of the parent under paragraph 1, subject to paragraph 3 and 4 of the Article (see for instance, the example in paragraph 4.3 above). Also, under paragraph 5, a parent will be deemed to have a permanent establishment in a State in respect of any activities that its subsidiary undertakes for it if the subsidiary has, and habitually exercises, in that State an authority to conclude contracts in the name of the parent (see paragraphs 32, 33 and 34 above), unless these activities are limited to those referred to in paragraph 4 of the Article or unless the subsidiary acts in the ordinary course of its business as an independent agent to which paragraph 6 of the Article applies. However, a subsidiary company will constitute a permanent establishment for its parent company under the same conditions stipulated in paragraph 5 as are valid for any other unrelated company, i.e. if it cannot be regarded as an independent agent in the meaning of paragraph 6, and if it has and habitually exercises an authority to conclude contracts in the name of the parent company. And the effects would be the same as for any other unrelated company to which paragraph 5 applies.

~~41.1 42. The same rules should apply to activities which one subsidiary carries on for any other subsidiary of the same company. ***The same principles apply to any company forming part of a multinational group so that such a company may be found to have a permanent establishment in a State where it has at its disposal (see paragraphs 4, 5 and 6 above) and uses premises belonging to another company of the group, or if the latter company acts on its behalf (see paragraphs 32, 33 and 34 above) so that a permanent establishment is deemed to***~~

exist under paragraph 5 of the Article. The determination of the existence of a permanent establishment under the rules of paragraphs 1 or 5 of the Article must, however, be done separately for each company of the group. Thus, the existence in one State of a permanent establishment of one company of the group will not have any relevance as to whether another company of the group has itself a permanent establishment in that State.”

Management services provided to another company of the group

3. The Working Party wishes to clarify the distinction between situations where a foreign enterprise carries on its business through a fixed place of business located in the premises of an associated enterprise and the frequent situation where an associated enterprise provide services (e.g. management services) to the foreign enterprise. It therefore suggests the following change:

Add the following new paragraph 42 immediately after paragraph 41.1 (see above change) of the Commentary on Article 5

“42. Whilst premises belonging to a company that is a member of a multinational group can be put at the disposal of another company of the group and may, subject to the other conditions of Article 5, constitute a permanent establishment of that other company if the business of that other company is carried on through that place, it is important to distinguish that case from the frequent situation where a company that is a member of a multinational group provides services (e.g. management services) to another company of the group as part of its own business carried on in premises that are not those of that other company and using its own personnel. In that case, the place where those services are provided is not at the disposal of the latter company and it is not the business of that company that is carried on through that place. That place cannot, therefore, be considered to be a permanent establishment of the company to which the services are provided.”

Participation in the negotiation of contracts

4. The Working Party wishes to clarify that the fact that a person merely participates in meetings for the negotiation of contracts is not enough, in itself, to conclude that the person has exercised an authority to conclude contracts in the name of a foreign enterprise. It therefore suggests the following change:

*Replace paragraph 33 of the Commentary on Article 5 by the following (the part added to the existing paragraph appears in **bold italics**)*

“33. The authority to conclude contracts must cover contracts relating to operations which constitute the business proper of the enterprise. It would be irrelevant, for instance, if the person had authority to engage employees for the enterprise to assist that person's activity for the enterprise or if the person were authorised to conclude, in the name of the enterprise, similar contracts relating to internal operations only. Moreover the authority has to be habitually exercised in the other State; whether or not this is the case should be determined on the basis of the commercial realities of the situation. A person who is authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority "in that State", even if the contract is signed by another person in the State in which the enterprise is situated **or if the agent has not formally been given a power of representation. The mere fact, however, that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has exercised in that State an authority to conclude contracts in the name of the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise.** Since, by virtue of paragraph 4, the

maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either.”