



***In Response***

**COMMENTS OF THE  
BUSINESS AND INDUSTRY ADVISORY COMMITTEE (BIAC) TO THE OECD  
WITH RESPECT TO THE OECD MODEL TAX CONVENTION AS REVISED BY  
THE 2002 UPDATE**

**September 15, 2003**

BIAC supports the OECD's Committee on Fiscal Affairs (CFA) in its efforts to revise the language of the Model Tax Convention (the Model) and the associated Commentary (the Commentary) to reflect both the evolution in the structuring of bilateral tax treaties as well as the dramatic changes to business practices and business models.

BIAC believes that the Model and the Commentary greatly enhance cross-border commerce and investment by providing guidance for the negotiation, implementation and subsequent interpretation of bilateral tax treaties. Such guidance is important in light of the new realities inherent in the global marketplace that has been created as the world has evolved toward a true global economy.

BIAC regards the work of the OECD, as well as BIAC's role in supplying input to the OECD as a continuing, and important, process and dialogue. In September, 2002, our affiliated organization in the USA - the US Council for International Business (USCIB) - submitted comments to the OECD on proposed changes to the Commentary, which had been prepared by Working Party No. 1 and which had been posted to the OECD Web site. A response to these comments was received from the CFA, and some of the suggestions contained therein were, in fact, adopted in the final text of the revised Commentary, which is most welcome.

BIAC has continued to analyze the 2002 revisions to the Commentary, in order to assess their impact on global business operations. We are of the opinion that the revised Commentary contributes to a better understanding and interpretation of the Model, but we find some of the new language particularly troublesome.

Based upon our study of the 2002 update together with continued observation and experience, a consensus has emerged among BIAC members that additional comments should be submitted on the revised Commentary. We trust that our comments will be taken into consideration by Working Party No. 1, as it engages in further work on the Model and the Commentary. This paper contains such further comments.

## **NEW COMMENTARY ON ARTICLE 1**

We believe that electronic commerce should not be included, under new Paragraph 21.3 of the Commentary, in the same category of activity as banking, insurance, shipping and finance. Paragraph 21.3, citing the fact that such activities do not require a substantial local presence, suggests that jurisdictions may want to deny treaty benefits to income arising from such activities if a treaty state (i) preferentially taxes that income, and (ii) regards information with respect to such activities as confidential. We are not aware of any states affording any such preferential tax regime to business activities merely because they are transacted electronically. Moreover, banking, insurance, shipping and financial activities generally generate an investment-type of return. Income generated by an e-commerce business is not generally of this sort. Accordingly, despite the fact that this paragraph purports only to provide examples of the type of activities that are susceptible to treaty shopping abuses, it most certainly conveys a negative connotation of electronic commerce which, we believe, is inappropriate given that enterprises which have adopted e-commerce business models normally earn their income through active business operations in the same way as other enterprises and that in the majority of cases, e-commerce is merely an extension of a pre-existing business.

Thus, we would recommend that the paragraph's reference to e-commerce activities be deleted entirely.

## **NEW PARAGRAPHS 4.1 – 4.6 IN COMMENTARY ON ARTICLE 5**

New paragraphs 4.1 through 4.6 of the Commentary on Article 5 (Permanent Establishment) are designed to provide further guidance on the question of what it means for an enterprise to have a permanent establishment by virtue of having space “at its disposal” (“disposal”) through which it conducts business activities.

The deployment of technical and consulting teams to work temporarily at the premises of customers, clients or affiliated enterprises located in foreign countries is a common situation for many companies operating internationally today. Considerable internal and professional time is spent attempting to resolve the issue of whether or not such deployments will create a permanent establishment. The ramifications of having a permanent establishment are significant and burdensome, including income tax liability, VAT requirements, loss of the exemption for individual compensation under Article 15 and the attendant filing and compliance costs. The Model and the Commentary must address this common fact pattern if the Model hopes to provide useful and relevant guidance to today’s multinational enterprises. We believe that the text and examples in the revised Commentary create increased ambiguity and lack of clarity.

The long-standing text of the Commentary has set forth the principle that a “place of business” requires that space be at the “disposal” of the enterprise. According to paragraph 4, which was unchanged by the 2002 revisions, in the case of premises belonging to another person, a place of business may be found “where the foreign enterprise has at its constant disposal certain premises or a part thereof owned by the other enterprise.” The revised

Commentary elaborates on this point by stating that “no formal legal right to use” the place is required, but states in paragraph 4.2: “Whilst no formal legal right to use a particular place is required for that place to constitute a permanent establishment, the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise.”

The revised Commentary does not define the term “disposal” but sets forth four examples to illustrate when the place of business of another person is, or is not, to be considered at the “disposal” of the enterprise.

Paragraph 4.2 concludes that a salesman’s visits to a customer’s premises, even on a regular basis to take orders and meet the purchasing director, do not cause those premises to be “at the disposal” of the salesman’s employer/enterprise. This is a sensible result; however, the example would be more useful if the reasons for not finding “disposal” were elaborated.

Paragraph 4.3 addresses the case of “an employee of a company who, for a long period of time, is allowed to use an office in the headquarters of another company (e.g., a newly acquired subsidiary) in order to ensure that the latter company complies with its obligations under contracts concluded with the former company.” The example concludes that the premises are at the disposal of the first company. (As the example notes, whether or not there is a permanent establishment will depend also on the duration and nature of the activities (e.g., the conduct of preparatory or auxiliary activities should not rise to the level of permanent establishment.)) There is no discussion of the reasons why being at another company’s premises “for a long time” to review contract compliance (example 1) amounts to “disposal” but being in the purchasing director’s office “regularly” to meet and/or take orders (example 2) does not entail “disposal.” We fail to see why there is disposal in one case but not the other, particularly since the Commentary makes it clear that length of time and nature of the activities (separate criteria to be considered in evaluating whether or not there is a permanent establishment) are not determinative of the question of “disposal.”<sup>1</sup>

The third example (paragraph 4.4) concludes that a trucking company using a delivery dock at a customer’s warehouse every day for a number of years for the purpose of delivering goods ordered by the customer does not have at its disposal the premises of the customer. The fourth example (paragraph 4.5) concludes that a painter who spends three days a week for two years painting in the office building of his main client has a permanent establishment. The example fails entirely to mention that the premises are “at the disposal” of the painter or the reasons therefor, which is a surprising omission since the stated purpose of the examples in paragraphs 4.2-4.5 was to illustrate disposal.

It is unclear, and potentially confusing, as to why there is “disposal” in example 4 but not in example 3. In each case, physical presence on the premises of the customer is essential to accomplishing the task at hand. In each case, the time factor is lengthy. Is it because the

---

<sup>1</sup> We also think it ill-advised for the Commentary to use as an example a situation where a permanent establishment may exist without the likelihood that profits will be attributable thereto. We are concerned that the presence of such an example will encourage certain tax authorities to seek to attribute profits to such a permanent establishment should it exist.

painting is done entirely on the premises whereas the transport activity only ends at the dock? Is there something about the nature of painting the walls of another person that is inherently indicative of “disposal?” On the contrary, we would argue that performing a painting contract, for example, in a secure military base under military supervision would not put the base at the enterprise’s “disposal”.

The most important deficiency of the revised Commentary is the lack of guidance as to what factors constitute “disposal”. Purely conclusory examples do not establish generally applicable guidance on the elements of “disposal.” There is no discussion in the Commentary of what is meant by the term. No facts are given in the examples that highlight the distinctions. “Disposal” is the crucial threshold question when one or more representatives of an enterprise work at the location of another enterprise. A serious effort should be made to define the term.

A traditional interpretation of the English word “disposal” in this context would appropriately conclude that the visitor has a certain degree of commercial autonomy and flexibility in its operations at the premises of the other party.

The notion of disposal will be a question of fact. The following factors would appear to us to be relevant:

1. whether or not the visitor is allowed to carry on unrelated activities on the host enterprise’s premises, or is only permitted to use the premises for purposes of carrying on the activities specified by the host enterprise;
2. whether or not the presence of the visitor at the host enterprise is publicly acknowledged, for example, by posting the person’s name, or the enterprise’s name, on the door, by providing a dedicated telephone or fax line, business cards, etc;
3. whether the host company has space within its premises used as a “visitor’s office” to accommodate the occasional visits of such persons as affiliated company personnel, vendors and consultants;
4. whether the visitor is allowed to use a single office throughout his visit or is moved from place to place to accommodate the needs of his host;
5. whether the visitor is present continuously, or comes and goes;
6. whether other persons are allowed to use the particular space;
7. whether the visitor’s enterprise sends a variety of different personnel at different times to carry out the activity; and
8. whether the visitor is permitted to access the host enterprise’s premises outside of ordinary business hours.

If, for some reason, the CFA continues to be unable to formulate generally applicable criteria for determining whether or not premises are at the disposal of another person, we fear that the disposal examples may be misapplied to find a permanent establishment in cases where certain of the Model’s exceptions would apply. Therefore, we urge that the Commentary make specific mention of the potential applicability of the “preparatory or auxiliary” exception of Article 5 (4) (e) in situations where personnel of one enterprise are allowed to use the premises of another enterprise. In such cases, the use does not create a permanent establishment if the use is for the purpose of carrying on an activity of a preparatory or

auxiliary character. This would include, for example, the presence of visitors for the purpose of collecting information for their enterprise, receiving training, or conducting stewardship activities. It could also apply to the presence of an enterprise's personnel on the premises of another enterprise to carry out the delivery of goods to the host enterprise.

The "delivery dock" example in new paragraph 4.4 is one such example, but we are concerned that it could be read to imply an inappropriately narrow interpretation of the Article 5(4) exception relating to the use of facilities for the purpose of delivering goods. This exception of course also applies where the personnel of the delivering enterprise in fact have the customer's premises at their disposal and spend time on the premises carrying out activities that are incidental to the delivery, which could include installation, testing, training for the receiving enterprise's personnel, etc.

Finally, we note that new paragraph 4.6 specifies that a road paving enterprise carries on business "through" the location where the road paving takes place. Similarly, we believe the Commentary should point out that this activity will nevertheless not create a permanent establishment unless it continues for the 12-month period required by Article 5(3). We consider a continuous 12-month minimum period to be necessary before making PE determinations.

## **CHANGES TO PARAGRAPH 6 IN COMMENTARY ON ARTICLE 5**

We are concerned that the revisions to paragraph 6 of the Commentary on Article 5 have effected a potentially significant change to the permanent establishment concept. We are greatly troubled by the statement, "A place of business may, however, constitute a permanent establishment even though it exists, in practice, only for a very short period of time because the nature of the business is such that it will only be carried on for that short period of time."

Some have claimed that this does not represent a significant change from the prior version of the Commentary. Although the Commentary previously recognised that a place of business can constitute a permanent establishment even though it exists in practice for only a short period of time, that reference occurred in an entirely different context. In both the 2000 and 2002 versions, the basic rule is stated in the first sentence of paragraph 6, as follows: "Since the place of business must be fixed, it also follows that a permanent establishment can be deemed to exist only if the place of business has a certain degree of permanency, i.e. if it is not of a purely temporary nature." In the 2000 version, the principal effect of the second and third sentences was to illustrate the importance of determining whether the enterprise's initial intent was to establish either a temporary (implying no PE) or a permanent (implying a PE) place of business, and to describe the consequences when subsequent acts contradicted that initial intent.

Accordingly, the second sentence (which contained the six-month reference) began with an important qualification, as follows: "*If the place of business was not set up merely for a temporary purpose*, it can constitute a permanent establishment, even though it existed, in practice, only for a very short period of time because of the special nature of the activity of

the enterprise or because, as a consequence of special circumstances (e.g. death of the taxpayer, investment failure), it was prematurely liquidated.” Similarly, the third sentence referred to cases where the initial intent indeed was to establish a place of business only for a temporary period, but the business eventually continued for such a long period of time that the original “temporary” intention was overcome. Accordingly, the proper interpretation of the second sentence in the 2000 version is that “very short periods of time” can result in a PE only when the enterprise, in fact, intended to operate in the jurisdiction permanently, but either unanticipated circumstances intervened or other (undefined) “special nature” conditions exist.

That structure to paragraph 6 has disappeared in the 2002 update, and with it the parameters that limited the application of the reference to “a very short period of time.” The current Commentary’s statement, without any limitation, that a place of business that exists for “a very short period of time” could constitute a permanent establishment “because the nature of the business is such that it will only be carried on for that short period of time” suggests that there is no real requirement of permanency which is on its face in contradiction to the first sentence of paragraph 6. There is no prescriptive content to the reference to the “nature of the business” here. Any activity of whatever sort which in fact is carried out for only a short period of time is of a nature that can be discharged during a “short period of time.” Accordingly, the new text could encompass too many business activities.

The concept of a permanent establishment or fixed place of business has always been interpreted as requiring some degree of permanence and longevity, whether through recurring activities or continuous activities. A place of business that is not fixed and exists only for a “very short period of time” is almost by definition “of a purely temporary nature,” and, therefore, should never constitute a permanent establishment. The revised language becomes meaningless and creates confusion by indicating that a facility can be both “not of a temporary nature” and in existence for “a very short period of time.”

We are concerned that, with an open-ended requirement like “nature of the business” being the sole limitation, tax collectors could determine that permanent establishments exist in connection with any operation that is short-lived. For example, almost all consulting services could be seen as being inherently short-lived. It is the very nature of consulting services that they are only performed for a short period of time without a fixed place of business. However, short-term services are a paradigmatic situation where a permanent establishment should not be deemed to arise. We, therefore, urge revisions to the Commentary to make it clear that a place of business that exists for “a very short period of time” can constitute a permanent establishment only when both the place of business was not set up merely for a temporary purpose and the special nature of the business is such that either no other jurisdiction has closer ties to the business activities or the business is prematurely liquidated.

The reference in the revised Commentary to “a very short period of time” also suggests that there is no minimum period, whether continuous or recurring, during which a multinational enterprise must make use of an office or other fixed place of business in order for it to constitute a permanent establishment. Although the revised Commentary does suggest that a period of business activity of at least six months is “normally” necessary to create a permanent establishment, the Commentary does not advocate six months or any other period

of time as a standard. The Commentary reads: “Whilst the practices followed by Member countries have not been consistent in so far as time requirements are concerned, experience has shown that permanent establishments normally have not been considered to exist in situations where a business has been carried on in a country through a place of business that was maintained for less than six months.” It is not clear to us that the revised Commentary’s reference to a period of six months, insofar as it is anecdotal rather than prescriptive, will be at all helpful in resolving uncertainties. Different tax authorities are likely to derive differing implications from this reference.

If a formal minimum time test were considered for inclusion in Article 5 of the Model to apply to certain types of services businesses, such as consulting, systems integration, training and the like, BIAC would urge that a twelve-month threshold, rather than a six-month threshold, be adopted as a more appropriate period of time during which the business in question must be conducted. The Model already provides that a building site or construction or installation project must be in existence for more than twelve months to constitute a permanent establishment. We believe that various other services projects should be treated in the same way. As a general matter, it is not clear why, having adopted the one-year rule for construction and installation, which are clearly not permanent, the Commentary suggests allowing shorter periods for other businesses.

#### **REVISION TO PARAGRAPH 32.1 AND NEW PARAGRAPH 33.1 IN COMMENTARY ON ARTICLE 5**

The modification to paragraph 32.1 in the 2002 update suggests that a person (i.e., a local host country enterprise) might be considered to be an agent possessing a grant of authority to conclude contracts under paragraph 5 of Article 5 if an enterprise (a foreign enterprise) is not actively involved in the transaction or the foreign enterprise routinely approves transactions that the local person pursues for the foreign enterprise. More specifically, the proposed modification adds a sentence that expressly states that the lack of active involvement by a foreign enterprise in transactions involving its goods or services may be indicative of a grant of authority to an agent. It further clarifies this point by way of an example which states that an agent may be considered to possess actual authority to conclude contracts where such agent solicits and receives orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transaction.

We believe strongly that this language extends the dependent agency concept beyond what is contemplated by the plain language in the Model. In this connection, paragraph 5 of Article 5 applies to deem a permanent establishment to exist only where a person has, and habitually exercises, an authority to conclude contracts. The new language suggests that a person may be considered for purposes of the treaty to possess an authority to conclude contracts even where no such authority may actually exist under the terms of the contract between the foreign enterprise and the person operating locally. . The terms of the contract under the relevant applicable law as applied to the factual situation under consideration, should be the sole deciding factor as to what authority is vested in the local person. For instance, if the local person does not have the legal authority to conclude contracts, then the person should not be said to exercise such an authority regardless of how inactive the foreign enterprise may be.

For example, in many cases a dependent agent may solicit sales which will be consummated according to standard terms and conditions which have been carefully drafted by the foreign enterprise. The foreign enterprise, in fact, may insist that the dependent agent not allow deviations from the standard terms and conditions. In these cases, sales generally are effected without significant involvement by the enterprise at the time of sale, but the absence of such involvement at the time of sale in no way indicates that the dependent agent, rather than the foreign enterprise, holds the authority to conclude contracts. Similar issues arise when orders are placed through automatic order entry systems. Again, there is no active involvement at the time of sale by the foreign enterprise, but it was the foreign enterprise, not the dependent agent, that established the terms of trade by determining under what conditions the foreign enterprise was willing to provide goods or services.

Accordingly, we believe it is inappropriate to include this language in the Commentary since the agency status of the local enterprise should be dependent on the specific fact pattern, contractual arrangements and applicable law. In addition, not only should the “lack of active involvement” concept be eliminated, but the language of the Commentary should be amended to clarify that attendance at, or participation in, contract negotiations by the local representatives will not per se indicate the existence of an authority to conclude contracts binding the (foreign) enterprise.

New paragraph 33.1 makes it clear that for an agent to be considered to “habitually” conclude contracts, the presence of the foreign enterprise in the host state must be more than merely transitory. This conclusion is appropriate and helpful. The new paragraph, however, does not stop there. It goes on to state that in determining whether a person is “habitually exercising” contracting authority will depend on the nature of the contract and the business of the principal. It further suggests that in making this determination, the “same sorts” of factors considered in paragraph 6 would be relevant.

It is not clear what “sorts” of factors in paragraph 6 are specifically being referenced in paragraph 33.1. This needs clarification. A major cause of concern for us is the statement, in new paragraph 6, that a place of business may constitute a permanent establishment even though it exists in practice for a very short period of time if the nature of the business is such that it will only be carried on for that short period of time. If this language is intended to constitute one of the “sorts” of factors considered in paragraph 6 for defining “habitually”, then it raises the concern that this language could be viewed to mean that, in certain instances, concluding a single contract would be sufficient to create a permanent establishment. For example, if the nature of the business only requires the execution of a single contract that may be of a long term nature, is this language intended to mean that the execution of that contract in the host contracting state is sufficient to create a host country permanent establishment. It would be presumed that the response to the question would be negative since the authority is clearly not being “habitually” exercised in the host contracting state. With this new language in the Commentary, however, such a conclusion would no longer be so clear.

## REVISIONS TO THE COMMENTARY ON ARTICLE 5 TO ELIMINATE POTENTIAL CONFUSION

We also suggest that certain recent events indicate that the existing guidance in the Commentary on Article 5 is subject to erroneous interpretations. We are concerned this situation could lead to further confusion and conflicts in applying article 5 and that revisions to the Commentary to eliminate such conflicts and confusion would be helpful.

1. We urge that paragraph 4 of the Commentary be revised to clarify the following:
  - a. A place of business of an enterprise in a particular jurisdiction is a place of business there only if that enterprise uses it to conduct its business. A place at which a juridical entity other than the enterprise (including a juridical entity under common control with the enterprise) renders services, including management services, to an enterprise does not constitute a place of business of the enterprise.
  - b. The activities that are performed at a place within a jurisdiction by juridical entities that are **not** the enterprise but are under common control with the enterprise are not relevant to a determination of whether the enterprise has a place of business in the jurisdiction. Only the activities that the enterprise itself performs are determinative of whether the enterprise has a place of business in the jurisdiction.
  - c. The existence in a jurisdiction of a juridical entity that controls, is controlled by, or is under common control with an enterprise does not in and of itself create a place of business for that enterprise in that jurisdiction, even if the juridical entity and the enterprise are managed to act in concert or pursue a common strategy.

In addition, we suggest that revising paragraph 32 by adding language to clarify that a dependent agent's just rendering services, including oversight, in a jurisdiction to an enterprise that does not otherwise have a fixed place of business in that jurisdiction does not in and of itself create a permanent establishment for that enterprise. A dependent agent must be acting in the name of the enterprise and habitually exercising the authority to conclude contracts in the name of the enterprise to attribute a permanent establishment in a jurisdiction to an enterprise that does not otherwise have a fixed place of business in that jurisdiction. A dependent agent that assists in the negotiation of contracts but lacks the authority to conclude the contract does not cause the principal to have a permanent establishment, even if the dependent agent and the principal are under common control.

2. We urge that the Commentary on Paragraph 4 of Treaty Article 5 (specifically paragraph 27 thereof) be revised to clarify that the activities that an enterprise performs within a jurisdiction can be of a preparatory or auxiliary character even if the nature of the activities that other members of the affiliated group that controls, is controlled by, or is under common control with that enterprise perform are not of a preparatory or auxiliary character. The

activities that are performed by juridical entities that are **not** the enterprise but are under common control with the enterprise are not relevant to a determination of whether the activities of the enterprise are of a preparatory or auxiliary character.

\*\*\*\*\*

BIAC submits these comments in the interests of ensuring that the Commentary and Model will continue to provide effective and clear guidance in the formulation and application of income tax treaties with respect to common international transactions in today's environment of global business. We are fearful that the many ambiguities and apparent contradictions in the recent revisions will ultimately undermine the credibility of the Committee's work, and that is a result we would not welcome.