



In Response

BIAC COMMENTS TO WORKING PARTY 1 PAPER
ON THE DEFINITION OF A "PERMANENT ESTABLISHMENT" AND
ITS APPLICATION IN THE CONTEXT OF ELECTRONIC COMMERCE

January 13, 2000

Mr. Joseph Guttentag
Chairmen
OECD Committee on Fiscal Affairs
U.S. Department of Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C.

Dear Mr. Guttentag:

**THE APPLICATION OF THE PERMANENT ESTABLISHMENT
DEFINITION IN THE CONTEXT OF ELECTRONIC COMMERCE**

We refer to the draft paper on the above topic issued by Working Party No.1 on Tax Conventions and Related Questions, the subgroup of the CFA responsible for updating the OECD Model Tax Convention. This draft, which we believe was prepared by the Secretariat of the Fiscal Division, was distributed at the initial meeting of the Business Profits TAG in the last week of September, 1999. The document represents a comment document, with December 31, 1999 as the cutoff date for comments to be submitted. In essence, the draft document proposes language for insertion in the commentary on Article 5 of the Model to reflect how the permanent establishment doctrine would operate in the context of electronic business

BIAC wishes to take this opportunity to convey to you, as the Chair of the CFA, our concern with regard to certain procedural matters as well as to provide you with an overview of our thoughts on the draft.

To be frank, we were quite disappointed with the fact that the subject draft document had been prepared in advance and was distributed to the members of the Business Profits TAG at the September meeting. The business representatives of the TAG, for whom we speak, had the distinct impression that they were being presented with a technical position established in

advance by the “government side” (in effect, a *fait accompli*) without their input. It is true that the views of interested parties, including those of BIAC, were being solicited; however, in implementing the principle underlying the establishment of the TAG approach (i.e., a true government/business joint venture), the discussion draft at issue should have been issued following (rather than before) the meeting of the Business Profits TAG, at which a full discussion of the subject could have taken place. In this way, the proposal would have included the views of the business representatives. Perhaps, this might have meant that approval of the proposal at the February meeting of Working Party No. 1 would not have been possible, but there is very little justification for putting this matter on such a fast track.

At this point, we would suggest that an early meeting of the Business Profits TAG be scheduled, at which the subject matter of the comment draft be the primary topic for discussion. Let the coalition of government and business representatives explore, discuss, even debate the issues involved so as to come up with a consensus.

Having said the above, we would like to convey to you an overview of our comments. They will be presented in detail to the Secretariat. Our thoughts are as follows:

- The conclusion in the draft that a web site should not be considered a permanent establishment is the correct interpretation of the treaty definition and is the appropriate answer.
- The suggestion in the preamble of the draft that the Working Party’s conclusion (as specified in the preceding bullet) might change is very troubling, and a clear statement that a server *per se* can never be a permanent establishment is needed.
- The view that a server can constitute a permanent establishment even if there is no human intervention is incorrect. A computer server is not the equivalent of a vending machine, and serious income allocation and transfer pricing issues could arise if taxpayers were required to analyze what transpires in a server on a transaction by transaction basis

Please let us know if you have any questions

Sincerely

Richard M. Hammer
Chairman, BIAC Committee on Taxation and Fiscal Policy

CC: Jeffrey Owens, OECD

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