ICAEW TAX REPRESENTATION

INTERPRETATION AND APPLICATION OF ARTICLE 5 (PERMANENT ESTABLISHMENT) OF OECD MODEL TAX CONVENTION

Comments submitted on 16 February 2012 by ICAEW Tax Faculty in response to the publication on 12 October 2011 of a public discussion draft *Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention*.

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PATENT BOX: CORPORATION TAX REFORM

INTRODUCTION

1. OECD issued a public discussion draft *Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention* containing proposals for additions and changes to the Commentary on Article 5, Permanent Establishment, of the OECD Model Tax Convention ("OECD Model").

2. The deadline for comment was 10 February and we are grateful to OECD for allowing us a short extension in order to finalise and submit our comments.

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3. The notes below refer to the consolidated version of paragraphs 1 to 35 of the Commentary on Article 5 (as amended by the proposals for changes), under the ANNEX of the above mentioned public discussion draft.

WHO WE ARE

4. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the ICAEW provides leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The ICAEW is a founding member of the Global Accounting Alliance with over 775,000 members worldwide. The Tax Faculty is the focus for tax within ICAEW.

5. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

6. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter TAXline to more than 11,000 members of the Institute who pay an additional subscription, and a free weekly newswire.

COMMENTS

Issue 4: Home office as PE (proposed new paragraphs 4.8 and 4.9)

7. This is, we believe, the first OECD Model commentary guidance on when Home offices constitute a PE and could potentially affect a considerable number of Multi-national corporations (MNCs).

8. The proposed new paragraphs 4.8 and 4.9 to the Commentary on Article 5 set out criteria to decide whether an individual's home office constitutes a PE of the enterprise for which the individual carries on an activity. The issue will arise generally in the case of expatriate employees, cross-frontier workers and travelling consultants.

9. The general rule is that a location may not be automatically considered at the disposal of an enterprise simply because it is used by an individual who works for the enterprise. All facts and circumstances of each case need to be taken into consideration. If the

business activities at an individual's home are carried on in an intermittent or incidental way, that home may not be considered at the disposal of the enterprise.

10. The comments in proposed new paragraph 4.8 appear to be reasonable, including the question of whether the employer has required the employee to work from home, but there is no obvious logic apparent in the distinction drawn in paragraph 4.9 between the non-resident consultant present for an extended period (undefined) in another state and working from a presumably temporary 'home' (as opposed to a hotel) which is to be treated as a PE and the cross-frontier worker performing most of their work from their home rather than in the office made available to them in the other state which is to be treated as not being a PE.

11. The non-resident consultant may well simply choose to work from home, rather than being required to do so by their employer. If the latter is the decisive criterion envisaged by WP1, then the comments in paragraph 4.9 do not necessarily follow.

12. We recommend that this issue should be clarified.

Issue 6: Time requirement for the existence of a permanent establishment (paragraph 6 of the Commentary)

13. Paragraphs 6.1 and 6.2 propose exceptions to the general practice of Contracting States that, unless a place of business is maintained for 6 months or more, it does not constitute a PE.

14. The two examples of annually recurrent 5 week presence at an international commercial fair, and the single 4 month operation of a restaurant in a house in connection with filming a film on location may of themselves not be of general application, but the carving out of exceptions from the current norm that places of business operated for less than 6 months do not constitute a PE is a development that we do not welcome.

15. In particular in relation to the first of the examples it is likely that it would take several years during which the 5 week presence had been maintained before it would meet the new PE criterion and be deemed to be a PE. It would create unacceptable uncertainty if one was not in a position to determine at the time that a PE had been created which is the effect of the current 6 month rule.

Issue 7: Presence of foreign enterprise's personnel in the host country (paragraph 10 of the Commentary)

16. The proposed changes to paragraph 10 in relation to secondees are helpful but the comments in paragraph 44 are of concern. These relate to the situation where a secondee remains on their home country payroll (often for HR/benefits/compensation/currency reasons) and the host company is charged on a cost + basis. Paragraph 44 mentions the possibility that this cost + indicates that what the secondee is doing in the host country is not part of the host company's activity but rather part of the home company's activity, hence there is PE exposure. Reference is then made to the criteria in paragraphs 8.13-8.15 of the Model commentary re the host state company being the "economic employer " for Article 15 183 day protection purposes to avoid a home state company PE in the host country. Whilst the changes are designed to be helpful, given the multiplicity of criteria in paragraphs 8.13-8.15 and the subjectivity sometimes involved eg who instructs the individual (matrix management), the outcome may not always be certain. In the worst case, this might leave MNCs with the choice of accepting a local "economic employer" and so host country taxation of secondees even

where present for no more than 183 days in the host country or accepting a PE of the non-resident company in the host state.

Issue 8; Main contractor who subcontracts all aspects of a contract (paragraphs 10 and 19 of the Commentary)

17. We believe that this should be dealt with under the dependent agency type PE rule rather than deeming the subcontractor(s) to be a PE of the non-resident main contractor. Plus this "principle" of deeming a 3rd party subcontractor to be a new type of PE of the main contractor could be extended to other industries eg financial services re brokers acting for non-resident principals. This would create a very unhelpful precedent and we do not believe it should be pursued.

Issue 14: Does a development property constitute a PE? (paragraph 22 of the Commentary)

18. We query whether the analysis at paragraph 86 is correct in terms of the interaction between treaty and domestic law.

19. A domestic charge under the Business Profits Article 7 cannot be justified in relation to the host state being permitted to charge under the Capital Gains Article 13. See the Malaysian High Court case of Euromedical Industries, where in the absence of a PE, Malaysia's domestic withholding tax on technical assistance fees paid to a UK parent was blocked (the fees being business profits for treaty purposes rather than royalties, but there being no Malaysian PE).

Issue 19: Meaning of "to conclude contracts in the name of the enterprise" (paragraph 32.1 of the Commentary)

20. The proposed addition to paragraph 32.1 will expressly provide that a principal enterprise bound by a contract concluded by another person with a 3rd party would not be protected from having a PE in the country of that other person merely by virtue of that other person not disclosing that it was acting for the principal enterprise in its dealings with the 3rd party This would in particular appear to be targeted at principals in commissionaire arrangements, but as worded goes much wider than this.

21. The analysis is however incomplete, in that the existence or otherwise of a PE should be with regard to all the facts and in particular the conduct of the parties, and it would be preferable if the revised commentary reflected this.

Further contact

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APPENDIX 1

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see http://www.icaew.com/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide-4-99-towards-a-better-tax-system.ashx).