

# The OECD discussion draft on the definition of permanent establishment

2012

Jacques Sasseville writes about the distinct issue  
related to the definition of permanent establishment

**T**he concept of 'permanent establishment' is the keystone of the existing tax treaty rules that govern the allocation of taxing rights over the business profits that foreign enterprises derive from a country. Almost all existing tax treaties include a definition of that concept based on Article 5 of the OECD Model Tax Convention.

The basic part of that definition is short and deceptively simple: *"For the purposes of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on."*<sup>1</sup> That basic definition is completed by a list of examples<sup>2</sup>, a special rule applicable to construction sites<sup>3</sup>, a list of exceptions<sup>4</sup>, a deeming provision applicable to activities carried on through dependent agents<sup>5</sup> and a clarifying provision dealing with the application of the definition in the case of related companies<sup>6</sup>.

Applying the different parts of that definition to the very different ways in which enterprises carry on business operations abroad raises a number of interpretation and application issues. The Commentary on Article 5 has been changed a number of times to deal with such issues<sup>7</sup>.

On 12 October 2011, the OECD Committee on Fiscal Affairs released a discussion draft entitled *Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention*<sup>8</sup>. The discussion draft deals with 25 distinct issues related to the definition of permanent establishment which were identified in previous OECD work, such as the work on business restructurings<sup>9</sup> and on the application to electronic commerce of the current treaty rules for the taxation of business profits<sup>10</sup>, in comments from OECD member countries and in comments from the OECD Business and Industry Advisory Committee (BIAC).

Work on these issues began in 2009 and was carried on by a Working Group set up by Working Party 1<sup>11</sup> to deal with these issues. The mandate of that Working Group, which included representatives from the tax authorities of most

OECD countries and of some observer countries, was to provide additional guidance on the existing definition of 'permanent establishment'; no changes to that definition were envisaged as part of the project.

The discussion draft includes a description of each issue examined by the Working Group together with a background analysis and the recommendation of the Working Group on the issue. In many cases, that recommendation takes the form of proposed changes to the Commentary on Article 5 of the OECD Model Tax Convention.

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Comments on the discussion draft were received from around 45 organisations and individuals<sup>12</sup>. While these comments touch upon all the issues that were examined by the Working Group, the proposed changes to the Commentary that attracted the most comments are those dealing with the following issues:

- Meaning of 'at the disposal'
- Main contractor who subcontracts all aspects of a contract
- Presence of foreign enterprise's personnel in the host country
- Meaning of 'to conclude contracts in the name of the enterprise'
- 'Home office' as a permanent establishment
- Time requirement for a permanent establishment

Many of these comments request an expansion of the guidance proposed in the discussion draft. In some cases, however, the comments reflect diverging views on some important aspects of the definition of 'permanent establishment'.

The comments were first examined at the February 2012 meeting of Working Party 1. The Working Party then decided that a special meeting should be held in September 2012 to discuss these comments in details.

The Working Party also decided that a public consultation meeting, to which all the persons and organisations who sent comments on the discussion draft would be invited, would be held immediately after that special meeting.

That public consultation meeting will allow a discussion of the controversial aspects of the proposals included in the discussion draft and of the areas on which additional guidance was requested through the comments received.

The Working Party also intends to discuss the proposals included in the discussion draft with tax treaty officials from non-OECD countries. This will be done at the next OECD Annual Tax Treaty Meeting, which will be attended by tax treaty officials from around 100 countries and international organisations. ■

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### Endnotes

1. Paragraph 1 of Article 5.

2. Paragraph 2.

3. Paragraph 3.

4. Paragraph 4.

5. Paragraphs 5 and 6.

6. Paragraph 7.

7. For example, the 2010 update to the Model Tax Convention included changes dealing with the application of the permanent establishment definition in the case of common telecommunication operations

(see <http://www.oecd.org/dataoecd/23/43/45689328.pdf>).

8. Available at <http://www.oecd.org/dataoecd/23/7/48836726.pdf>

9. In 2005, the OECD Committee on Fiscal Affairs mandated a Joint Working Group to carry on work on treaty and transfer pricing issues related to business restructurings

(see [http://www.oecd.org/document/11/0,3343,en\\_2649\\_37989760\\_38087051\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/11/0,3343,en_2649_37989760_38087051_1_1_1_1,00.html)). At the end of 2007, having taken stock of the progress made to that point, the Committee referred the work the work related to the definition of permanent establishment to its Working Party 1 (see note 12 below).

10. In 1999, the Committee on Fiscal Affairs set up a Technical Advisory Group (TAG) on Monitoring the Application of Existing Treaty Norms for Taxing Business Profits with the general mandate to “examine how the current treaty rules for the taxation of business profits apply in the context of electronic commerce and examine proposals for alternative rules”. The final report of the TAG “Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce?” (available at <http://www.oecd.org/dataoecd/58/53/35869032.pdf>) included some suggestions for clarification of the definition of permanent establishment.

11. Working Party 1 on Tax Conventions and Related Questions, which is the Committee’s subsidiary body in charge of changes to the OECD Model Tax Convention.

12. These comments are available at

[http://www.oecd.org/document/52/0,3746,en\\_2649\\_33747\\_49679284\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/52/0,3746,en_2649_33747_49679284_1_1_1_1,00.html)