

Revised Discussion Draft on a New Article 7 (Business Profits) of the OECD Model Tax Convention

January 30, 2010

On January 30, 2010, TEI submitted comments on a revised draft of Article 7 and its commentary of the OECD Model Tax Convention. TEI's comments, which took the form of a letter to Jeffrey Owens, Director of the Centre for Tax Policy & Administration of the Organisation for Economic Development in Paris, were submitted under the aegis of its European Direct Tax Committee whose chair is Johann H. Müller of AP Moeller-Maersk.

On 24 November 2009, the Committee on Fiscal Affairs (CFA) of the Organisation for Economic Co-operation and Development (OECD) released a revised draft of a new Article 7 (Business Profits) for the OECD Model Tax Convention as well as related changes to the treaty commentary. The first version of the proposed revisions was released for comment on 7 July 2008, and the Joint Drafting Group on Attribution of Profits of Working Parties No. 1 and 6 held a public consultation meeting on that draft on 17 September 2009. Tax Executives Institute was pleased to submit comments on the first version of the discussion draft and participate in the consultation meeting.

Tax Executives Institute was founded in 1944 to serve the professional needs of business tax professionals. As the preminent association of business tax professionals worldwide, TEI has a significant interest in promoting sound tax policy and the fair and efficient administration of the tax laws at all levels of government. Our 7,000 members represent 3,200 of the largest companies in the United States, Canada, Europe, and Asia and thus have a significant interest in the OECD's Model Tax Convention and its commentary.

TEI commends the OECD for the substantial revision of Article 7. With the revisions, the proposed Article 7 will be more effective than either the current Article or the July 2008 proposal in minimising instances of double taxation. TEI also applauds the revisions of the commentary in the revised discussion draft, including confirmation that, as a general principle, neither profit allocation methods nor the documentation requirements should be more stringent in dealings between a PE and Head Office under Article 7 than what applies to transac-

tions among associated enterprises under Article 9. Overall, the Joint Drafting Group has produced substantially improved and, more important, workable guidance.

TEI also believes, however, that several issues bear possible further consideration, consultation, and action. Specifically, several pending OECD projects will affect the definition, determination, and ramifications of a Permanent Establishment (PE) under Article 5. Hence, TEI reiterates its recommendation that the OECD prescribe conditions and circumstances under which taxpayers will be afforded a grace period in order to satisfy documentation requirements under Article 7 (or other Articles of the Model Tax Convention). The legal and tax uncertainties associated with the inadvertent creation of PEs remain. Despite taxpayers' best efforts to comply with myriad jurisdictional rules to which they are subject, the business activities in a particular jurisdiction may exceed the *de minimis* thresholds for permitted preparatory or auxiliary activities and a PE may be inadvertently created. Where that occurs, taxpayers will not have contemporaneous documentation and records available to support a proper attribution of profits and the OECD should ensure that taxpayers are accorded time to create those records.

In addition, as noted during the Article 7 consultation, business documentation requirements have grown exponentially in OECD guidance and member state rules. While the desire for more information may be understandable, excessive documentation is not a substitute for sound judgment or a panacea for all unresolved issues in tax administration or lacunae in substantive tax rules. In pending and future projects, we urge the OECD and member states to take a

fresh look at the documentation burdens the guidance may engender.

Finally, we have previously noted that paragraph 26 of the new commentary to Article 7 incorporates the principles relating to Dependent Agent PEs set forth in Section D-5 of the Report on the *Attribution of Profits to Permanent Establishments*. TEI remains concerned that the application of the principles in Article 7 to an unplanned, deemed dependent agent PE under Article 5(5) may result in excessive compensation to the source country. This could occur because it is difficult to distinguish between the provision of services to the principal/foreign company for a fee and the provision of services *on behalf of* a principal/foreign company. Although the Report on the Attribution of Profits to Permanent Establishments addresses this matter, it may not be considered authoritative guidance because it is not part of the Model Tax Convention. As with the documentation issues, we believe this issue should be monitored for potential reconsideration.

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Again, TEI commends the OECD for the 24 November 2009 revisions to Article 7 and the related commentary and appreciates the efforts of the Joint Drafting Group of Working Parties No. 1 and 6 in making the guidance more workable. These comments were prepared under the aegis of TEI's European Direct Tax Committee whose Chair is Johann Müller. If you have any questions about this submission, please contact Mr. Müller at +45 3363 4374 (or johann.muller@maersk.com), or Jeffery P. Rasmussen of TEI's legal staff at +1 202 638 5601 (or jrasmussen@tei.org).