

# Problems with Permanent Establishments

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## Presenter

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*“When there is an income tax, the just man will pay more and the unjust less on the same amount of income” – Plato*

## What is a PE? – a helicopter view

- A fundamental concept
- Determines the right to taxation
- OECD Model Convention
  - Framework used by developed countries
- *“.....a fixed place of business through which the business of an enterprise is wholly or partly carried on.” (Article 5(1), OECD)*

## What is a PE? – a helicopter view

- Three Requirements;
  - The existence of a “place of business”,
  - The “place of business” must be of a fixed nature and
  - The enterprise being carried is required to be carried on through the fixed place of business

## Place of Business

- In general – premises / facilities used for purposes of the enterprise
- Formal legal entitlement not necessary
- Substance over form
- Facilities not at the disposal of the enterprise
  - Sales people concluding contracts at client premises
  - Possible to have a number of PE's

## Fixed Place of Business

1. *“A place of management*
2. *A branch*
3. *An office*
4. *A factory*
5. *A workshop; and*
6. *A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.”*

*Article 5(2) OECD Model Treaty*

## Fixed Place of Business

- Physical Presence
  - Era of manufacturing & retailing businesses
  - Not in keeping with modern business

## Operations carried on through a Permanent Establishment

- Activities carried on wholly or partly through it
- Carried on through it on a regular basis
- OECD Treaty – 2008
  - “.....a fixed place of business **through** which the business of an enterprise is wholly or partly carried on.”
- OECD Treaty – 1963
  - “.... a fixed place of business **in** which the business or enterprise is wholly or partly carried on.”

## Operations carried on through a Permanent Establishment

- Revised definition results in a wider application of the concept
- Possible for an entity to have a number of PE's if it has a number of locations it can carry out business through
- Domestic law will determine if business is carried on through a PE

## Construction Sites

*“A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.”*

*Article 5(3) OECD Model Treaty*

## Construction Sites

- Period varied between 3 & 12 months
- Commencement of timescale
- Temporary discontinuance
- Subcontracting

## Foreign Agents

- “Acting in the ordinary course of their business”
- Confusion as to meaning
  - OECD clarification not adequate
  - Legal system in each jurisdiction
- Autonomy to negotiate and conclude contracts
- Position can differ depending on treaty by treaty basis
  - Ireland / Japan Treaty & Ireland / Pakistan Treaty
  - Retaining stock

## Multiple PE's

- “Place of business” may move around
- Commercially & geographically identified
  - Single unit (e.g. Mine)
- Multiple PE's
  - Increased tax cost
  - No provision for offset of losses under OECD or UN Model Treaties

## Negotiating Parties

- May include territorial waters
  - E.g. Exploration activities
  - What jurisdiction are you operating in?
  - Difficult for tax payer to operate and identify
  - Failing to identify geographically
  - Potential increased real tax cost

## Our sourcing of back office services

- Authority for Advanced Rulings - Morgan Stanley & Co
- MS not considered to have a PE in India
  - No fixed place of business
  - No ability to conclude contracts
- Ruling is significantly important
  - Persuasive value
  - Important role in international tax

## E-Commerce

- OECD Commentary
- Distinction between:
  - Location of computer hardware
  - Data and software used by the equipment
- Website not considered to be a PE
- Server – would constitute a PE

## Summary

- Concept is intrinsic to international taxation
- Guidance is useful but not conclusive
- Place of business / multiple places of business
- Construction operations
  - Time period used as yard stick
  - Difficult negotiations with foreign authorities
  - Temporary discontinuance
- Concept should be a “working” definition
  - Evolve with modern business