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Opinion Statement of the CFE
on an EU definition of Permanent Establishment

Prepared by the CFE Fiscal Committee

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The following submission comprises a formulation proposal for a supplementary legal definition of the term “permanent establishment” which could be included in a future Commission Recommendation or Council Directive .

1. Facts / Initial Problem

This term defined in German as *Betriebsstätte* in § 12 of the German Fiscal Code (Abgabenordnung) is only legally codified at bilateral level in the OECD Model Agreement, to the extent that EU countries have based their Treaties thereupon. In delimitation thereto, the term fixed establishment was legally defined according to technical guidelines and – with regard to the law on value-added tax – concerns *any establishment which is of some duration and equipped, to a reasonable extent, with human and technical resources to meet company purposes or provide the characteristic company services.*

The Banking Directive (2006/48/EC) contains specific rules for branch establishments of banks and financial institutions set up in a Member State.

Furthermore, in the Parent-Subsidiary Directive (90/453/EEC) – amended by Directive 2003/123/EC – the term *Betriebsstätte* (permanent establishment) is defined as *any fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on in so far as the profits of that place of business are subject to tax in the Member State in which it is situated by virtue of the relevant bilateral tax treaty or – in the absence of such a treaty – by virtue of national law (cf. Annex 1).*

Art. 3 of the Interest and Royalties Directive (2003/49/EC) defines the term “*permanent establishment*” as follows:

(c) the term “permanent establishment” means a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on.

In the OECD Model Treaty, however, a permanent establishment is considered to be any fixed place of business through which the purpose of business is wholly or partly promoted, in particular the place of management¹, the branch, an office, a factory, a place of work (workshop) or a mining, oil or gas field, an extraction site, or any other place for the extraction of natural resources.

The OECD Model Agreement also defines at the same time that there is *no* permanent establishment in the event that the possibilities and facilities solely result in purposes of storage, exhibition, or the delivery of goods or services used for the purpose of the enterprise. The same also applies for the safeguarding of goods or services, as well as for the sale of goods and services or, respectively, any other place which only provides auxiliary services. This also comprises any other form of a fixed place which consists of a combination of the exclusionary provisions as far as in the final result this fixed place only provides services of a preparatory or auxiliary² type for the overall performance.

In the national laws of the Member States, in particular also in the German Fiscal Code, *Betriebsstätte* or permanent establishment is defined as any fixed facility or plant which is used for the activity of an enterprise. Permanent establishment is to be considered, in particular, the place of management, branches, branch offices, places of fabrication or workshops, warehouses, purchasing or sales offices, mines, quarries or other stationary, locally progressing or floating sites for the extraction of natural resources, as well as executions of construction work or erections, even of a locally progressive or floating kind, if they last longer than 6 months.

The respective national provisions thus partly considerably exceed the legally defined term of permanent establishment in the OECD Model Treaty, as well as the definition in EU law, e.g. in the Parent-Subsidiary Directive.

2. Legal Problems

On the one hand, national regulations (like, e.g., § 12 of the German Fiscal Code) comprise considerably differentiated business activities which hardly leave any possibilities not to

¹ On the question whether and in which circumstances a company that is a member of a corporate group may constitute a “*place of management*” of another company of the group so as to constitute a permanent establishment, see the OECD document “*Revised Proposals Concerning the Interpretation and Application of Article 5 (Permanent Establishment)*” of 19 October 2012.

² On the question whether the activities that are mentioned in subparagraphs *a*) to *d*) of paragraph 4 of Art. 5 are automatic exceptions or whether these exceptions are conditional on the activities being of a preparatory or auxiliary nature, see the OECD document “*Revised Proposals Concerning the Interpretation and Application of Article 5 (Permanent Establishment)*” of 19 October 2012.

assume a permanent establishment. This inevitably results in collisions of national regulations of Member States.

On the other hand, the OECD Model Agreement includes, in No. 1 and No. 2 a-f, legal assumptions for the existence of a permanent establishment and in Item 4 a-f negative prerequisites for the non-existence of a permanent establishment.

This shows that, in a permanent establishment, activities for the company are required to be of duration, significance and sustainability. Subordinate or merely preparatory or other forms of auxiliary activities are, by definition, an exclusionary reason for the assumption of a permanent establishment. In particular, the overall impression which this permanent establishment provides for the purposes of the company as a whole will be important; thus, particularly if the performances of this unit are characteristic for the performances of the company or, respectively, the outside appearance of the company (like the name or corporate design) gives the impression that the company is managed via the special unit of permanent establishment.

This explains that, of course, the place of corporate management, or a dependent branch rendering essential performances of the company as a whole, or a field office will convey the character of permanent establishment.

In the same vein, the characteristic of permanent establishment is also rendered by a factory in which, of course, performances are rendered in the interest of the company and for the purpose of the company; this applies as well to a workshop or to deposits of natural resources of a substantial extent.

With regard to buildings or other fixed facilities, the OECD Model contains a 12-month rule according to which all such buildings or facilities set up for a shorter period do not present a permanent establishment. Deviating national provisions (like, e.g., the German Fiscal Code) distribution centers, warehouses or other assembly equipment of considerable duration, as well as purchasing and sales offices are designated as permanent establishment, although they do not fall under the OECD Model Treaty.

The general provision in Art. 3 (c) of the Parent-Subsidiary Directive according to which permanent establishment is considered any fixed business facility in a Member State by means of which the activity of a company of another Member States is carried out wholly or partly is meaningless in practice; if this definition is taken straight and literally, the activity of the company of another Member States must be carried out wholly or partly by this fixed business facility. That means auxiliary or preparatory activities are entirely excluded, that the company's activity must be effected through this permanent establishment and that, moreover, this business facility has to be fixed, i.e. firmly connected with ground and land.

Excluded is thus any form of long-term mobile business facility or those that can be designed in a mobile manner. E-Commerce services are also excluded since these services for the company are not rendered by the fixed business facility but developed and rendered virtually.

All forms of rendering services only fall under the term of fixed business facility if this fixed business facility renders wholly or partly services which are *significant* for the company. That means, the company-specific performance area must be rendered in this fixed business facility or, respectively, by means of this fixed business facility.

This does not cover any form of mediation or brokerage of services which, in the proper sense, is only effected outside of this fixed business facility. Here to be named are, for example, airlines, insurance groups and other forms of possibly personalised services, such as law firms, tax consultancies, etc. The definition in the Parent-Subsidiary Directive merely covers the producing trade as far as this fixed business facility renders the activity, i.e. the company's services, wholly or partly, i.e. billably also divisibly. Mere suppliers which may have a considerable effect will render – according to the wording – no divisible service. These suppliers might provide complex performances – e.g. in mechanical engineering, in the automotive sector, shipping and aircraft construction. Rendering performance can only be considered from the viewpoint of the recipient. From that viewpoint, the performance must present itself wholly or partly; i.e. it must be divisible and thus able to be considered as a partial performance of the overall performance. Accordingly, when considered literally and for complex performance units – such as an aircraft or an automobile – the performance would not be considered divisible from the point of view of the recipient. Although the manufacture of an engine is not insignificant for the automobile, from the viewpoint of the recipient, the production of an engine is not a partial performance of the automobile so that although a factory which produces engines in one Member State actually presents a fixed business facility for the sales facilities in another Member State, it nonetheless is not the place in which the activity for this company is carried out either wholly or partly.

In this respect, the term of permanent establishment according to the Parent-Subsidiary Directive is not sufficient literally, but only generally and analogously. This inevitably results in a maze of different possibilities of solutions comprising a hotchpotch of potential interpretations and thus no longer establishes any rigid framework of definition. According to it, all and everything could be covered by the term of permanent establishment if only it is effected in a fixed business facility. However, , an oil field is not a business facility, and progressing construction (erection) is not fixed since it changes permanently. Thus, the term of permanent establishment is not to be derived from the Parent-Subsidiary Directive.

The abovementioned Banking Directive does not apply for branch establishments of banks and financial institutions as a suitable starting criterion – all the more so since it generally takes place in solid buildings, has a long-term perspective and accordingly comes under the area of sectors, i.e. the area of branch offices of the OECD Model Treaty and is covered elsewhere already.

For the sake of good order, reference should here be made yet to the formulation proposal for public proposals in the Commentary of 4 March 2003 to the OECD Model Treaty which probably, however, should not have any significant influence on any further legal definition possibly to be provided.

The definition of a fixed establishment is also not suitable to be used as a definition of a permanent establishment since non-fixed facilities are one of the areas for which a solution is particularly sought. Otherwise, the differentiations between permanent establishment and fixed establishment would be obsolete. The permanent establishment can thus only be seen as legally being something other than the fixed establishment.

3. Proposed Solution

Apart from the activity designs – essentially based on the permanent establishments – of place of management, branches, producing factory, workshop, or branch office as a subordinate unit of management, a permanent establishment can only be established due to the circumstance that, in it, essential decisions for the company are taken or, respectively, performances for the company are rendered wholly or partly in a definable form.

From a logical point of view, this permanent establishment must then be provided with its own sovereignty since the management purpose can only be independently pursued with this sovereignty.

Furthermore, such permanent establishment must be provided with its own monetary and human resources so that it is able to fulfill the company's business purpose by carrying out the business activity in ; and in a contrast thereto, mere distribution centers, intermediate storage sites, purchasing and sales offices and third-parties charged with these tasks do not present any permanent establishments since these facilities do not carry out the company's activity in their own competence. Only in the case of sales offices, a permanent establishment could be assumed if such sales office would have, at any time, unrestricted and non-restrictable access to the products and services of the performing company and thereby can also independently render the performance of the company. If the sales office performs only preparatory activities and sales are established by approval for example from

the main business, there will be no permanent establishment since the sales office lacks the independence of rendering performance³.

As far as the exploitation of natural resources is concerned, a permanent establishment can only be established on location if this permanent establishment itself carries out the exploitation of the natural resources, meaning that there will not only be intermediate storage, e.g. as a waste product of another production. It is accordingly decisive that there is only a permanent establishment if, by the activity taking place thereon, the company's business purpose is rendered in a significant manner wholly or partly from the point of view of the recipient of delivery, while the provided services or, respectively, produced goods presenting the performance of the company are rendered with autonomy documented towards the outside. This autonomy is to be documented both to the outside and the inside with the award of competence and also to be implemented as documented so that independence can be assumed.

³ Similar to the judgment of the European Court of Justice in case C-55/94, Gebhard, see paragraphs 27-28.