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VIA E-MAIL
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Ms. Marlies de Ruiter
Head, Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy & Administration
Organisation for Economic Co-operation and Development
2, rue André-Pascal
75116 Paris
France

Re: Comments on *Revised Discussion Draft—BEPS ACTION 7: Preventing the Artificial Avoidance of PE Status*

Dear Ms. de Ruiter,

The Silicon Valley Tax Directors Group ("***SVTDG***") hereby submits these comments on the above-referenced *Revised Discussion Draft*, issued on May 15, 2015. SVTDG members are listed in Appendix A.

Sincerely,

Jeffrey K. Bergmann

Co-Chair, Silicon Valley Tax Director's Group

I. Introduction and summary

Thank you for the opportunity to provide comments on the revised discussion draft on behalf of the Silicon Valley Tax Directors Group ("SVTDG"). The SVTDG is composed of representatives from leading high-technology companies with corporate offices predominantly located in the area between San Francisco and San Jose, California (widely known as the "Silicon Valley"). It was formed in 1981 and now has 78 members (a list is available at http://www.svtdg.org/members.php and included in appendix A). The purpose of the SVTDG is to promote sound, long-term tax policies that support competitiveness. Members of this group believe that tax policies should enhance opportunities for productivity growth and cross-border trade.

The proposed changes to Article 5 and its Commentary represent a significant change to the long-standing and well accepted international standard of permanent establishment. These proposed changes introduce new terminology, or in some cases place greater emphasis on terms that were of significantly less relevance in the past. Accordingly, care must be taken in the Commentary to provide definitions which are precise, consistent with the treaty language, and preclude multiple simultaneous assertions of deemed permanent establishments in different countries with respect to the same transaction. To that end, we believe that the policy concerns with commissionnaires, for example, could have been addressed in a more focused manner by use of statutory references. Finally, we note that the proposed changes to Article 5 and the Commentary represent a significant change in law, and consequently should not be used as interpretative guidance for current treaties. To that end, we recommend the following text be included in any final guidance regarding changes to Article 5 of the Model Tax Convention and any related Commentary:

> Nothing in this document, including but not limited to any changes to the Model Tax Convention and Commentary described herein, represents an interpretation of the existing provisions of the OECD Model Tax Convention or Commentary prior to such changes, or of any treaties in which such previously existing provisions of the OECD Model Tax Convention are included. This document is only relevant to those treaties that adopt the changes advanced herein.

II. Comments on the Proposed Changes to Article 5(5)

A. Clarify that the term "habitual" applies to both the conclusion of contracts and the negotiation of the material elements of contracts

The proposed Article 5(5) Commentary states that "only persons *habitually* concluding contracts or *habitually* negotiating the material elements of contracts" can give rise to a deemed permanent establishment.[1] The proposed new language for Article 5(5), however, is potentially subject to misinterpretation as to whether the word "habitually" modifies only the phrase "concludes contracts", or is also meant to modify the phrase "negotiates the material elements of contracts". To eliminate any ambiguity as to the proper interpretation of this provision, we therefore recommend that the proposed text of Article 5(5) be revised to read as follows:

> 5. Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a Contracting State on behalf of an enterprise

[1] Proposed Article 5(5) Commentary ¶ 32 (emphasis added).

> and, in doing so, habitually concludes contracts, or habitually negotiates the material elements of contracts, …

For the same reason, the second bullet in paragraph 32.1 of the proposed Commentary to Article 5(5) should be revised to read as follows:

> – in doing so, that person habitually concludes contracts, or habitually negotiates the material elements of contracts; and

The references to "habitually" in paragraphs 33 and 33.1 of the proposed Article 5(5) Commentary are consistent with the recommended edits above, since the reference in each of these paragraphs to concluding contracts is not separated by a comma from the reference to negotiating the material elements of contracts, and thus it is clearer that the word "habitually" modifies both phrases.

B. The material elements of the contract should be limited to those over which the parties to the contract would ordinarily negotiate

The proposed changes to Article 5(5) expand the scope of a deemed permanent establishment to include situations where a dependent agent habitually negotiates "the material elements" of contracts. According to the proposed Article 5(5) Commentary, the purpose of this expansion is to address transactions in which "the key ingredients of the contractual relationship" are determined in one State, although the contract may be "formally concluded" in a different State.[2] The words the words "essentially" and "with further approval or review" in paragraph 32.5 are unnecessary and detract from the effectiveness of the paragraph in addressing the elements of negotiation that might give rise to a deemed permanent establishment in the absence of actual contract conclusion. Therefore, we recommend removing this language. Paragraph 32.5 suggests that the material elements of a contract would typically include the parties to the contract, as well as the price, nature and quantity of the goods or services covered by the contract. Since the focus of this test is whether "negotiation" takes place in the source country, the material elements of the contract should be those over which the parties to the contract would ordinarily negotiate. The determination of the parties to the contract and the nature of the goods and services to be purchased would not ordinarily be matters to be negotiated. Rather, these elements would be a precursor to engaging in negotiation. Therefore, the material elements of the contract, over which the parties could be expected to negotiate, typically would include the quantity and price of the goods or services covered by the contract. Other elements may or may not be material, depending on the facts and circumstances of the particular transaction, including warranties, indemnities, the contract term, rights granted and/or reserved, terms of use, and the law governing the contract. We recommend, therefore, that paragraph 32.5 of the proposed Commentary be amended as follows:

> 32.5 The phrase "or negotiates the material elements of contracts" is aimed at situations where contracts that are ~~essentially being~~ negotiated by a person in a given State are subject to formal conclusion~~, possibly with further approval or review,~~ outside that State. The fact that the key ingredients of the contractual relationship have been determined in the relevant State is sufficient to treat these contracts in the same way as if they had been formally concluded in that State. For the purposes of that rule, "the "material elements" of contracts" are those contract terms which, as a commercial

[2] *See* Proposed Article 5(5) Commentary ¶ 32.5.

> matter, are ordinarily the subject of negotiation between contracting parties. These elements may vary depending on the nature of the contract concerned but would typically include ~~the determination of the parties between which the contract will be concluded as well as~~ the price~~, nature~~ and quantity of the goods or services to which the contract applies. Depending on the facts and circumstances of the transaction, these elements also may include warranties, indemnities, terms of use, rights granted and/or reserved, the contract term, and the law governing the contract.

C. The term "negotiation" does not include marketing, solicitation and similar demand generation activities

The revised discussion draft proposes to expand the circumstances under which an enterprise might have a deemed permanent establishment under Article 5(5) to cover situations where a person "negotiates the material elements of contracts", even though that person may lack the authority to conclude contracts in the name of the enterprise. The policy justification given for this expansion is "to address *commissionnaire* structures and similar arrangements."[3] The revised discussion draft, however, does not apply the term "negotiation" in accordance with its ordinary meaning, potentially giving rise to assertions of deemed permanent establishments in many circumstances in which no negotiation has taken place in the source country.

The term "negotiation" refers to a bargaining process through which the terms of an agreement are arrived at.[4] It is distinct from marketing, solicitation and other similar activities through which demand for a product or service is generated, none of which involve bargaining over contractual terms. Certain statements in the revised discussion draft, however, suggest that activities other than contract conclusion or negotiation could give rise to a deemed permanent establishment. These statements should be revised to remove this implication. As discussed further in section II.D below, if the following passages are to be included in the final guidance communicating the revised Model Convention and Commentary text, we also recommend that these statements be revised consistent with the conclusion in paragraph 32.12 of the proposed Article 5(5) Commentary that a person acting on its own behalf, as opposed to on behalf of another, cannot give rise to a deemed permanent establishment.

> Executive Summary, page 4
>
> The October 2014 discussion draft indicated that changes were needed to the wording of Art. 5(5) and 5(6) of the OECD Model in order to address *commissionnaire* structures and similar arrangements. As a matter of policy, where the activities that an intermediary exercises in a country constitute the habitual ~~are intended to result in the regular~~ conclusion, or the habitual negotiation of the material elements, of contracts to be performed by a foreign enterprise, that enterprise should be considered to have a sufficient taxable nexus in that country unless the intermediary is performing these activities on its own behalf ~~in the course of an independent business~~.

[3] Revised Discussion Draft, Executive Summary, page 4.

[4] *See* BLACK'S LAW DICTIONARY 1200 (10th ed. 2014), which defines negotiation as: "A consensual bargaining process in which the parties attempt to reach agreement on a disputed or potentially disputed matter."

Paragraph 13, page 11

> As a matter of policy, where the activities that an intermediary exercises in a country constitute the habitual ~~are intended to result in the regular~~ conclusion, or the habitual negotiation of the material elements, of contracts to be performed by a foreign enterprise, that enterprise should be considered to have a sufficient taxable nexus in that country unless the intermediary is performing these activities on its own behalf ~~in the course of an independent business~~.

We believe that the revised language above more clearly reflects the policy underlying the proposed changes to the Article 5(5) Commentary.

Proposed paragraph 32.6 provides guidance on the application of the new negotiation standard. We believe, however, that this paragraph would be more effective if it provided clearer illustrations of negotiation without introducing the additional question of whether actual contracting might also be taking place. Therefore, we recommend that paragraph 32.6 be replaced with the following paragraphs:

> 32.6 The phrase "negotiates the material elements of contracts" must be interpreted in the light of the object and purpose of paragraph 5, which is to cover cases where a person negotiates the material elements of contracts to be performed by a nonresident enterprise. Thus, paragraph 5 would not apply where a person markets, solicits orders for, or otherwise generates demand for a nonresident enterprise's goods or services, but does not negotiate the material elements of contracts for the sale of such goods or services. Paragraphs 32.7-32.8 set forth examples that illustrate the application of paragraph 5.
>
> 32.7 RCO, a company resident of State R, distributes various products and services worldwide through its websites. SCO is a company resident of State S. SCO's employees engage in marketing and promotional activities with respect to RCO's products and services on behalf of RCO. SCO's employees also negotiate the price, quantity, delivery, and warranty terms of the contracts between RCO and its State S customers. RCO personnel review and accept the contractual terms in State R. The contracts are not binding on RCO, as a matter of contract law, until RCO signs, or performs under, the contracts. The remuneration of SCO's employees is partially based on the revenues derived by RCO from the contracts. In this example, SCO's employees are negotiating the material elements of the contracts that are concluded with RCO, and paragraph 5 should apply even if RCO can, and in some cases does, reject orders placed by State S customers.
>
> 32.8 Alternatively, assume that SCO's employees market and otherwise promote RCO's products and services on behalf of RCO, and encourage State S customers to enter into standard contracts with RCO online. The remuneration of SCO's employees is partially based on the revenues derived by RCO from the contracts. RCO sets all of the terms of such standard contracts, and SCO's employees have no authority to negotiate or vary these terms. SCO's employees can only explain the terms of the standard contract and advise customers where they can place orders. Since SCO has not negotiated the material elements of the contracts, paragraph 5 does not apply. The fact that SCO's employees engage in marketing and promotional activities on behalf of RCO and are

> partly remunerated based on revenues that RCO derives from its contracts with State S customers is not relevant to the determination of whether paragraph 5 applies.

The standard for imposing tax nexus on a nonresident must be clear. If the definition of a deemed permanent establishment under Article 5(5) is to be expanded to include negotiation that falls short of actual contract conclusion, then the term "negotiation" needs to be interpreted and applied in a manner consistent with its ordinary meaning. Negotiation involves bargaining over contract terms. Marketing, solicitation, and other demand generation activities do not involve the negotiation of contract terms, and therefore do not provide a sufficient basis for asserting tax nexus under Article 5(5).

D. Clarify that Article 5(5) does not apply to contracts concluded by a person on its own behalf

Paragraph 32.12 of the proposed Article 5(5) Commentary provides that "where a person concludes contracts on its own behalf and, in order to perform the obligations deriving from these contracts, obtains goods or services from other enterprises … the person is not acting 'on behalf' of these other enterprises" and therefore paragraph 5 does not apply. We fully agree with this conclusion and recommend that it be made more explicit in the Model Treaty itself through the addition of the following sentence to the end of the proposed text of Article 5(5):

> … This paragraph 5 shall not apply to a person acting on its own behalf.

Furthermore, this principle should apply to any person that concludes contracts on its own behalf, including a reseller of service contracts, or a licensee or lessee of property that sublicenses or subleases that property. To clarify this point, we recommend that the first sentence of paragraph 32.12 of the proposed Article 5(5) Commentary be revised as follows:

> The cases to which paragraph 5 applies must be distinguished from situations where a person concludes contracts on its own behalf ~~and, in order~~. For example, a person shall be considered to conclude contracts on its own behalf if it records on its books as gross income the revenue derived from such contracts. The fact that the person may obtain from other enterprises services, digital or physical goods, property rights, licenses, or other items necessary to perform the obligations deriving from these contracts~~, obtains goods or services from other enterprises~~ is not relevant to the determination of whether the person acts on its own behalf.

III. Comments on the Proposed Changes to Article 5(6)

The revised discussion draft proposes a change to Article 5(6) that would exclude from the definition of "independent agent" a person that "acts exclusively or almost exclusively on behalf of one or more enterprises to which it is connected." For this purpose, "connected" includes the holding of "at least 50 per cent" of the beneficial interests (or in the case of companies, the vote and value of the shares) of one person by the other person, or of both persons by a third person. Persons can also be "connected" if, based on the facts and circumstances, one person controls the other, or both persons are commonly controlled by a third person. The purpose of this rule, apparently, is to deem a dependent agent relationship to exist in situations where one party controls the other.

There are at least two problems with the current proposed changes to Article 5(6). First , a threshold of "at least 50 per cent" is the wrong threshold for testing for control. Many third-party joint venture arrangements are structured on a 50/50 basis, with neither party exercising unilateral control over the

joint venture. A rule that deems the joint venture to be a dependent agent of each of the joint venturers, and vice versa, is inconsistent with the purposes of the rule and will have a chilling effect on global investment and trade. Therefore, we would recommend that the ownership threshold in proposed subparagraph b) of Article 5(6) be revised to read "greater than 50 per cent", and that conforming changes be made to the relevant sections of the proposed Commentary. The second issue with the proposed changes to Article 5(6) is that control is irrebuttably presumed to exist if the prescribed ownership threshold is met. A more appropriate rule would be to set up a presumption of control in case of majority ownership that can be rebutted based on the facts and circumstances. We recommend, therefore, that subparagraph b) of Article 5(6) be revised as follows:

> For the purpose of this Article, a person shall be presumed to be connected to an enterprise if one possesses ~~at least~~ greater than 50 per cent of the beneficial interests in the other (or, in the case of a company, ~~at least~~ greater than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person possesses ~~at least~~ greater than 50 per cent of the beneficial interest (or, in the case of a company, ~~at least~~ greater than 50 per cent of the aggregate voting power and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise. In any case, a person shall be considered to be connected to an enterprise if, and only if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises.

Article 5(6) calls for a two-step analysis. In order for paragraph 6 to apply, (1) an agent acting on behalf of a foreign enterprise must be independent, and (2) said agent's activities on behalf of the foreign enterprise must also be within the scope of the ordinary course of its trade or business.

The proposed changes to the Commentary to Article 5(6) effectively conflate the two prongs of this test into one by suggesting that the only activities to be considered as part of this analysis are those related to a person's role as agent. A person can in the ordinary course of its business act both as a buy-sell distributor and as a sales agent. A person that operates an independent sales and distribution business for both related and unrelated parties should not give rise to a deemed permanent establishment of a foreign enterprise on behalf of which it acts as a sales agent merely because it adopts a buy-sell distribution model in its dealings with all other parties. For purpose of determining whether a person acts "exclusively or almost exclusively" on behalf of connected enterprises, the analysis should take into account any activity conducted by such person in the ordinary course of its business. Consequently, we recommend that paragraph 36 of the proposed Commentary to Article 5(6) be revised as follows:

> 36. Where an enterprise of a Contracting State carries on business dealings through ~~a broker, general commission agent or any other agent of~~ an independent ~~status~~ ***agent carrying on business as such***, it cannot be taxed in the other Contracting State in respect of those dealings if the agent is acting in the ordinary course of ~~his~~ ***that*** ***its*** business (see paragraph 32 above). …

Likewise, paragraph 38.5 should be revised as follows:

> 38.~~5~~7 ***An independent agent*** ~~Persons~~ cannot be said to act in the ordinary course of ~~their own~~ ***its*** business ***as such when it performs activities that are unrelated to*** ~~***the***~~ ***its business*** ~~***of an agent***~~ ~~if, in place of the enterprise, such persons perform activities which, economically, belong to the sphere of the enterprise rather than to that of their own~~

~~business operations~~. Where, for example, a ~~commission agent not only sells the goods or merchandise of the enterprise in his own name but also habitually acts, in relation to that enterprise, as a permanent agent having an authority to conclude contracts, he would be deemed in respect of this particular activity to be a permanent establishment, since he is thus acting outside the ordinary course of his own trade or business (namely that of a commission agent), unless his activities are limited to those mentioned at the~~ end of paragraph 5 ***company ~~that acts as a distributor~~ provides research and development services for a number of companies to which it is not connected, and in transactions unrelated to its R&D services business also acts as an agent ~~for~~ selling goods on behalf of a connected enterprise, the activities that the company undertakes as ~~a distributor~~ an agent for the connected enterprise will not be considered to be part of the activities that the company carries on in the ordinary course of its business ~~as an agent~~, and ~~will~~ therefore paragraph 6 shall not apply to the activities conducted on behalf of the connected enterprise ~~not be relevant in determining whether the company is independent from the connected enterprise on behalf of which it is acting~~***.

Consistent with our comments above, we also recommend that paragraph 38.7 of the proposed Article 5(6) Commentary be revised as follows:

> 38.7 The last sentence of subparagraph a) applies only where the person acts "exclusively or almost exclusively" on behalf of connected enterprises. This means that where the person's activities on behalf of enterprises to which it is not connected do not represent a significant part of that person's business, that person will not qualify as an independent agent. Where, for example, a person's sole business activity is selling goods or services as an agent acting on behalf of others, and the sales that ~~an~~ such agent concludes for enterprises to which it is not connected represent less than 10 per cent of all the sales that it concludes as an agent acting for other enterprises, that agent should be viewed as acting "exclusively or almost exclusively" on behalf of connected enterprises. If the person in this example is also engaged in the business of buying and selling goods and services as a distributor for enterprises to which it is not connected, and its sales as a buy-sell distributor represent a significant part of its overall business, then such person should not be viewed as acting "exclusively or almost exclusively" on behalf of connected enterprises, since the sale of goods and services as an agent and as a buy-sell distributor are not commercially distinct activities and should be considered part of the same trade or business.

IV. Comments on the Proposed Changes to Article 5(4)

The revised discussion draft proposes to limit the scope of Article 5(4) by making all activities subject to the condition that they be "preparatory or auxiliary". However, the proposed Commentary does little to clarify the proper application of these terms to activities that have long qualified for one or more of the specific exceptions in Article 5(4). The proposed interpretations of "preparatory" and "auxiliary" are excessively narrow and inconsistent with the historic interpretation of these terms. Finally, as described further below, we believe that clarification is needed regarding the application of these rules to specific situations.

A. The use of a warehouse to deliver goods to customers in other countries should not create a permanent establishment

Paragraph 22 of the proposed Commentary to Article 5(4) illustrates the application of this rule to facilities used by an enterprise for storing, displaying or delivering its own goods or merchandise. A key fact in this analysis is that the warehouse in State S is used to store and deliver goods that the nonresident enterprise sells to customers in State S. The fact that the warehouse facilitates sales to customers in State S is the reason that the nonresident enterprise can be regarded as having a significant involvement in the economic life of State S.[5] If the warehouse were to store and deliver goods primarily to customers outside of State S, however, the income arising from such sales would primarily arise from sources outside State S. Accordingly, maintaining the warehouse for purposes of deliveries to customers outside of State S should be considered preparatory or auxiliary as to State S, and therefore should not constitute a permanent establishment of the nonresident enterprise. We therefore recommend adding the following language to the end of paragraph 22:

> … Paragraph 4 would, however, apply to the warehouse if the majority of shipments from such warehouse are delivered to customers outside of State S, as the enterprise then would not be sufficiently involved in the economic life of State S through the warehouse to have a permanent establishment in State S.

This result is consistent with the original policy justification for excepting preparatory or auxiliary activities in Article 5(4), namely, that certain activities, "although they involve 'a fixed place of business' should be excepted from the general rule in order to foster international trade."[6] A warehouse that functions as a regional hub for the transshipment of goods facilitates precisely the kind of cross-border trade that the original architects of the OECD Model Tax Convention sought to encourage. This conclusion finds additional support in the old guidance regarding pipelines which has now been moved to paragraph 22.2 of the proposed Commentary, as that text suggests that Article 5(4) is intended to protect enterprises that structure their logistics operations on a regional basis from having a PE in every jurisdiction in which a component of the logistics chain is located.

B. Use the phrase "owns and operates " in order to more clearly reflect the circumstances under which a fixed place of business arises

The proposed language of paragraph 22 of the Article 5(4) Commentary states as a fact that the nonresident enterprise "maintains" in State S a warehouse. A number of places in the existing Commentary on Article 5 use some variant of the phrase "owns and operates" to indicate whether a nonresident enterprise has premises or equipment that could constitute a fixed place of business.[7] For example, the existing Commentary indicates that a nonresident enterprise may have a fixed place of business if the nonresident "owns and operates a cable or pipeline that crosses the territory of a

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[5] *Accord* OECD Model Tax Convention, Art. 5, Commentary ¶ 32 (both existing and proposed) (noting that a deemed dependent agent PE arises only in respect of persons who, in light of "the nature of their activity involve the enterprise to a particular extent in the business activities in the State concerned").

[6] Report of the Fiscal Committee of the O.E.E.C. Concerning the Elimination of Double Taxation, p. 46 (Sept. 1958).

[7] *See* OECD Model Tax Convention, Art. 5, Commentary ¶¶ 26.1, 42.3, 42.10.

country"[8] or "owns (or leases) and operates the server on which the [nonresident's] web site is stored and used."[9] The use of the word "maintain" in paragraph 22 might be misinterpreted as suggesting a lower threshold than that required for a fixed place of business. To eliminate this ambiguity, we recommend replacing the word "maintains" with the phrase "owns and operates" in paragraph 22. In the interest of consistency, conforming changes should also be made to paragraphs 22.3 and 30.3 to use the phrase "owns and operates" in place of the word "owns".

C. Clarify that a warehouse need not be operated by an "independent logistics company" to avoid being treated as a fixed place of business

Paragraph 22.3 of the proposed Commentary establishes that a warehouse of "an independent logistics company" is not a fixed place of business of a nonresident enterprise that stores goods or merchandise in the warehouse. This paragraph correctly expresses the conclusion that the mere presence of a nonresident enterprise's goods or merchandise at a warehouse owned and operated by another enterprise in a foreign jurisdiction does not give rise to a fixed place of business of the nonresident enterprise in that jurisdiction. The reference to an "independent" party in this paragraph, however, could be misinterpreted as limiting the application of this example to goods or merchandise stored at a warehouse of an unrelated entity. Whether the person that owns and operates the warehouse is independent is not relevant for purposes of determining whether a nonresident enterprise has a fixed place of business in a jurisdiction for purposes of Article 5(1). Therefore, where a nonresident enterprise simply stores its goods or merchandise in a warehouse, and does not engage in any activity on the warehouse premises through its own employees, the premises cannot constitute a fixed place of business of the nonresident, whether the premises belong to a related or unrelated party. We therefore recommend that paragraph 22.3 of the proposed Commentary be revised as follows to remove any implication that the warehouse must be owned and operated by an unrelated party.

> … Where, for example, a company in State S ~~an independent logistics company~~ owns and operates a warehouse in State S and continuously stores in that warehouse goods or merchandise belonging to an enterprise of State R, the warehouse does not constitute a fixed place of business at the disposal of the enterprise of State R, regardless of whether the enterprise and the company are connected or not, and subparagraph b) is therefore irrelevant.

V. Anti-Fragmentation Rule

The newly proposed paragraph 4.1 of Article 5 takes the anti-fragmentation rule presently in paragraph 27.1 of the existing Commentary and extends this rule to cover cases where multiple places of business in a country belong not only to a particular foreign enterprise, but also to other connected enterprises. This represents a fundamental change to a regime under which separate places of business are "to be viewed separately and in isolation", and which has never before aggregated activities of multiple enterprises for purposes of applying Article 5(4). The essential concern that paragraph 4.1 ostensibly seeks to address is the possibility that two nonresidents might fragment their activities in a source state so that both can separately rely on Article 5(4) to avoid a permanent establishment. The proposed Commentary interpreting this new provision goes further than is either necessary or appropriate to address this particular concern.

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[8] OECD Model Tax Convention, Art. 5, Commentary ¶ 26.1.

[9] OECD Model Tax Convention, Art. 5, Commentary ¶ 42.3.

Example B in paragraph 30.3 of the proposed Commentary applies the proposed anti-fragmentation rule of paragraph 4.1 to the activities of a separately incorporated subsidiary that is tax resident in the source country. The technical basis for taking the activities of SCO into account is flawed. The second bullet in Example B argues that SCO has a permanent establishment in State S, the country of its residence. But the term "permanent establishment" should refer only to the activities of a nonresident in another state, not the activities of a resident in its own state. Furthermore, there is no "fragmentation" issue when a local affiliate is involved, as that entity is fully taxable on all of its activities by the source state. The activities of SCO in Example B simply should not be considered in an anti-fragmentation analysis. The only potential preparatory or auxiliary activity in Example B, then is that of the separate fixed place of business of the nonresident enterprise, which by itself clearly does not raise any fragmentation issues. Therefore, we recommend the following changes to Example B:

> Example B: RCO, a company resident of State R, manufactures and sells appliances. ~~SCO~~TCO, a resident of State ~~S~~T that is a wholly-owned subsidiary of RCO, owns a store in State S, where it sells appliances that it acquires from RCO. RCO also owns a small warehouse in State S, where it stores a few large items that are identical to some of those displayed in the store owned by ~~SCO~~TCO. When a customer buys such a large item from ~~SCO~~TCO, ~~SCO~~TCO employees go to the warehouse where they take possession of the item before delivering it to the customer; the ownership of the item is only acquired by ~~SCO~~TCO from RCO when the item leaves the warehouse. In this case, paragraph 4.1 prevents the application of the exceptions of paragraph 4 to the warehouse and it will not be necessary, therefore, to determine whether paragraph 4, and in particular subparagraph 4 a), applies to the warehouse. The conditions for the application of paragraph 4.1 are met because
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> - ~~SCO~~TCO and RCO are connected enterprises;
> - ~~SCO~~TCO's store constitutes a permanent establishment of ~~SCO~~TCO in State S ~~(the definition of permanent establishment is not limited to situations where a resident of one Contracting State uses or maintains a fixed place of business in the other State; it applies equally where an enterprise of one State uses or maintains a fixed place of business in that same State)~~; and
> - The business activities carried on by RCO at its warehouse and by ~~SCO~~TCO at its store constitute complementary functions that are part of a cohesive business operation (i.e. storing goods in one place and selling these goods through another place).

To eliminate any uncertainty over the application of the anti-fragmentation rule to activities carried on by residents of the source state, we also recommend adding the following sentence to the end of proposed paragraph 4.1 of Article 5.

> … The activities to which this paragraph 4.1 applies shall not include activities carried on by a resident of a Contracting State through a fixed place of business located in the same Contracting State.

VI. Profit Attribution

We share the concerns of many who have commented on the earlier Action 7 discussion draft that proposing changes to the definition of a permanent establishment should not proceed without also taking into account the question of what profits are properly attributable to such a permanent establishment. We believe that in many cases, the expanded permanent establishment rules proposed in the revised discussion draft should not result in a material amount of additional profit being attributed to the source country. Therefore, we are pleased that the OECD is committed to addressing the matter of profit attribution in the coming year. In our view, the OECD is best equipped to take on this task, which should be handled by some combination of WP1 and WP6 delegates. We look forward to the opportunity to contribute to these efforts.

SVTDG Member Companies

1. Adobe Systems, Inc. Barry Slivinsky; Co-Chair
2. NetApp, Inc. Jeffrey K. Bergmann; Co-Chair
3. Accenture
4. Acxiom Corporation
5. Advanced Micro Devices, Inc.
6. Agilent Technologies, Inc.
7. Altera Corporation
8. Amazon.com
9. Apple Inc.
10. Applied Materials, Inc.
11. Avago Technologies
12. Aviat Networks, Inc.
13. Bio-Rad Laboratories
14. BMC Software, Inc.
15. Broadcom Corporation
16. Brocade Communications Systems, Inc.
17. Cadence Design Systems, Inc.
18. Chegg, Inc.
19. Cisco Systems, Inc.
20. Dolby Laboratories, Inc.
21. Dropbox
22. eBay, Inc.
23. Electronic Arts
24. Etsy, Inc.
25. Expedia, Inc.
26. Facebook, Inc.
27. FireEye, Inc.
28. Flextronics International
29. Fortinet
30. Genentech Inc.
31. Genesys
32. Genomic Health, Inc.

33. Gilead Sciences, Inc.
34. GlobalLogic, Inc.
35. GLOBALFOUNDRIES
36. Google, Inc.
37. GoPro, Inc.
38. Groupon
39. Hewlett-Packard Company
40. Ingram Micro, Inc.
41. Integrated Device Technology, Inc.
42. Intel Corporation
43. Intuit Inc. Sandra Hahn; Tax Director
44. Intuitive Surgical
45. KLA-Tencor Corporation
46. Lam Research Corporation
47. LinkedIn Corporation
48. Marvell Semiconductor, Inc.
49. Maxim Integrated
50. Mentor Graphics
51. Micosemi Corporation
52. Microsoft Corporation
53. Netflix, Inc.
54. NVIDIA
55. Oracle Corporation
56. Palo Alto Networks, Inc.
57. Pandora Media, Inc.
58. Pivotal Software, Inc.
59. Plantronics, Inc.
60. Qualcomm, Inc.
61. Rovi Corporation
62. salesforce.com
63. SanDisk Corporation
64. Sanmina Corporation
65. SAP
66. Seagate Technology

67. ServiceNow, Inc.
68. SMART Modular Technologies Corp.
69. Symantec Corporation
70. Synopsys, Inc.
71. Tesla Motors, Inc.
72. The Walt Disney Company
73. Twitter, Inc.
74. Uber
75. Visa
76. VMware Corporation
77. Xilinx, Inc.
78. Yahoo!, Inc.