



Recommendation of the Council on the Attribution of Profits to Permanent Establishments

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Background Information

The Recommendation on the Attribution of Profits to Permanent Establishments was adopted by the OECD Council on 17 July 2008 on the proposal of the Committee on Fiscal Affairs. The Recommendation aims to achieve consistency in Adherents' tax administrations in their approaches to determining the profits attributable to permanent establishments in order to reduce the risk of double taxation. The Recommendation builds on the 1997 OECD Recommendation concerning the Model Tax Convention on Income and on Capital (the Model Tax Convention) which calls Adherents, when concluding new bilateral conventions or revising existing bilateral conventions, to conform to the Model Tax Convention. The international tax principles for attributing profits to permanent establishments found in Article 7 of the Model Tax Convention have long been the subject of considerable uncertainty, particularly in respect of the extent to which they treat a permanent establishment as if it were an independent entity separate from the enterprise of which it is a part and dealing at arm's length with other parts of that enterprise. Hence, the Recommendation calls Adherents to follow the OECD 2008 Report on the Attribution of Profits to Permanent Establishments for bilateral tax conventions, which provides guidance on the principles for attributing profits to a permanent establishment under Article 7 of the Model Tax Convention.

THE COUNCIL,

HAVING REGARD to Article 5(b) of the Convention on the Organisation for Economic Co-operation and Development of 14 December, 1960;

HAVING REGARD to the Recommendation of the Council of 23 October 1997 concerning the Model Tax Convention on Income and on Capital (hereinafter referred to as the “Model Tax Convention”) [C(97)195/FINAL], in particular Article 7 (Business Profits) thereof on the taxation of business profits attributable to permanent establishments;

HAVING REGARD to the Recommendation of the Council of 13 July 1995 [C(95)126/FINAL], amended on 11 April 1996 [C(96)46/FINAL], 24 July 1997 [C(97)144/FINAL], 28 October 1999 [C(99)138/FINAL], 16 July 2009 [C(2009)88] and [22 July 2010] [C(2010)99], on the Determination of Transfer Pricing between Associated Enterprises;

HAVING REGARD to the Report of the Committee on Fiscal Affairs on the Attribution of Income to Permanent Establishments [DAFFE/CFA(93)10/REV2] (hereinafter referred to as the “1993 Report”);

HAVING REGARD to the Recommendation of the Council of 26 November 1993 concerning the Attribution of Income to Permanent Establishments with respect to the Model Tax Convention on Income and Capital [C(93)147/FINAL];

HAVING REGARD to the Report on the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations [DAFFE/CFA(95)19 and Corrigendum I] adopted on 27 June 1995 by the Committee on Fiscal Affairs, as supplemented by the report on intangible property and services adopted on 23 January 1996 by the Committee on Fiscal Affairs [DAFFE/CFA(96)2] and incorporated in Chapters VI and VII; by the report on cost contribution arrangements adopted on 25 June 1997 by the Committee on Fiscal Affairs [DAFFE/CFA(97)27] and incorporated in Chapter VIII; by the report on the guidelines for monitoring procedures on the OECD Transfer Pricing Guidelines and the involvement of the business community [DAFFE/CFA/WD(97)11/REV1], adopted on 24 June 1997 by the Committee on Fiscal Affairs and incorporated in the Annexes; by the report on the guidelines for conducting Advance Pricing Arrangements under the mutual agreement procedure adopted on 30 June 1999 by the Committee on Fiscal Affairs [DAFFE/CFA(99)31] and incorporated in the Annexes; by the report on the transfer pricing aspects of business restructurings, adopted by the Committee on Fiscal Affairs on 22 June 2010 [CTPA/CFA(2010)46] and incorporated in Chapter IX; revised by the report on comparability and profit methods, adopted by the Committee on Fiscal Affairs on 22 June 2010 [CTPA/CFA(2010)55], which replaced Chapters I III; modified by an update of Chapter IV which was adopted by the Committee on Fiscal Affairs on 6 June 2008 [CTPA/CFA(2008)30/REV1]; by an update of the Foreword and of the Preface which was adopted by the Committee on Fiscal Affairs on 22 June 2009 [CTPA/CFA(2009)51/REV1]; and by an update of the Foreword, Preface, Glossary, Chapters IV-VIII and Annexes which was adopted by the Committee on Fiscal Affairs on 22 June 2010 [CTPA/CFA(2010)47] (hereinafter referred to as the “Guidelines”);

HAVING REGARD to the 2008 Report on the Attribution of Profits to Permanent Establishments adopted on 24 June 2008 by the Committee on Fiscal Affairs [CTPA/CFA(2008)31] (hereinafter referred to as the “2008 Report”);

HAVING REGARD to the 2008 update to the Model Tax Convention adopted on 25 June 2008 by the Committee on Fiscal Affairs [CTPA/CFA(2008)36/ANN], and in particular its revised Commentary on Article 7 (hereinafter referred to as the “2008 Commentary”);

HAVING REGARD to the 2010 Report on the Attribution of Profits to Permanent Establishments adopted on 22 June 2010 by the Committee on Fiscal Affairs [CTPA/CFA(2010)38] (hereinafter referred to as the “2010 Report”);

HAVING REGARD to the 2010 update to the Model Tax Convention adopted on 22 June 2010 by the Committee on Fiscal Affairs [CTPA/CFA(2010)43], and in particular its new version of Article 7 and accompanying Commentary (hereinafter referred to as the “2010 Commentary”);

HAVING REGARD to the differences between the version of Article 7 which existed prior to the 2010 update to the Model Tax Convention (hereinafter referred to as the “pre-2010 Article 7”) and the version of Article 7 introduced by the 2010 update to the Model Tax Convention (hereinafter referred to as the “2010 Article 7”);

HAVING REGARD to the fundamental need for co-operation among tax administrations in order to remove the obstacles that international double taxation presents to the free movement of goods, services and capital between both Member countries and non Member economies;

CONSIDERING that the Recommendation of the Council of 23 October 1997 [C(97)195/FINAL] recommends to Member countries that, for the purposes of the bilateral tax conventions concluded on the basis of the Model Tax Convention, the determination of the profits that should be attributed to the permanent establishment situated in one State of an enterprise of another State be made on the basis of Article 7 (Business Profits) of the Model Tax Convention and the Commentary thereon, as modified from time to time;

NOTING that practices regarding the attribution of profits to permanent establishments and interpretations of the pre-2010 Article 7 of the Model Tax Convention and of the Commentary thereon as it read prior to the 2008 update to the Model Tax Convention have varied considerably and that this lack of a common interpretation and consistent application of Article 7 can lead to problems of double taxation and double non-taxation;

NOTING that these problems are of growing importance in view of the large number of multinational enterprises that operate through permanent establishments, particularly in the financial sector;

ACKNOWLEDGING the need to achieve consistency in the approaches of tax administrations, on the one hand, and of enterprises, on the other hand, in the determination of the profits attributable to permanent establishments;

I. RECOMMENDS to the Governments of Member countries:

1. that their tax administrations follow, when applying the provisions of their bilateral tax conventions that are drafted on the basis of the pre-2010 Article 7 of the Model Tax Convention, the guidance in the 2008 Report to the extent that its conclusions do not conflict with the 2008 Commentary on Article 7;

2. that their tax administrations encourage taxpayers to follow the guidance in the 2008 Report when applying the provisions of bilateral tax conventions that are drafted on the basis of the pre-2010 Article 7 of the Model Tax Convention and, to that end, that they give the 2008 Report publicity in their country and have it translated, where necessary, into their national language(s);

3. that their tax administrations follow, when applying the provisions of their bilateral tax conventions that are drafted on the basis of the 2010 Article 7 of the Model Tax Convention, the guidance in the 2010 Report;

4. that their tax administrations encourage taxpayers to follow the guidance in the 2010 Report when applying the provisions of bilateral tax conventions that are drafted on the basis of the 2010 Article 7 of the Model Tax Convention and, to that end, that they give the 2010 Report publicity in their country and have it translated, where necessary, into their national language(s).

II. INVITES non Member economies whose bilateral tax conventions contain provisions drafted on the basis of either the pre-2010 Article 7 or the 2010 Article 7 of the Model Tax Convention to take account of the terms of this Recommendation.

III. DECIDES to repeal the Recommendation of the Council of 26 November 1993 [C(93)147/FINAL].

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