

# Kluwer International Tax Blog

## Permanent Establishment: La lutte continue

Jonathan Schwarz (Temple Tax Chambers; King's College London) · Monday, July 24th, 2017

Google's international corporate structure and operating model has featured significantly in the political and legal debate about the taxation of multinational companies, particularly in the technology sector. Although presented in anonymous form, "Rco Group", engaged in internet search and advertising services described in the OECD BEPS Action 1, [Addressing the Tax Challenges of the Digital Economy, Annex B \(2014\), Typical tax planning structures in integrated business models, B2](#), has been recognised as representing the Google model.

The tax efficacy of that structure has been challenged in a number of countries. France is the only country, so far, where the issue has been adjudicated by the courts. On July 12, 2017 the Paris Administrative Tribunal ruled that Google Ireland Limited, an Irish resident company that sold advertising services to French customers, did not have a permanent establishment in France during the period from 2005 to 2010. The basic operating structure in France is familiar enough: Although Google Ireland Limited did not have any place of business in France, another group company, Google France, provided administrative and marketing support to Google Ireland for which it charged a service fee. The French company did not accept orders for advertising for display in France from French customers, which had to be approved by Google Ireland at its offices in the Irish Republic.

### No PE for Google in France

The Paris Administrative Tribunal dismissed the French Tax Administration's argument that Google Ireland had a permanent establishment in France as defined in article 2 of the France-Ireland double tax treaty. Most international tax practitioners would be unsurprised by this ruling. The treaty between Ireland and France follows the OECD Model, so that, if the Irish company has no fixed place of business itself in France under article 5(1) of the Model, it will only have a permanent establishment in France article under 5(5) of the Model, if there is a dependent agent there with authority to conclude contracts on behalf of the Irish company and who habitually exercises that authority. The Tribunal found that Google France did not have authority to conclude contracts and that its activities were preparatory or auxiliary within article 5(4) – its authority was only to find customers for Google Ireland. Given the amount of tax at stake and the political profile of the case, the appeal against the decision by the French tax administration is also unsurprising. It is likely to reach the Conseil d'Etat (Supreme Administrative Court).

This orthodox interpretation and application of article 5 of the OECD Model definition of permanent establishment has also been one of the drivers behind changes to the definition of

agency permanent establishment in BEPS Action 7, Preventing the Artificial Avoidance of Permanent Establishment Status, Final Report (2015) .

### **New meaning of agency permanent establishment**

This new definition has appeared as an optional provision in article 12(1) of the BEPS Multilateral Instrument signed on 7 June 2017 in Paris, and in the revised Draft 2017 Update to the OECD Model Tax Convention published on 11 July 2017. Under the revised definition, an agency permanent establishment will also exist where “a person... is acting in a ... State on behalf of an enterprise... and in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise.”

Who plays the principal role leading to the conclusion of contracts and why, is likely to be a matter of some debate. A mere introducer may not be such a person, but, where contracts are routinely concluded without material modification by the enterprise, the question may become more finely balanced.

If this does not change the treatment of arrangements exemplified by Google in France, will the changes to the operation of the preparatory or auxiliary exception in article 5(4) of the OECD Model do so? BEPS Action 7 has resulted in two changes reflected in the Draft 2017 Update to the OECD Model and article 13 of the MLI. The first is that no activities are automatically preparatory or auxiliary. Instead, it is necessary that activities are actually preparatory or auxiliary in relation to the business of the enterprise.

In addition, a new anti-fragmentation rule in article 5(4) of the OECD Model and an option in article 13(4) of the MLI requires business activities carried on by two enterprises at the same place, or by the same enterprise or closely related enterprises at both places, to be looked at together, if they constitute complementary functions that are part of a cohesive business operation. This would appear to have limited impact for digital economy activities that are simply not undertaken in a state because, for example, the servers that host the software that performs the business activities are not in the state where the customer is present.

### **BEPS MLI position**

The status quo for Google in France is maintained on these issues under the BEPS MLI. There is no match on the amended definition of agency permanent establishment to include commissionaires and similar arrangements under article 12 as between France and Ireland. Likewise, Option B in article 13(3) of the MLI applies to this treaty, so that excluded activities or places specified, continue to be outside the definition of permanent establishment. How widely the new definition will be adopted, remains to be seen.

### **VAT**

This conclusion is reinforced by the VAT treatment. The Paris Administrative Tribunal also ruled that Google Ireland was not liable for French VAT because it did not have a fixed establishment in France within article 44 of the EU VAT Directive 2006/112. The CJEU has consistently held that a fixed establishment requires both the human and technical resources to undertake the relevant activities in the country. Without servers in France or personnel to do this, there was no fixed establishment in the country.

## Digital economy conundrum

The OECD Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for Taxing Business Profits gave its Final Report issues in June 2004 the title “Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce?” The BEPS Action 1 Final Report “Addressing the Tax Challenges of the Digital Economy” in October 2015, similarly raised questions rather than provided any consensus for a new agreed allocation of taxing rights for digital economy businesses. As Churchill might have asked, is this the end of the beginning or the beginning of the end?

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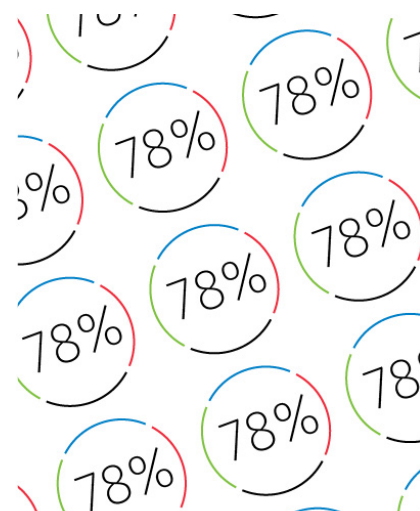
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This entry was posted on Monday, July 24th, 2017 at 2:03 pm and is filed under [BEPS](#), [OECD](#),

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### Permanent Establishments, Tax Treaties, VAT

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