COMMENTS RECEIVED ON REVISED DISCUSSION DRAFT

BEPS ACTION 7: PREVENT THE ARTIFICIAL AVOIDANCE OF PE STATUS

15 June 2015
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Ms Marlies de Ruiter  
Head, Tax Treaties, Transfer Pricing and Financial Transactions Division  
OECD/CTPA  

By email: taxtreaties@oecd.org  

11 June 2015  

Dear Ms de Ruiter  

OECD Revised Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status  

We welcome the opportunity to comment on the OECD's revised discussion draft on Action 7: Preventing the Artificial Avoidance of PE Status.  

Who we are  

The 100 Group of Finance Directors represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent around 90% of the market capitalisation of the UK FTSE 100 Index, and in 2014 paid, or generated, taxes equivalent to 14% of total UK Government receipts. Our aim is to contribute positively to the development of UK and international policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. Whilst this letter expresses the views of The 100 Group of Finance Directors as a whole, those views are not necessarily those of our individual members or their respective employers.  

Our views  

We are concerned that a project intended to tackle BEPS has turned into a broader review of the allocation of taxing rights between source and residence countries. This will result in an increased risk of double taxation in non-abusive circumstances unless there is a very clear consensus as to the precise detail of how the new approach will be applied, including objective (rather than subjective) criteria and "bright lines" tests, supported by clarifying examples. The revised proposals are still somewhat subjective in nature and further guidance will be necessary. There is a particular risk that very large numbers of very small PEs will arise which will create administrative difficulties for all.  

We welcome the assurance that the attribution of profit to PEs will be examined during 2016 and would be very willing to contribute to that work.  

The Discussion Draft seeks to address artificial avoidance of PE status through the use of commissionaire arrangements and similar strategies. Commissionaire arrangements, and other arrangements involving dependent agents, are quite frequently employed in non-abusive cases. We believe that the proposed measures will not only impact commissionaire arrangements, but also a wide range of arrangements used for making direct sales or providing sales support, i.e. limited risk distributor and other principal structures. Furthermore, appropriate weight should be given to the nature of the activities and the functions being performed, outside the territory in which it is argued that the PE exists. In
such instances, where significant substance and activities do take place outside the territory, 'bright line', objective tests or gateways could perhaps be used to exclude the existence of a PE. We suggest that there is a strong case for applying the existing rules where there is no intended abuse and where arrangements, often of long standing nature, represent an efficient way of conducting business. For example, where a genuine representative office is established and operates as a non-taxable presence the existing practice should not be disturbed. We feel that there is still time to develop a test to exclude non-abusive cases.

The new approach to determining whether an activity is preparatory or auxiliary will require very fine judgments on complex questions of fact. The additional guidance is helpful but it would also be useful to outline a review mechanism or other process to build on experience as it develops in a coherent manner rather than to allow potentially conflicting practices to develop in individual countries.

The revised anti-fragmentation rule is clearer than the previous draft. It would be helpful to emphasise, as strongly as possible, that the rule applies only to complementary functions that are part of a cohesive business operation and that a wider “force of attraction” principle is not therefore supported. However, we are concerned that in practice proving the negative statement that a function is not a complementary function that is part of a cohesive business operation is not sufficiently workable to avoid the implication that whenever a multinational entity has a subsidiary in a source state, any additional activity, however minor, carried on by a non-resident will create a PE. This appears to render all the discussions of preparatory and auxiliary activities null and void when there is a subsidiary in the same state, as there will very often be. The inclusion of activities of a resident subsidiary seems to essentially prejudge the outcome of the test of whether the PE threshold is reached, which is what the anti-fragmentation rule is meant to be.

We strongly recommend that the anti-fragmentation rule only apply to the aggregated activity of non-resident related parties. This would retain the coherence of an anti-fragmentation rule as a threshold test. If the OECD insists on an anti-fragmentation rule that includes the activity of resident, we strongly urge the inclusion of a carve out in situations where the combined activity of the non-residents is minor by comparison to the (taxed) activity of the residents. Such an exception would go some way to preventing the proliferation of low value PEs.

We would be very happy to discuss this in more detail with you. Please do get in touch if you wish to discuss this further with me and the Committee.

Yours sincerely

Andrew Benfield
Chairman, Taxation Committee
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www.the100group.co.uk
12 June 2015

By email to: taxtreaties@oecd.org

Marlies de Ruiter
Head, Tax Treaties
Transfer Pricing and Financial Transactions Division
OECD/CTPA

Dear Marlies,

**BEPS Action 7: Preventing the artificial avoidance of Permanent Establishment (PE) status**

*General comments*

AFME\(^1\) and the BBA\(^2\) welcome the opportunity to respond to the OECD’s discussion draft entitled “BEPS Action 7: Preventing the artificial avoidance of PE status” published on 15 May 2015. We wish to make clear that while AFME and the BBA have separate and distinct memberships, for the purposes of the OECD discussion draft, both organisations have decided to submit a single, combined response since our respective members share some concerns with the OECD’s proposals in the discussion draft.

We welcome that the OECD is consulting with business on its proposals. We believe that this approach is to the benefit of both policymakers and business and helps to avoid any unintended

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\(^1\) The Association for Financial Markets in Europe (AFME) represents a broad range of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks and other financial institutions. AFME advocates stable, competitive and sustainable European financial markets, which support economic growth and benefit society.

\(^2\) The British Bankers’ Association (BBA) is the leading association for the UK banking and financial services sector, speaking for 180 banking members, headquartered in 50 jurisdictions and operating in over 180 territories worldwide jurisdictions, on the full range of UK or international banking issues. Collectively providing the full range of services, our member banks make up the world’s largest international banking centre.
consequences arising from the OECD’s initial proposals. We believe that it is also valuable for the OECD to take account of the views of business on the practical aspects of operating the intended policy.

The very short time available to consider the discussion draft poses a challenge for all businesses and the OECD secretariat. Should it be of assistance we would be pleased to meet with the OECD Secretariat to discuss these matters in greater detail or provide further information upon request.

We have chosen to provide brief comments, and to illustrate our concerns with the proposals on the commentary on Article 5(5) of the Model Tax Convention by way of examples. Our letter of 9 January 2015 in response to the previous consultation on Action 7, sets out our detailed concerns, which we do not believe have been entirely addressed by the revised proposals and draft commentary.

**Dependent agent PE test**

We note the proposed new test in Article 5(5) of the OECD’s Model Tax Convention may be met where a person acts in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, or negotiates the material elements of contracts. We also note the proposed changes to the commentary on Article 5(5) on the meaning of the phrases “habitually” and “concludes contracts, or negotiates the material elements of contracts”.

We are still concerned that arrangements which are generally considered to be part of the ordinary course of business of financial institutions, and which do not lead to base erosion or profit shifting, could be caught by the test in Article 5(5). We think it is unhelpful to both tax authorities and taxpayers to alter Article 5(5) in a manner which could lead to a significant number of new permanent establishments arising, but where the activities and taxable profits are already fully recognised in the territory of the agent.

We set out below some specific examples of activities which we would consider part of the ordinary course of business of banks which we are concerned could fall within the proposed dependent agent PE test. Where possible, we suggest below some changes to the commentary on Article 5(5) which we believe would provide much needed reassurance to the financial services sector. Without further clarity in the commentary, there is a risk that Article 5(5) could be interpreted on an inconsistent basis in different jurisdictions and this could have a distortive impact on cross-border trade and unnecessarily increase tax compliance costs for taxpayers and tax authorities.

**Example 1**

Banks with global operations will often centralise the trading of certain products or markets within hub entities for a variety of commercial and regulatory reasons, and will utilise sales people based in multiple local country or regional coverage entities (e.g., local subsidiaries or sister companies) to sell those products to clients globally. For example, a bank might centralise trading of the UK equities products within a UK based entity, and utilise sales people in entities in other locations to sell those products to clients globally. The local companies will often be
substantial banking or other financial services businesses carrying out their own operations in
the local market, in addition to the sales activity on behalf of a non-resident described above.

Under existing practices, the above sales activities would typically be rewarded on an arm’s
length basis and would not generally be expected to create a PE. If a PE was created, it is
unlikely that it would lead to any increased tax liability as the local sales activity has already
been fully remunerated. However additional tax filings could be needed, whereas at present the
activity is included in the tax returns of the local company.

From an administrative perspective we would envisage that this would lead to greater demands
being placed on tax administrations’ resources to cope with a greater volume of work as
businesses seek to ensure tax compliance. Furthermore, we are concerned that the obligations
imposed on taxpayers and tax authorities will not lead to a material difference to the tax
collection and may generate significantly more disputes, which will need to be resolved via
dispute resolution procedures. We also note that the recognition of a new PE for tax purposes
could in some cases result in additional non-tax consequences e.g. a jurisdiction’s regulatory
authority might examine whether there was also a PE for regulatory purposes. The costs and
complexity of any increased administrative burdens do not appear proportionate or productive
for those cases where the agent is adequately rewarded.

We include an example illustrating such a case at Appendix 1.

Example 2

Banks spend a great deal of time and effort in establishing and building relationships with
prospective clients. A bank may spend some years speaking to a prospective client in a
jurisdiction before the bank is engaged on a mandate, or generates any revenue from the
relationship. Some of those discussions may involve visits to the client’s jurisdiction; in some
cases the bank may have local staff involved. These staff may be working for a local subsidiary,
affiliate or a branch of the bank, which ultimately will provide services to the customer e.g.
advice and support in respect of an equity capital raising by the local client. Often the result of
that relationship management may be transactions that are entered into with a member of the
bank’s group outside of the client’s jurisdiction because that company is best placed to provide
the relevant service, for example securing investors in another market for a new issue of shares
by the client.

Under existing practices, the local subsidiary, affiliate or branch will receive compensation for
the work of the local staff, under transfer pricing policies appropriate to the services performed
and agreed with local tax authorities.

We include an example illustrating such a case in Appendix 2.

Example 3

We believe that Paragraph 33.1 of Paragraph 5 of the commentary to Article 5(5) should make
clear that business personnel may undertake short term business travel to jurisdictions without
creating a PE. We include an example illustrating such a case at Appendix 3, although there are other possible examples which could be used to illustrate this point.

**Recommended changes to the commentary for Article 5(5)**

To address the concerns arising in Examples 1 to 3 above, we would strongly recommend the following steps:-

a) it should be made clear that where a group's transfer pricing policy appropriately provides for income, which is recognised and taxed by an appropriate entity taxable in the relevant jurisdiction, the recognition of a further permanent establishment is not required. In these cases, the income recognised should be consistent with approved transfer pricing policy. For banks, reference should be made to the principles contained in the OECD's 2010 report on the attribution of profits to permanent establishments.

b) further guidance should be developed as to the meaning of the terms "habitually" and "concludes contracts, or negotiates the material elements of contracts" and how they should be interpreted in the context of regulated banking activities. We should be pleased to contribute to the development of such guidance.

We believe that proceeding with steps (a) and (b) above would be consistent with the objective of addressing BEPS activity while not producing unnecessary administrative burden on taxpayers and tax authorities.

We are grateful for the opportunity to share our comments with the OECD on the discussion draft and we would be happy to discuss any of the above in greater detail with the OECD and would be pleased to contribute further as the OECD's work develops.

Yours sincerely,

Richard Middleton
Managing Director
Tax and Accounting Policy
AFME

Sarah Wulff-Cochrane
Director of Policy
Taxation
BBA
Appendices 1, 2 and 3 are attached separately
A Co is the company in the group responsible for trading equities or government bonds.

Sales are made to customers in jurisdiction B to F.

For commercial and/or regulatory reasons, sales people in each country are responsible for local customers.

Pricing decisions are made by A Co traders in Country A.

The sale is made by A Co directly to customers B to F.

Currently each of B Subsidiary, C Branch, D Subsidiary, E Affiliate, and F Affiliate receive an appropriate arm's length fee for their sales services consistent with the OECD's approved approach on transfer pricing.

A permanent establishment (PE) of A is only recognised in country C under current practices.

We are concerned that without further guidance, PE's will now be recognised in country B, D, E, and F with no incremental recognition of taxable profits.
A Co and Z Co have staff who provide services - e.g. capital raising - relevant to their domestic market to international customers. This may be because the domestic markets in countries A and Z have a much wider range of potential investors in new share issues than is the case in countries B, C, D, E and F. This approach helps independent businesses in countries B, C, D, E and F raise the new share capital that they need at the best price.

Each of B Subsidiary, C Branch, D Subsidiary, E Affiliate and F Affiliate has a member of staff responsible for maintaining good working relationships with customers in their respective jurisdictions.

Customers of B to F may wish to access the services of A Co and Z Co infrequently, but when they do, the contractual relationship may be of a significant size.

The only PE currently recognised is that of A Co in Country C.

The staff in countries B, D, E and F are otherwise working on behalf of local subsidiaries.

These local subsidiaries, affiliates and branch receive an appropriate arm’s length fee for their services.

The terms of the contracts with A Co and Z Co are negotiated and agreed by those companies in countries A and Z. However, staff in the local subsidiaries might have some limited involvement in discussions relating to any such contract.

We are concerned that without further guidance, PE’s will now be recognised in countries B, D, E and F with no incremental recognition of taxable profits.
The facts are the same as set out in Appendix 2. However, one or two staff of A Co visit the customer in country E in the course of a short visit to country E, discuss some aspects of a possible contract during that visit, but do not agree the terms of that contract with the customer until some weeks or months later when they are in country A. We consider that A Co does not have a PE in country E in that case - nor is it intended by the revisions to Article 5(5) that it should - and that the guidance on what is meant by both “negotiates the material elements” and “habitually” needs to be sufficient to make that clear.
Dear Ms de Ruiter,

The Luxembourg Insurance and Reinsurance Association (ACA) is an association regrouping insuring and reinsurance companies based in Luxembourg. Our aims are to protect and defend the interest of our members, and to discuss any given issues, (being it of fiscal, regulatory or other nature) which may affect the insurance industry.

ACA’s goal is thus to establish and foster an on-going contact between the insurance companies and to address any question in relation to their activities. In this respect, ACA had commented on Action 7 of the BEPS Action Plan and wishes to comment on the revised discussion draft of Action 7 of the BEPS Action Plan.

First of all, ACA agrees with your analysis that option M should not be taken into account and that “no specific rule for insurance enterprises should be added to Article 5”, which reflects also our prior comments made in January 2015.

ACA would like to emphasise the necessity of clear definitions of “material elements” in Article 5(5) and “dependent agent” in Article 5(6) as these are of prior importance to the insurance industry.

As mentioned in our the previous comments insurance companies assume five “key functions” as defined by the Solvency2 Directive (2009-138 EC) i.e. “risk management, own risk and solvency assessment, internal control, internal audit and actuarial function” which by their nature are essential i.e. “material elements” to allow for an insurance undertaking to market its products. Functions such as sales and marketing of insurance, back-office processing of application, administrative support, claims handling and investment management are not “key functions” and should consequently not create a permanent establishment for tax purposes.
It is common for insurance companies to rely on intermediaries (such as agents) to distribute their products on either the national territory and/or abroad (depending on the business model) regardless of the country of residence of the insurance company. Albeit that these agents may “depend” on one insurance undertaking (i.e. as a so-called “tied agent”) their tasks do not consist in carrying out any of these “key functions” as their functions do not include the assumption and management of insurance risk/business but moreover consist in the distribution of the insurance products of that very insurance company.

ACA’s proposal aims at clarifying these specificities inherent to the insurance sector so as to avoid any legal uncertainty i.e. working for one insurance undertaking as such (i.e. sales) is not to be considered constitutive of “material elements” of an insurance contract. Those precisions should be added in the commentary to Article 5(5) and 5(6), as the mere application of the concept of “dependent agent” to the insurance sector could otherwise result in the recognition of a permanent establishment solely for tax and not for regulatory purposes.

Yours sincerely,

Marc HENGEN
Administrateur-Délégué
The UK Insurance Industry

The UK insurance industry is the third largest in the world and the largest in Europe. It is a vital part of the UK economy, managing investments amounting to 26% of the UK’s total net worth and contributing £11.8 billion in taxes to the Government. Employing over 315,000 people in the UK alone, the insurance industry is also one of this country’s major exporters, with 28% of its net premium income coming from overseas business.

Insurance helps individuals and businesses protect themselves against the everyday risks they face, enabling people to protect themselves, their families, their homes and assets, provide for a financially secure future and manage the risks faced in their businesses. Insurance underpins a healthy and prosperous society, enabling businesses and individuals to thrive, safe in the knowledge that problems can be handled and risks carefully managed.

The ABI

The Association of British Insurers (ABI) is the voice of the UK insurance, representing the general insurance, protection, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK.

The ABI’s role is to:

- Be the voice of the UK insurance industry, leading debate and speaking up for insurers.
- Represent the UK insurance industry to government, regulators and policy makers in the UK, EU and internationally, driving effective public policy and regulation.
- Advocate high standards of customer service within the industry and provide useful information to the public about insurance.
- Promote the benefits of insurance to the government, regulators, policy makers and the public.

Introduction

1. The ABI continues to support the aims of the OECD BEPS Action Plan to address weaknesses in the international tax environment and we are grateful for the opportunity to comment on the updated discussion draft. Our comments reflect our desire to ensure that any measures are workable, well targeted, and proportionate in the context of the efficiency of commercial insurance operations.

2. We welcome the conclusion of Working Party 1 that no specific rule for insurance operations should be introduced.

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1 Discussion draft on OECD BEPS Action 7: Preventing the Artificial Avoidance of PE Status released 15 May 2015.
A. Artificial avoidance of PE status through commissionnaire arrangements and similar strategies

3. We are pleased that Working Party 1 has concluded that Option B is preferable to Options A, C and D and that additional commentary on interpreting Articles 5(5) and 5(6) has been added. However, Option B is still widely drafted and although the commentary on how those Articles should be interpreted is generally helpful it needs to be expanded and some of the meanings need to be more specific in order to avoid inappropriate impacts on insurers. In particular, the commentary does not suggest that the facts and circumstances of the business value chain should be taken into account as part of the determination of whether there is a PE. We believe it should. We also believe the meaning of “material elements” of contracts and “dependent agent” needs to be more specific.

4. Unless the commentary is extended and the meaning of “material elements” of contracts and “dependent agent” made more specific the outcome will be the creation of a number of insurance PEs for tax (but not regulatory) purposes for activities that are not Key Entrepreneurial Risk-Taking (KERT) functions. As explained in 2010 OECD Report on the Attribution of Profits to Permanent Establishments Part IV (Insurance) (“Part IV”) the KERT function of insurance is the assumption and management of risk/business by appropriately skilled employees, which with the capital that is required to be held against these risks is where insurers have their economic substance. Although Part IV does not specifically apply when determining whether a PE exists, a conclusion that PE’s should exist even where the activities undertaken are not high value will lead to many additional PEs with non-KERT functions being created and following the principles of Part IV will have no or minimal additional profit attributed to them. This creates an unnecessary administrative burden for business and tax authorities.

5. We explained in paragraph 30 of our response to the original discussion draft\(^2\) that we believe there is an enormous difference between commissionaire arrangements and the sale of insurance. The updated commentary on interpreting Articles 5(5) and 5(6) appears to be written in the context of businesses that sell goods etc., and we believe the inappropriate impacts identified in paragraphs 7 and 8 below arise because the commentary does not take into account the relative importance of the functions performed by the business in question i.e. no account is taken of where the KERT functions (i.e. what drives the profit) are performed.

6. The functions performed by insurers in the insurance business value chain and the relative importance of those functions to their business depend on various factors including the type of insurance business (general, life or reinsurance), the line of business and the products sold. The insurance business chain is explained in detail in Part IV, which in particular recognises a number of times (for example in paragraph 94) that the main KERT function of insurers is generally the assumption and management of insurance risk/business.

\(^2\) Discussion draft on OECD BEPS Action 7 (Preventing the Artificial Avoidance of PE Status) released 31 October 2014.
7. Taking into account the differences between commissionaire arrangements and the sale of insurance and the insurance business value chain, the aspects of insurance business models that may be inappropriately impacted include:
   - Sales and marketing of insurance products – it is acknowledged in Part IV that sales and marketing is only one of the functions in the insurance business value chain and that such functions are unlikely to be a KERT function.
   - Routine non-KERT functions performed by an in-house service company, such as back office processing of applications, claims handling, investment management, administrative support and/or consultancy services.
   - Where Delegated Underwriting Authorities (DUAs) (see Appendix 2 of our response to the original discussion draft for a description) are in place, and the agent acts exclusively or almost exclusively for the insurer. The authority granted under a DUA is strictly limited and there would be no KERT function undertaken by the agent.

8. Although tax PEs would be created in each of these circumstances as a result of the proposed amendments to Articles 5(5) and (6), the functions being performed are non-KERT and therefore no or minimal additional profit would be attributed to the PEs created (which would already be rewarded commensurate with the duties performed). There would therefore be a disproportionate compliance burden placed on insurers.

9. We do not believe the object and purpose of Article 5 is to create PEs for non-KERT functions which are already being rewarded commensurate with the duties performed. We therefore believe that the commentary should be expanded to help limit the inappropriate impacts identified in paragraphs 7 and 8 above. Currently there is nothing in paragraphs 32.5 to 32.8 of the commentary that suggests the facts and circumstances of the business value chain should be taken into account as part of the determination of whether there is a PE. We believe that the commentary would benefit from such an addition.

10. We also suggest that to recognise the fact that the insurance value business chain is different to the selling of goods that:
   - in the insurance context “material elements” of contracts should be linked to the assumption and management of the insurance risk/business,
   - an unconnected agent who is performing non-KERT functions and being rewarded commensurate with the duties performed should not be treated as a “dependent agent” even where the agent acts exclusively for a particular business, and
   - where an agent connected with the insurer is performing regulated (non-KERT) activities in the same territory as the customer and is rewarded directly, on arm’s length terms, by the customer this should not necessarily lead to the creation of a PE. This could, for example, relate to a broker distributing insurance products where the broker is rewarded through a fee charged to the customer independently from any fees charged by the provider of the insurance products. The broker will be taxed on their arm’s length fee in the jurisdiction in which the customer is located and the customer will also be subject to taxation (if applicable) in that jurisdiction. The insurance products concerned
may involve standard contracts and therefore the broad statement in paragraph 32.6 of
the commentary that the use of a standard contact falls within “concludes contracts or
negotiates material elements of contracts” would result in PEs being created where
there would be no or minimal additional profit attributed. This situation also potentially
applies to DUA arrangements – see paragraph 7 above. Our suggestion in paragraph 9
above that the commentary should be expanded so that in determining whether there is
a PE the facts and circumstances of the business value chain should be taken into
account, should help mitigate against any inappropriate impacts.

11. Part IV of the report provides comprehensive guidance defining and discussing risks, risk
management and allocation of risk in the context of insurance businesses and therefore
referencing the relevant existing guidance for insurers would seem to be a sensible approach
given the time and review which has already gone into this process. On this basis, we believe
there should be a reference to Part IV in the commentary on Article 5(5) and 5(6). A suitable
place to include this in the commentary would be in paragraph 39.

B. Artificial avoidance of PE status through the specific activity exemptions

1. List of Activities included in Article 5(4)

12. We have no comments on the updated proposals.

2. Fragmentation of activities between related parties

13. We believe that that clear commentary and guidance on the meaning of “constitute
complementary functions” and “cohesive business operation” is necessary to ensure that there
is consistency in how these words are interpreted by different tax authorities. Without this there
is a risk that different territories will have a different interpretation leading to disputes and
potentially double taxation.

C. Splitting-up of contracts

14. We have no comments.

D. Insurance

15. We welcome the conclusion of Working Party 1 that no specific rule for insurance operations
should be introduced.

E. Profit attribution to PEs and interaction with action points on transfer pricing

16. We have no comments on the updated proposals.

Association of British Insurers
12 June 2015
OECVD Revised Discussion Draft under BEPS Actions 7 – Preventing the Artificial Avoidance of PE Status

We welcome the opportunity to comment on the OECD’s revised discussion draft on revisions to Article 5 of the OECD Model Tax Convention. Our comments focus specifically on the new anti-fragmentation rule, due to the far reaching impact which we believe will result from this change. We are pleased to contribute our comments on this issue below.

Proposal 3: New Anti-Fragmentation Rule

Under the current proposal the anti-fragmentation rule prevents the application of the paragraph 4 exemptions in instances when an enterprise already has a permanent establishment in that territory and the business activities, when combined with the existing permanent establishment (“PE”), “constitute complementary functions that are part of a cohesive business operation.”

The proposed guidance at paragraph 30.3 indicates that where “an enterprise of one State uses or maintains a fixed place of business in that same State” then this would constitute an existing PE for the purposes of the anti-fragmentation rule.

The implication of this would be that for any territory in which a multinational enterprise currently operates through a fixed place of business, which for AstraZeneca would be all of its global subsidiaries in over 60 countries, the paragraph 4 exemptions could not be relied upon for any activity undertaken in that territory by the overseas parent if this was considered to constitute a complementary function that would form a cohesive business operation in that territory.

The paragraph 4 exemptions would therefore no longer be available to AstraZeneca in a large number of territories in which we operate unless any additional activity is not a complementary function, which in practice would be very hard to prove. We therefore believe the proposal would capture many arrangements which are entirely commercial and in no way motivated by tax avoidance. We have set out below one example of how the anti-fragmentation rules would impact a commercial operation of AstraZeneca which should not be subject to tax avoidance rules.

In Hungary AstraZeneca currently has a buy / sell legal entity, AstraZeneca Kft, which purchases products from AstraZeneca UK Ltd (“AZUK”) and sells these into the market, making an arm’s length profit for its sales and distribution function. Separately to this AZUK contracts with a third party distributor in Hungary which provides a warehousing service for AZUK’s stock bound for various Eastern Europe territories, including Hungary. The third party distributor is a Hungarian legal entity unconnected to AstraZeneca and is
remunerated for its warehousing service accordingly. Under the current OECD guidance we would rely on the paragraph 4 exemptions to prevent the warehouse from creating a PE of AZUK. However, as AstraZeneca Kft would constitute a PE for the purposes of the anti-fragmentation rules, this could no longer be relied upon if the warehousing function of AZUK constitutes a complimentary function that forms a cohesive business unit with AstraZeneca Kft, and a PE could result. It would then need to be determined whether the entire warehouse function would form a complimentary function or only the service in respect of the stock bound for AstraZeneca Kft. If the latter, the profit attributable to the warehousing function would then need to be apportioned between the Hungarian PE and the remaining stock.

In addition, as the third party distributor is already being remunerated for the provision of its warehousing service, any tax levied on AZUK in respect of the warehouse would be double taxation of that function. The OECD guidance, both in respect of the revised article 5 and also article 7, is currently unclear whether the tax assessed on the permanent establishment should be reduced for any tax already being paid in that territory by an unconnected party in respect of that same function.

The example illustrates the complexity, subjectivity and ultimately non-productive effort in applying the proposed anti-fragmentation rule. Following from this example we therefore think there are a number of key areas which need to be addressed in respect of the anti-fragmentation rule.

The first and most important point is that we recommend there should be an exemption from the rule where there is a clear commercial purpose for the fragmentation.

In addition, it would seem more reasonable for the rule to only operate to combine current non PE creating activities of an overseas entity in a territory, rather than including existing local PE’s. The would preclude any activity by an overseas company in a territory in which they have a subsidiary automatically creating a PE risk, irrespective of how minor that additional activity is.

We also recommend that clearer guidance regarding what constitutes “complementary functions that are part of a cohesive business operation” is required, as there is little commentary on this in the current draft.

Finally, we would welcome future guidance to ensure that when apportioning profit to a PE, that profit is reduced for any amounts already being paid to unconnected enterprises in that territory for the use of that PE. This is critical to avoid uncertainty and double taxation which could otherwise require competent authority involvement to resolve.

We note from the final paragraph on page 7 of the revised discussion draft that the OECD recognises the need for additional guidance on the attribution of profit, and that this will be released following the finalisation of Actions 7 – 10, however we wanted to take this opportunity to emphasise the importance of this guidance in light of the anti-fragmentation rules.
We appreciate the opportunity to submit our views and should you wish to discuss our response further in a meeting or on a call then please do not hesitate to contact me.

Yours sincerely

Ian Brimicombe
Vice President Corporate Finance
AstraZeneca
Dear Mrs. de Ruiter,

BDI* refers to the OECD Revised Discussion Draft “Preventing the Artificial Avoidance of PE Status” issued on 15 May 2015. We would like to thank you for the possibility to provide our comments that allow us to engage with you on these important issues. We focus our feedback on the most fundamental issues raised in the draft.

In the revised draft the OECD has moved from a series of alternative options to specific proposal under each PE issue and added some additional guidance to various concepts. We welcome every effort to provide additional clarity to the OECD Model Tax Convention. However, we are still concerned that the proposals in the Draft will result in a lowering of the PE threshold that goes beyond the specific problems related to BEPS in general and the digital economy in particular. Therefore, the proposals as they stand, are likely to result in a dramatic increase in PEs with allocation disputes and double taxation as the end result. It must be ensured that bona fide business is not being impaired by an increasing numbers of PEs.

A. Artificial avoidance of PE status through commissionaire arrangements and similar strategies

We appreciate the efforts to narrow the concept of “associated enterprises” and also to provide additional guidance as to the interpretation of paragraphs 5 and 6. However, we are still concerned that the proposals will affect not only commissionaire arrangements but also other principal sales structures.

* BDI (Federation of German Industries) is the umbrella organization of German industry and industry-related service providers. It speaks on behalf of 36 sector associations and represents over 100,000 large, medium-sized and small enterprises with more than eight million employees. A third of German gross domestic product (GDP) is generated by German industry and industry-related service.
The proposals are based on the presumption that a restructuring of a sales company to a commissionaire structure will substantially reduce the taxable profits in the country of the commissionaire. We believe this to be a transfer pricing issue rather than a PE issue which should be addressed through a proper functional analysis and a discussion about appropriate remuneration.

We are also concerned that a number of the Discussion Draft proposals will lead to difficulties in interpretation, and ultimately, disputes. Difficulty in interpretation is exacerbated by the use of several new concepts and terminology. Where new language is proposed, every effort should be made that sufficiently detailed guidance is provided to facilitate objective and consistent interpretation.

B. Artificial avoidance of PE status through the specific activity exemptions

The Draft proposes changes to paragraph 4 of Article 5 by making all the exceptions in the paragraph subject to a preparatory or auxiliary condition.

Although the activities listed in 5.4 in many cases are of a preparatory or auxiliary character, it is acknowledged in para 21 in the Commentary to Article 5 that this is not always the case. There seems to be a lack of consensus between Member States as to the original purpose of the paragraph, i.e. whether it should cover only preparatory or auxiliary activities. Regardless of the original purpose, the Draft clarifies that Working Party 1 has concluded that situations that give rise to BEPS concerns need to be addressed.

To do so, the measure in question has to be sufficiently targeted. Our concern, however, is that the proposed measure will not only target BEPS concerns but will also affect traditional businesses with a dramatic increase in PEs as a result. Again, the measure seems to go beyond the intended objective and indeed change the international standards on the allocation of taxing rights on cross-border income.

We therefore encourage the OECD to give further and more specific guidance and to develop a sufficiently robust framework to implement this proposal on an internationally consistent basis in order to prevent substantial additional uncertainty and deriving disputes between businesses and tax administrations.

With regard to the fragmentation of activities between related parties we believe that Option J is an expansive anti-fragmentation rule, which will be difficult to operate in practice, moving away from the widely agreed concept of separate entity reporting. It will be necessary to monitor the activities of each and every entity on a worldwide basis and to connect those activities to the activities of all other entities. In big multinational enterprises this task will be extremely difficult to fulfill. We also believe that more detailed guidance is needed regarding the notion of “complementary functions that are part of a cohesive business operation”. The two examples given in the Commentary are not sufficient.
C. Splitting-up of contracts

Although a principal purpose test would, in principle, give companies a possibility to show that no abuse was intended it would undoubtedly open up for wide application by tax authorities and induce additional uncertainty into the PE test. The example provided in the Draft (Example E) does not give much guidance or assurance as to the application of the PPT rule since it is a fairly clear cut case.

The “automatic” approach in option K has its flaws due to the fact that it applies indiscriminately and would also capture situations where there is no BEPS concern. In addition the minimum presence of 30 days is too short and would be difficult to administer and monitor. All parts of an MNE may not be fully aware of all the activities of the group as a whole.

E. Profit attribution to PEs and interaction with Action Points on Transfer Pricing

Since the kind of activities mentioned under paragraph 4 of Article 5 have been recognized not to generate any or very little income, the question of profit attribution to PEs is of major importance. Although we welcome the acknowledgement that work on profit attribution is indeed required, we believe that this work should actually take place before amendments to the Model Convention and associated Commentary have been finalized. Countries are often motivated to create PEs in order to attribute profits to those PEs. Given that the proposals will lead to a significant number of new PEs, it would seem prudent to have up-front discussions (with government delegates and the broad stakeholder community) on how attribution principles will apply, and whether those updated principles will result in an increase in taxable profits, over and above what has already been declared under Article 9 principles (where there are already taxable entities). Only after such an assessment would countries be best placed to determine whether the proposed amendments, which introduce great subjectivity, are appropriate.

Agreeing to profit attribution principles is a notoriously difficult area of international taxation, and many years were required to develop the current guidance applicable to the financial services industry. We welcome the OECD initiative to provide further guidance in this important area before the end of 2016. Full and ongoing stakeholder input will be required throughout the development of this work to ensure that the new guidance is fit for purpose.

Please do not hesitate to contact us if you have any questions.

Sincerely,

Berthold Welling   Dr. Karoline Kampermann
BEPS MONITORING GROUP

Comments on BEPS Action 7: Revised Discussion Draft on Preventing Artificial Avoidance of PE Status

This report is published by the BEPS Monitoring Group (BMG). The BMG is a group of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. This paper has not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives.

This paper has been prepared by Sol Picciotto and Jeffery Kadet, with comments and input from Cristián Garate, Markus Henn, Annet Oguttu, James Stewart, and Maria Villanueva.

We are grateful for the opportunity to contribute these comments.

SUMMARY

We are concerned that this revised discussion draft (RDD) seems to have given too much weight to the quantity of comments received on the initial draft, failing to take into account that since the vast majority came from the same community of MNEs and their paid tax advisers, it is hardly surprising that they tend to agree. In particular the RDD picks out the comments which defended ‘the fundamental concept of the independence of legal entities’, without mentioning our submission pointing out that it flies in the face of business reality to claim that associated entities within a multinational corporate group operate as independent parties, a view which is supported by economic theory and practice, and by most independent commentators.

We welcome that nevertheless a majority of the Working Party agreed to the proposed anti-fragmentation rule, although it has been given very limited scope. Indeed, the Working Party has interpreted its mandate very narrowly, focusing essentially on commissionaire arrangements and sales-related activity, so that its proposals will only deal with a few types of corporate fragmentation, those related to delivery of goods to customers. The proposals on commissionaire arrangements leave unclear whether they will apply even to activities such as marketing, while failing to deal with many other types of functional fragmentation which facilitate BEPS.

The RDD does not deal at all with the reality of the modern world in which real value is created through scientific research and the development and testing of products and services, in continuous processes of innovation and improvement. This is not just a ‘digital economy’ issue. Spending on innovation is key to the success of many businesses today. This must be reflected in Article 5 with sufficient nuance that MNEs will not continue to undervalue for source countries the value that is truly created within their borders.

The report also does not deal with the key issue of attribution of profits, which has been deferred to be dealt with after the G20 deadline for the BEPS project, perhaps in conjunction with the continued work on the Digital Economy. The weakness of these proposals is confirmed by the introduction by some OECD countries (e.g. Australia, UK) of unilateral measures to tax ‘diverted profits’. Developing countries should also take measures to protect their tax base, e.g. through withholding taxes on fees for services, but these are blunt instruments (applying to gross payments rather than profits). An internationally coordinated approach would clearly be far better both for business and revenue authorities.
The BEPS project is in our view seriously weakened by this failure to reconsider the permanent establishment concept to provide a definition of taxable presence more suited to the 21st century.

1. GENERAL REMARKS

A. Nature of the Consultations.

1. This revised discussion draft (RDD) results from a review by Working Party 1 of the proposals in the initial discussion draft, ‘in light of’ the written comments submitted on that draft and the discussions at the public consultation meeting. We are concerned that undue consideration may have been given to the quantity of submissions supporting some of the options or proposals, without taking account of the source of the submissions. This gives the appearance that the process has been captured by vested interests. It is notable that out of almost one hundred comments received, it seems that only four were not from tax advisers, industry associations, or specific MNEs, all parties with a vested interest in minimising change from the status quo. The discussions at the public consultation were similarly dominated by participants representing vested interests, with only a handful of independent commentators.

For example, the RDD states that ‘The vast majority of commentators who expressed a preference for one of the options supported Option B (more than twice as many commentators than for the three other options combined)’ (para. 17). It is hardly surprising that the ‘vast majority’ of comments would tend to agree, if they come from the same community of MNEs and their paid tax advisers and tax planners. The existence of a shared perspective is also evident as regards the independent entity principle, in relation to which the RDD reports that ‘It was argued that the proposed changes disregarded the fundamental concept of the independence of legal entities and seemed to assume a level of coordination among associated enterprises that might not correspond to reality’ (para. 20). We and other independent commentators1 pointed out that it is rather the ‘fundamental concept’ of supposed independence of MNE affiliates which does not ‘correspond to reality’, but this view is not mentioned in the RDD. Yet it is fanciful to suggest that associated entities within a multinational corporate group operate in reality as independent entities. It is regrettable if credence is given to such views simply because they are put forward by a large number of MNEs and their paid tax planners and advisers, whose speciality is creating artificial structures to take advantage of the independent entity fiction.

In relation to the proposal for an anti-fragmentation rule the RDD at least mentions that ‘a few commentators supported the idea’ and that one (ourselves) ‘argued that the proposal did not go far enough’, but again seems to stress the numerical weight of submissions, which inevitably were opposed. We are however heartened that WP 1 nevertheless by majority decided to support a version of this proposal, although it has been given very limited scope of application.

This treatment of the comments received seems to result from the way this and indeed most of the consultations have been designed. The intention seems to be essentially to test the reaction of the MNE and tax advice and tax planning communities, and give the members of

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1 For example Prof. Edward Kleinbard’s comment on the BEPS project: ‘I wish them the best, but I think that they’ve made their lives very hard for themselves by insisting on the arm’s length principle as an untouchable sort of axiom... The multinationals exist for the purpose of being integrated, for the purpose of creating synergy that would not be obtainable through a series of arms’ length contracts. It’s nonsensical to chase a model that is inconsistent with both reality and with the best economic theory of the firm’. Tax Foundation blog 15 May 2015. http://taxfoundation.org/blog/making-sense-profit-shifting-edward-kleinbard
these communities an opportunity to marshal their objections. The effect is that much of the process is dominated by vested interests. In this way proposals, which may already be relatively modest or even timid in order to achieve consensus among governments, are further watered down when subjected to a withering hail of concerted attacks from these communities. It is noticeable that there have been very few submissions from independent commentators such as academics.

While we appreciate the open and transparent way the public consultations have been conducted, the evaluation of the responses should take into consideration that they have been dominated by vested interests.

B. Scope of this Action Point.

We remain concerned that Working Party 1 has interpreted its mandate far too narrowly. The BEPS Action Plan stated that it should

*Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionnaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.* [our emphasis]

These proposals deal only with the commissionnaire problem and a modification of the specific activity exceptions. The central issue of what should be considered taxable presence in the 21st century economy has not been tackled, but deferred. The draft also contains nothing on the the profit attribution issues, which have been deferred for further work beyond the G20 deadline (RDD p. 7). It seems that this may be done in conjunction with the work of the Task Force on the Digital Economy on Action 1, which has also been deferred until the work on other action points (including this Action 7) is complete. We see at least two problems with this.

Firstly, the need to reconsider the question of taxable presence and the PE definition goes beyond both cross-border sales and the Digital Economy sector. As pointed out both in our submission and some others, notably that from TUAC, fragmentation of corporate structures which seems tax motivated (and in any case results in significant tax avoidance) is far from confined to downstream activities (contracting and customer delivery). Production activities have also been fragmented, in ways which allow attribution of disproportionate profits to affiliates with lower effective tax rates. Outsourcing manufacturing (factoryless production) gives further scope for the artificial switching of profit. Also, the report on the Digital Economy published last September showed that digitisation has effects across all sectors, to a greater or lesser extent. Digitisation is part of a wider shift to immaterial production, as companies increasingly supply services and not only physical products. The requirement of physical presence for 6 or 12 months under the existing PE concept has clearly become increasingly inadequate with this shift to services. This has been a particular problem for developing countries, but is now affecting many more, as shown by the concerns regarding internet-based multinationals. Deferring the issue to be considered in the context of the Digital Economy Task Force might result only in proposals to deal with supposedly special cases. There is a clear need for a wider reconsideration of articles 5 and 7, which should be done by WP 1.

Secondly, the failure to tackle this issue promptly will further exacerbate the likelihood of unilateral measures by states. As we pointed out in our previous comments, a number of states, including OECD members, already apply a wider view of taxable presence and the PE definition. Many, especially developing countries, deal with the problem by applying
withholding taxes on fees for services, and the UN Committee is working on a treaty article which would allow taxation of payments by residents for services. Such withholding taxes can certainly be easy to administer and relatively effective, but they are blunt instruments, since they are applied on a gross basis rather than on profits. Furthermore, some countries which are OECD members and presumably centrally involved in the BEPS project, are now introducing unilateral measures, notably Australia and the UK. These are aimed at taxing profits, but they do not provide any clear basis for determining either what is considered taxable presence or the appropriate level of profits, and in effect leave it to each company to decide whether and how much to pay.

There is a danger that a free-for-all will develop, with different countries making unilateral and relatively arbitrary claims to tax. Yet the BEPS project was driven by the recognition of the need for a more coordinated approach. This can only be achieved if those involved look beyond short-term considerations of the implications for their particular country or company. A more far-sighted view also entails a bolder approach to re-evaluation of the basic provisions, including the PE concept, which clearly need updating to meet the needs of the 21st century economy.

For these reasons, our specific comments in the next section will take a broader perspective. We appreciate that the Working Party has taken decisions and narrowed down the options presented earlier, and is not now requesting wider comments. We nevertheless consider it important, both for those directly involved in these consultations and the wider public, to evaluate these revised proposals in such a broader perspective. It is also especially important for developing countries, which are particularly concerned with the issue of the PE definition, to evaluate the proposals resulting from the BEPS project in the light of possible alternatives.

C. Drafting of the proposals

Our final general comment regards the drafting. The proposed redrafting of paragraphs 5 and 6 has resulted in convoluted formulations which make them very difficult to understand. It results in piling exceptions on exceptions, which makes it very hard to disentangle the positive provisions. If these proposals are to make their way into the model convention, or to the proposed multilateral convention (although we do not support their inclusion), we recommend that they be rewritten from scratch, instead of as patches to the previous versions.

This also applies to the proposed revised Commentaries, which include complex formulations, and in some cases errors of grammar or syntax. For example, the new proposed paragraph 22.3 of the Commentary includes the following:

This subparagraph is irrelevant in cases where a stock of goods or merchandise belonging to an enterprise is maintained by another person in facilities operated by that other person and the enterprise does not have the facilities at its disposal as the place where the stock is maintained cannot therefore be a permanent establishment of that enterprise

This needs correcting for it to make sense.

The existing Commentary is already 83 pages long, extremely technical, in some cases contradictory and full of exceptions. The proposed revisions do not increase clarity, but make it even more complex and obscure. We make some more specific comments in the next section.
**SPECIFIC COMMENTS**

A. Artificial avoidance of PE status through *commissionnaire* arrangements and similar strategies

WP 1 has exacerbated its narrow approach to its remit by choosing the narrowest of the options it proposed. Under this option the profits from sales or services made in a country would only be considered taxable there if the MNE’s ‘connected enterprise’ in that country ‘negotiates the material elements’ of contracts, which are either (i) in the name of the foreign enterprise, or (ii) for sale of or transfer of rights to goods or property owned by that foreign enterprise, or (c) for the provision of services by that foreign enterprise.

This narrow definition will allow MNEs to continue to fragment and treat as separate activities which are closely related to or a critical support for sales, but do not entail the ‘negotiation of material elements of contracts’, or if those contracts do not entail the sale of goods owned or services provided by the foreign enterprise. Many activities of engagement with customers may be considered not to involve ‘negotiation’ of contracts or contractual terms. A MNE may, under this proposal, have an affiliate in a country employing large numbers of people dealing with customers and potential customers, advertising and marketing its services, and providing after-sales support, which would be regarded as separate from the actual sales. The distinction between ‘marketing’ and ‘negotiation of material terms of contracts’ in particular creates a grey area which would be fertile ground for tax planners. Allowing a separation between the mere act of negotiating and concluding contracts and the wide range of related relationships with customers leaves a very wide hole through which many types of BEPS-motivated fragmented structures will continue to flourish. It also shows a misunderstanding of the importance of integration not only of customer-facing functions but also of the whole supply chain, to the real competitive advantages of MNEs, in contrast to the artificial fragmentation designed to reduce taxes.

Many internet-based sellers now use fragmentation planning to achieve BEPS objectives, and maintaining extensive inventory locally in the country of the customers is critical to their business models that promise quick customer delivery. Local warehousing, delivery, and other support provided by a related party under business fragmentation planning allow critical activities that are centrally directed, managed and controlled to be legally separated from a group seller that may conduct little activity of its own and that maintains no employees of its own in the country of the customers. These warehousing, delivery, and other activities constitute an essential and significant part of the seller’s business. They are, without question, parts of a cohesive whole. Often, other group members will perform purchasing or manufacturing as well as the development, maintenance and expansion of the website where products are shown and sales are made. Yet in such cases the offshore seller could conduct little or no activities of its own.

The BEPS project was initiated to prevent common tax-motivated structuring such as this. Yet, where an internet-based seller has only inventory maintained and delivered from a local warehouse not under its control and with no employees of its own in the country of the customers, it will not likely have a permanent establishment under either Paragraph 5 or Paragraph 1 of Article 5 of the OECD Model.²

Regarding Paragraph 5, under these proposals if the local service provider is not negotiating or concluding sales contracts with customers it should not create a permanent establishment

² The UN Model’s article 5(5)(b) does include maintenance of a stock of goods belonging to the enterprise for delivery on its behalf in the definition of dependent agent.
of the foreign seller. As for Paragraph 1, with no employees of its own in the country of the customers, the seller will arguably not be carrying on its business through the warehouse location, with respect to which the local related party is providing services and is receiving an arm’s length service fee (see Paragraphs 10 and 42 of the Commentary on Article 5).

By allowing such fragmentation, the Working Party has apparently accepted that there can be not only a separation of functions but also of risks, since the RDD states that issues such as a low-risk distributor arrangement are best dealt with under Action 9 (para. 22). Yet treating as separate such related functions, which are typically closely coordinated within MNE groups, would leave the key issue of allocation of profit to be dealt with under transfer pricing rules. It also seems to assume that this depends on the analysis of functions performed and risks assumed by the separate entities. This would continue to give priority to transfer pricing evaluation methods based on functional analysis, which are not only highly subjective and complex, but inappropriate in both theory and practice. As we pointed out in our response on these proposals, the notion of transfer of risk within an integrated MNE is totally meaningless since it has no real effect vis-a-vis third parties, except of course tax authorities. Yet it seems that there is no agreement among states involved in the BEPS project on this point, since even the modest proposal to introduce the concept of ‘moral hazard’ has been challenged.

B. Artificial avoidance of PE status through the specific activity exemptions

1. Making all the subparagraphs of Article 5(4) subject to a ‘preparatory or auxiliary’ condition.

Instead of dealing directly with the issue of taxable presence, WP 1 has preferred to tinker with the exceptions. The proposal extends to all the activities listed in subparagraph 4 the ‘preparatory and auxiliary’ condition, so that the listed activities will only qualify for the exception provided that they can, in combination, be considered ‘preparatory or auxiliary’. The draft Commentary further states that whether they are ‘preparatory or auxiliary’ should be considered in relation to the business of ‘the enterprise as a whole’.

Opting for this minimal drafting change to the text of the article itself seems an easy solution, but it results in placing great weight on the terms ‘preparatory or auxiliary’ (P&A). No attempt has been made to define these terms, so their interpretation will only be guided by the discussion in the Commentary. The RDD retains paragraph 21.1 which states that the decisive criterion to evaluate the P&A test is whether or not the activity of the fixed place of business ‘in itself forms an essential and significant part of the activity of the enterprise as a whole’. This is essentially tautological, since the whole point is to decide what is the ‘activity of the enterprise as a whole’. Indeed, the paragraph states that ‘Each individual case will have to be examined on its own merits’, suggesting that decisions will be ad hoc and not principled.

Some further elaboration is now proposed in new para. 21.2, which begins: ‘As a general rule, an activity that has a preparatory character is one that is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole’. We find this phrasing clumsy and obscure. What is meant by ‘in contemplation of’? The phrase ‘the essential and significant part of the activity’ seems to be an amalgamation of ‘the essential activity’ and ‘a significant part of the activity’, but linked by ‘and’ instead of ‘or’. Does it cover an activity which is a significant part of but not essential to the enterprise as a whole? The next sentence introduces the notion that a preparatory activity might ‘often be carried on during a relatively short period’, but this is immediately contradicted by a counter-example. The attempt to specify what may be regarded as ‘auxiliary’ is equally unhelpful. The last sentence seems to suggest the test is
whether the activity ‘requires a significant proportion of the employees or assets of the enterprise’, but this is stated only obliquely as a negative, and there is no attempt to specify what may be considered a ‘significant proportion’.

An important issue is the treatment of research and development, which is a key factor of MNE competitiveness, while IP is also central to BEPS structures of many MNEs. ‘Scientific research’ is mentioned as one of the kinds of activity covered by subparagraph (e). A MNE could continue to claim that an affiliate in a country carrying out R&D is a contract researcher, and that its activities are not ‘preparatory or auxiliary’ to the sales of final products in that country, which could therefore be attributed to a different affiliate.

At the risk of oversimplification, two examples may be worth providing. First, say that an aircraft manufacturer decides to set up a centre for cold-weather research in Siberian Russia. The purpose is to develop better de-icing procedures for their aircraft and to learn if different paints and other coatings to the bodies of their aircraft will fare better in the cold. The R&D effort creates a better and safer aircraft, but the manufacturing takes place outside Russia, although using knowledge created within Russia. Any connection between the eventual sales price of an aircraft and the contribution of this cold-weather research to that profitability is likely to be considered remote, and hence not ‘preliminary’.

Second, say that a software company sells a particular software product to customers worldwide, and that a significant component of that software was produced through an office in Bucharest, Romania. While management and direction came from the home office, a team of Romanian software engineers and programmers conducted the work. In this case, the software development contributes directly to a product that is sold to customers. This would probably not be considered remote, as there is a direct connection between the software development and the revenue from the sale of products. Further, since there are presumably a number of software engineers and programmers contributing to this product in a number of locations, it is very possible to allocate actual revenues by one or more allocation keys (e.g. development hours, marketing costs, etc.). This is not just a “digital economy” issue. R&D spending is key to the success of many businesses today. This must be reflected in Article 5 with sufficient nuance that MNEs will not continue to undervalue for source countries the value that is truly created within their borders.

The OECD has itself developed analytical frameworks for characterising and classifying both research and experimental development (the Frascati Manual), and innovation (the Oslo Manual), which could be used to argue that some R&D activities are not ‘preparatory or auxiliary’. However, those classifications are for statistical purposes, and not necessarily a guide to the qualitative contribution, or to determining the value. Of course, under the approach adopted here, profit attribution is a separate issue. Hence, it entails two processes: (i) deciding on which entities may be considered to have a taxable presence (applying the ‘preparatory or auxiliary’ test), and then (ii) attributing profit (applying whichever transfer pricing method is deemed most appropriate). Both of these are ad hoc and subjective, difficult to administer, and likely to lead to conflicts.

Thus, these proposals allow continuing opportunities to design fragmented structures for BEPS purposes, exploiting the vague and ill-defined concepts ‘preparatory and auxiliary’. A much simpler and more effective approach, as explained in our previous submission, would be to reverse the presumption in article 5(7), so that any affiliate of a MNE would normally be treated as creating a taxable presence for any activities which ‘constitute complementary

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3 In a sentence moved from para. 23 to 24, although the bracketed text mistakenly says it has been moved to para. 23).
functions that are part of a cohesive business operation’, to use the term proposed for the anti-fragmentation rule. This could be combined with systematization of the profit split method, as we have argued in our other submissions, so that the aggregate profits of such cohesive business operations could be apportioned on the basis of defined allocation keys reflecting the MNE’s real activities in each country and appropriate to its business model.

C. Limited effects of the proposed anti-fragmentation rule.

The Working Party has at least agreed, apparently by majority, to include an anti-fragmentation rule, as proposed under Option J of the 2014 DD. This would allow considering together activities which ‘constitute complementary functions that are part of a cohesive business operation’. However, it would apply only in the very limited circumstances of the activities described in article 5.4, and the issue of whether they would if taken separately be regarded as ‘preliminary or auxiliary’ (RDD para. 40). We welcome acceptance that this anti-fragmentation rule should be introduced. However, we greatly regret the very limited scope it has been given.

The provision is drafted as an exception (which is qualified by two conditions and a proviso) to the exception in paragraph 4 of article 5. As suggested above, we find this formulation convoluted and suggest that, if it is decided to include this proposed draft in either the model convention or the proposed multilateral convention, it should be rewritten.

The limitation to paragraph 4 means that sales could continue to be attributed to the foreign affiliate, if its related entities do not negotiate the material elements of contracts. With no permanent establishment of the foreign seller, the possible application of Paragraph 4 of Article 5 never arises, meaning that the newly drafted Commentary in Section B of the Discussion Draft that would expand the scope for determining what is preparatory or auxiliary is not relevant. As such, the result contemplated in newly redrafted Paragraph 22 would not be achieved. Newly drafted Paragraph 30.1 provides: ‘Under paragraph 4.1, the exceptions provided for by paragraph 4 do not apply to a place of business that would otherwise constitute a permanent establishment…’ (Emphasis added.) In other words, if there is no PE, the exceptions do apply.

We nevertheless propose that two approaches should be considered to appropriately deal with this situation where the foreign seller would otherwise escape having a permanent establishment.

A first approach is to broaden Paragraph 5 to cause such critical activities performed by a group member in the country of the buyers to be seen not as an independently provided service, but rather as the direct conduct by a group member of the foreign internet seller's business. In a real and substantial sense, in a case such as this, the local group member is carrying out the business operations of the foreign internet seller by entering into a rental contract for a warehouse, employing personnel who conduct the business of the seller, and arranging for third-party support as necessary, e.g. negotiating contractual arrangements with common carriers to make local deliveries. Often, of course, the local group member will conduct other crucial functions such as selling advertising to be included on the seller’s website, accepting product returns from customers, providing local language customer phone and online support, etc.

If this first approach were to be considered, it would mean both expanding the above-quoted Paragraph 32.6 and Paragraph 32.3 by adding to the latter the sentence shown in italics:

32.3 A person is acting in a Contracting State on behalf of an enterprise when that person involves the enterprise to a particular extent in business activities in the State concerned. This will be the case, for example, where an agent acts for a principal,
where a partner acts for a partnership, where a director acts for a company or where an employee acts for an employer. This will also be the case under any service or other agreement where, in light of all the facts and circumstances, the person is performing any function that is an essential and substantial portion of the enterprise’s business. A person cannot be said to be acting on behalf of an enterprise if the enterprise is not directly or indirectly affected by the action performed by that person.

A second approach is to make expressly clear that this type of described situation can be covered by Paragraph 1 of Article 5.

Presently, the Commentary on Article 5 acknowledges that space or premises belonging to one person that is at the disposal of a related enterprise and that constitutes a fixed place of business through which the enterprise carries on its own business can be a permanent establishment (see Paragraphs 41 and 41.1). However, the Commentary also makes an appropriate distinction of that case from one where the business being conducted is the business of the person and not the business of the related enterprise. Paragraph 42 states, in part:

…it is important to distinguish … the frequent situation where a company that is a member of a multinational group provides services (e.g. management services) to another company of the group as part of its own business carried on in premises that are not those of that other company and using its own personnel. In that case, the place where those services are provided is not at the disposal of the latter company and it is not the business of that company that is carried on through that place. That place cannot, therefore, be considered to be a permanent establishment of the company to which the services are provided. Indeed, the fact that a company’s own activities at a given location may provide an economic benefit to the business of another company does not mean that the latter company carries on its business through that location…

In many cases, of course, this Commentary paragraph provides appropriate guidance. However, as in the above-mentioned example involving an internet-based seller using a local related party to provide many functions that are essential and significant parts of the seller’s business, it is not appropriate guidance.

With the above in mind, we recommend that the following language be added at the end of Paragraph 42 of the Commentary on Article 5:

However, where a company that is a member of a multinational group provides services (e.g. warehousing and delivery of inventory to customers) to another company of the group where those services constitute an essential and significant part of the business of the latter company with the respective businesses of both companies being activities that constitute complementary functions that are part of a cohesive business, then the latter company will be considered to carry on business through the premises of the former company thereby constituting a permanent establishment of that latter company.

D. Suggestions for Redrafting

1. Deletion of Former Paragraph 37

Paragraph 37 prior to amendment includes a requirement that a broker, general commission agent, or any other agent of an independent status must be independent of the enterprise both legally and economically. This requirement appears not to have been moved to any other paragraph in the Commentary.
Paragraph 38 states that ‘independence’ now will depend ‘on the extent of the obligations which this person has vis-à-vis the enterprise’. This paragraph goes on to note as criteria of independence both the ability that the enterprise has over the agent to subject it to detailed instructions or comprehensive control, and which party bears the entrepreneurial risk of the agent’s activities. The paragraph then states that certain matters covered in the following paragraphs regarding independence should be kept in mind.

Despite the apparent elimination of the Paragraph 37 sentence that the enterprises must be independent both legally and economically, Paragraph 38.1 refers to ‘the test of legal dependence’ (emphasis added) in a manner that implies that a prior paragraph in the Commentary has created a specific ‘test of legal dependence’.

Given the newly refocused attention on independence being on ‘obligations which this person has vis-à-vis the enterprise’ with ‘legal’ independence seemingly being a criterion of somewhat lesser importance, it appears that this reference to ‘the test of legal dependence’ should be amended in some manner. The concept of independence is far too ambiguous, and lacking in a requirement of substance. Para. 38.2 (p. 18) states: ‘[an independent agent] will not be subject to detailed instructions from the principal as to the conduct of the work. The fact that the principal is relying on the special skill and knowledge of the agent is an indication of independence’. Secretarial services provided by law firms in low tax/no tax jurisdictions are sufficient to enable such firms to claim that they are ‘managed and controlled’ in these locations. At the same time secretarial services are routinely undertaken by many enterprises. Hence as a result of the provision of secretarial services, a subsidiary with no assets or employees is deemed to be ‘managed and controlled’ in a low/no tax jurisdiction. This is a major source of BEPS.

2. Artificial Avoidance of PE Status through the Specific Activity Exemptions: Toll-Manufacturer Example

Paragraph 22.4 involves several examples involving a toll-manufacturer. One issue is whether an enterprise’s stock of goods maintained with a toll-manufacturer will cause the location where the goods are maintained to be at the disposal of the enterprise. Assuming it is determined that the goods are at the disposal of the enterprise and that other conditions are satisfied for permanent establishment status under paragraph 1 of Article 5, a second issue is whether the maintenance of that stock of goods by RCO constitutes a preparatory or auxiliary activity. If so, then Paragraph 4 applies to prevent there being a permanent establishment.

In regard to this second issue, Paragraph 22.4 includes:

This will be the case if RCO is merely a distributor of products manufactured by other enterprises as in that case the mere maintenance of a stock of goods for the purposes of processing by another enterprise would not form an essential and significant part of RCO’s overall activity. In such a case, unless paragraph 4.1 applies, paragraph 4 will deem a permanent establishment not to exist in relation to such a fixed place of business that is at the disposal of the enterprise of State R for the purposes of maintaining its own goods to be processed by the toll-manufacturer.

Because of new Paragraph 4.1, in any case where a connected enterprise is a manufacturer in relation to the goods, then a determination will have to be made in light of all activities of connected enterprises regarding whether the maintaining of the goods will meet or fail the preparatory and auxiliary test.

On the other hand, where Paragraph 4.1 is not involved because there is no connected enterprise relative to the stock of goods held by the toll-manufacturer, then we are concerned about what this example is trying to illustrate.
The example for this purpose involves RCO, which ‘is merely a distributor of products manufactured by other enterprises’. If RCO is ‘merely a distributor’, this must mean that RCO has purchased the relevant goods from the vendor after the completion of manufacturing by the toll-manufacturer. Such manufacturing services must have been conducted by the toll-manufacturer for the vendor and not under any contract with RCO, since RCO ‘is merely a distributor of products manufactured by other enterprises’. If this is the case, then with respect to RCO, the goods may be physically held by a toll-manufacturer, but it is not in the context of any toll-manufacturing agreement between RCO and the toll-manufacturer. The only such agreement would be between the vendor and the toll-manufacturer.

Since there is no processing being conducted by the toll-manufacturer for RCO but only storage of goods, then Subparagraph 4 c) is not the relevant subparagraph for consideration. Rather, the appropriate subparagraph will normally be Subparagraph 4 b).

If it is decided to retain this example, then it should make clear that the Subparagraph 4 c) issue will be for the vendor and not for RCO, which is only a ‘mere distributor’.

3. Collection of Information for the Enterprise

Paragraph 22.6 includes the following example:

Where, for example, an investment fund sets up an office in a State solely to collect information on possible investment opportunities in that State, the collecting of information will be a preparatory activity and the office will therefore be deemed not to be a permanent establishment.

Where the office is an office of the legal entity that will make the investment, this fits within the logic of the proposed provisions. However, often the office set up in a State will be an office not of the investment fund that will make the investment, but rather an office of the fund management company that may be a general partner of the fund and/or be party to a service or management agreement with the investment fund. This fund management company hopes to earn either incentive percentage payouts under the partnership agreement, or sizable commissions for finding profitable investments and performing other fund management functions, or indeed both of these. Such other functions could include supplying directors and other support and guidance to investee companies. We suggest the following additional sentences be added at the end of Para 22.6 to reflect this critically important contrast.

However, where, for example, the enterprise that sets up the office is not the investment fund but rather the fund manager or any other enterprise (whether an connected enterprise or not) under contract to collect information on possible investment opportunities in that State, the collecting of information will be an essential and significant part of the service of the enterprise vis-à-vis its client. In such case, this will not be preparatory activity and the office will therefore be a permanent establishment. The same result will occur where the fund manager or other enterprise acts as general partner (or managing unit holder in the case of a limited liability company) and its profit participation under the organization’s operating documents provides an incentive for successful investing of the fund’s assets.

4. Splitting Up of Contracts: Amendment of Example

The example under “Proposal 4: Changes Dealing with the Splitting-Up of Contracts” includes:
The first contract is concluded with RCO and the second contract is concluded with SUBCO, a recently incorporated wholly-owned subsidiary of RCO resident of State R.

To prevent taxpayers from fragmenting contracts and activities in manners that avoid the limiting terms of this example, the example must not say that SUBCO is recently incorporated, is a wholly owned subsidiary, or is a resident of state R. We suggest the following language for the example:

Example E: RCo is a company resident of State R. It has successfully submitted a bid for the construction of a power plant for SCO, an independent company resident of State S. That construction project is expected to last 22 months. During the negotiation of the contract, the project is divided into two different contracts, each lasting 11 months. The first contract is concluded with RCO and the second contract is concluded with SUBCO, a subsidiary of RCO that is a connected enterprise. The contracts with RCO and SUBCO provide that both companies are jointly and severally liable for the performance of the contract concluded with SUBCO.

The example goes on to say: ‘In this example, in the absence of other facts and circumstances showing otherwise …’ Because of this, if the respective historical businesses of RCO and SUBCO truly supported the breakup of the project into two contracts, then that would be fine. For example, if RCO’s historical business was to perform the land preparation and foundation work for power plants and SUBCO’s historical business was the construction of buildings that house generators, then the split up of the contracts could be respected. However, if such other facts and circumstances were not present, then the time period of the two contracts should be combined.

E. Profit attribution to PEs and interaction with action points on transfer pricing

We of course recognize that work on attribution of profit issues related to Action 7 cannot realistically be undertaken before the work on Action 7 and Actions 8-10 has been completed. As such, we agree that this area should be the subject of follow-up work to be carried out after September 2015 with a view to providing the necessary guidance before the end of 2016.

While we understand that this area will be focused on in the months ahead, we feel compelled to cover one important issue so that it can be considered and emphasized when work on this important area begins after September 2015.

The following is from paragraph 19 of the Discussion Draft and was repeated several other times (paragraphs 28 and 54), but in all cases without any comment within the Discussion Draft either agreeing or disagreeing with the point made by the complaint.

A complaint that was also found in many comments and that was made during the consultation meeting was that these options (as well as many of the other options included in the discussion draft) would create a multitude of PEs to which no or little profits could be attributed.

This ‘complaint’ of the many MNE representatives and the legal and accounting firms that act as their paid professional advisors strongly implies that nothing should be done to broaden the definition of permanent establishment since most if not all new permanent establishments created under broadened rules would have little if any income associated with them. They are saying, of course, that if the local commissioner, agent, or other party whose actions create the permanent establishment has been paid an arm’s length amount, then there will be little or
no additional income to be reported by the principal that is making the sales or selling services.

It has been clear from the start of the BEPS process that commissionnaire and similar arrangements have been an important part of the worst BEPS excesses; such an important part that the language of Action 7 itself is specifically concerned with ‘the use of commissionnaire arrangements’. Considering this, we believe that this representation by MNEs and their paid advisors is misinformed at best and dishonest, misleading, and disingenuous at worst.

Considering these MNE and advisor representations, *we discuss briefly below why total taxable income from an expanded definition of PE should always be higher than under non-PE treatment for situations where a PE is avoided because important functions occur within a commissionnaire, agent, or other service provider.*

Say that an MNE, resident and headquartered in country A, has separated its centrally managed operations amongst its group members so that the group member (X) making product sales to customers in country B has no local activities or employees of its own in country B. To support its sales to country B customers, X contracts with Y, a group member resident in country B, for various support operations. These various support functions could include, for example, marketing activities, sales efforts, local warehousing and delivery, etc. Further, Y could be legally a commissionnaire, an agent, or only a service provider. Under the contractual relations between X and Y, Y is at limited risk so that the commissions or service fees it receives are relatively low reflecting its low level of assumed risk. Assume for purposes of this discussion that the commissions or service fees are at arm’s length.

Assume that under the current Article 5 definition of PE that X has no PE in country B, but will have a PE under a future expanded Article 5 definition. For both simplicity and to clearly illustrate a key point, assume that X’s PE is considered to include solely the activities that Y is conducting for X.

Y will of course be taxable in country B on its own profits, which as noted above are based on its arm’s length commissions and/or service fees received.

Before the expansion of the Article 5 PE definition, X as an overseas seller has no PE and will be free of any country B tax. After the Article 5 expansion, X will have a PE and will be taxable in country B, but on what?

Needless to say, specifically how profits attributable to the PE are determined is beyond the scope of this comment letter. However, there’s one important point to make.

Y’s level of profits from its activities reflect its contractually lowered assumption of risk. Assume that in this particular case Y will get paid at least its expenses incurred plus a limited profit element no matter whether its services result in any sales for X or whether it inventories, warehouses, or delivers any of X’s products, etc. On the other hand, X’s profits from those same activities conducted by Y reflect X’s full commercial business risk. If X sells insufficient product to recoup its expenses including its local expenses in country B (i.e., the commissions and services fees paid to Y), then X will have a loss. If X sells plenty of product, then X will be the sole beneficiary with Y receiving no additional commission or service fees.

Clearly, X is in business to make profits. It believes that paying for Y’s activities will allow it to make sales and a profit on sales to customers in country B. The point of course is that the value of Y’s local activities to X, an overseas seller, is much higher to X since X is taking the business risk of paying Y for these local support operations irrespective of how many local
sales are made. The portion of X’s profits (assuming of course that X has made some sufficient level of profits) that will be attributable to its PE cannot be the same as the limited risk commissions and service fees earned by Y under its artificial limited-risk position.

In addition to the above, of course, there will also be many situations, especially for MNEs operating in the digital economy, where X is selling or providing products or services to country Y customers where that customer base itself is a relevant asset of the X PE in country B. That will further increase the profits attributable to X’s PE far above any commissions and service fees paid to Y.

In short, we believe consideration should be given to making clear in future guidance why an expansion of the PE definition in Article 5 is fully expected to result in increased levels of taxable profit within the country of the PE, taking into account both the taxable income of any local commissionaires, agents or service providers and the taxable income of the PE.
June 12, 2015

Ref: REVISED DISCUSSION DRAFT: BEPS ACTION 7: PREVENTING THE ARTIFICIAL AVOIDANCE OF PE STATUS

Dear Marlies,

BIAC thanks the OECD for the opportunity to provide comments on its Revised Discussion Draft on Action 7 (Prevent the Artificial Avoidance of PE Status) of the Base Erosion and Profit Shifting (BEPS) Action Plan issued 15 May 2015 (the Discussion Draft).

As we have said before, the current PE rules have worked well for the past fifty years, providing a level of certainty that has encouraged multinational businesses to invest across the globe. We do acknowledge that changes to the rules are required, but we must be careful that those changes are not delivered at the cost of the cross-border trade and investment that is so necessary to deliver growth and jobs.

We welcome the narrowing of the proposals in the Discussion Draft, which appears to indicate that Working Party 11 is moving towards a high-level agreement on the Action 7 recommendations. We also appreciate the OECD’s efforts to provide guidance to apply these proposals, through suggested amendments to the Commentary of the OECD’s Model Tax Convention. That being said, we are concerned that the Discussion Draft continues to be a non-consensus document, and that consensus will likely not be reached until the Committee on Fiscal Affairs can consider all proposals together.

It is clear the OECD must deliver proposals by the September 2015 deadline to satisfy the G20 mandate. That deadline could be satisfied by delivering the proposed changes to the language of Article 5, with work extended into 2016 on the profit attribution guidance, and on the language of the Commentary. Aligning the work on the Commentary and profit attribution guidance will help to improve the objectivity and practicability of the proposals, and would mitigate, to a certain extent, the risk that governments seek to apply new PE principles before profit attribution guidance has been agreed. As indicated above, BIAC does understand that changes to the PE standard will be made, but it is crucial that the new rules are very clear, and at least as well understood as the rules that they replace, providing the bright line tests that help to promote cross-border trade and investment.
We are, in particular, concerned about potential divergences between the principles supporting the language of Article 5 and those supporting the more extensive Commentary that facilitates its application. It appears from the Discussion Draft that the Commentary reflects a broad interpretation of the Article 5 language. As you will see from our comments, BIAC is concerned that the broad and subjective nature of the Commentary lowers the PE threshold to a much greater extent that would be justified based on an objective reading of the Article 5 proposals.

We have respected your request for short comments, but we would make one further general comment – as the work on the 2015 deliverables nears completion, we encourage the OECD to provide transparency over how the CFA intends to negotiate and agree the consensus BEPS package, and what further work will be required after September 2015 on all of the actions – including where and how that work will include opportunities for stakeholder consultation.

Sincerely,

Will Morris,
Chair, BIAC Tax Committee
A. Artificial avoidance of PE status through *commissionnaire* arrangements and similar strategies

Dependent agent rule

1. We understand the concerns that have led the OECD to propose changes to the threshold under paragraph 5 of Art. 5. However, we are worried that the proposed Commentary to accompany the revised paragraph 5 of Art. 5 of the OECD model suggests a broader application of the dependent agent rule than is warranted by reference to the text of the revised paragraph 5. In particular, the commentary in proposed paragraphs 32.4, 32.5 and 32.6 all suggest a broad application of the proposed dependent agent rule, including in circumstances where the agent concerned may take no, or very little, substantive role in the process by which contracts are concluded or negotiated. In BIAC’s view, the Discussion Draft may be proposing the language of Option B, but the proposed Commentary interprets that language in such a way as to effectively apply the standard contained in Option A. BIAC opposed Option A in its earlier consultation responses, as it was exceedingly ambiguous and overbroad. We urge that the drafting of these important paragraphs be revisited, and the wording amended and clarified to conform to the language of revised paragraph 5 of Art. 5. This should involve accommodating the variety of situations that may arise in practice (for example, where multiple locations play a substantive role leading to the conclusion of contracts).

2. BIAC is also concerned that a number of the Discussion Draft proposals will lead to difficulties in interpretation, and ultimately, disputes. Difficulty in interpretation is exacerbated by the use of several new concepts and terminology. Where new language is proposed, every effort should be made that sufficiently detailed guidance is provided to facilitate objective and consistent interpretation. The following examples are intended to illustrate BIAC’s concerns:

   a. When paragraph 32.5 refers to the “key ingredients” of a contractual relationship, it omits to state that those “key ingredients” may vary depending on the legal system adopted by a particular country. Such differences will likely lead to interpretation issues unless the commentary to Article 5 is very clear and objective.

   b. Without further guidance, it will likely be difficult to understand in practice when an employee should be considered to have “convinced” a customer to enter into a contract (example in paragraph 32.6).

   c. It is unclear whether the PE threshold has been breached where a senior representative visits a customer (in the customer’s State) to discuss the final aspect of a contract. In such a situation, that same representative may have conducted the vast majority of the negotiations outside of the country – the Discussion Draft appears to suggest that such activities could constitute a PE. At present, a very short visit to a customer’s location would not breach the threshold. Depending on how and where the line between PE and non-PE activities is drawn, the administrative burden to ensure compliance could be significant. Such examples illustrate the need for very clear profit attribution guidance to split the value of the negotiating activities between countries. If this part of the Commentary is only intended to apply to a representative that is permanently in the State, then that should be made clear.
The term, to “habitually conclude or negotiate [...] contracts” will be of great importance in determining whether a PE is created. Detailed and objective practical guidance is necessary, otherwise it will be almost impossible for taxpayers to understand with a sufficient level of confidence whether they have satisfied their compliance obligations.

**Independent agent rule**

3. We understand that Working Party 1 will not always agree with the views expressed by commentators in the consultation process. However, it is disappointing that, despite noting the "strong objections" to the proposals for amending the independent agent rule, there is no explanation of why a decision has been made to proceed with the proposed revision relating to connected parties. This is significant because the proposed change seems out of line with what we take to be the essence of the independent agent test, namely whether the agent concerned is, or is not, in reality carrying on the business of the principal. If the proposed change is driven by the OECD’s concerns about manipulation of the test by MNEs, the use of a rebuttable presumption of dependence in the case of connected parties (rather than the proposed outright bar on independent status) would retain the ability to apply the existing test in appropriate cases.

4. In addition to the above comments, we are also concerned at the clarity of the explanation in the Commentary of what it is to be independent. With the removal of the economic dependence test from the commentary, the guidance has, if anything, become vaguer as to what is required if an agent is to be regarded as independent. We recommend that the guidance be expanded to achieve a greater level of clarity on the specific requirements of the test.

**Profit Attribution**

5. BIAC welcomes the OECD’s decision to undertake further work on its profit attribution guidance. As noted in our cover letter, we would suggest that only the proposed text of Article 5 be finalized in 2015, and that the OECD’s 2016 mandate should include work on profit attribution and the language of the Commentary to ensure that the proposals are as objective and practicable as possible. This would provide the time required to ensure that the clearest and most coherent recommendations are delivered.

6. There are concerns that the proposals to change the dependent and independent agent rules will lead to the creation of multiple PEs where there may be little or no incremental profits attributable over and above the relevant transfer pricing result. Working on profit attribution and the language of the Commentary at the same time would contribute to addressing these concerns.

**B. Artificial avoidance of PE status through the specific activity exemptions**

**B.1. List of activities included in Art. 5(4)**

7. BIAC has been concerned that Option E would lead to an increase in legal uncertainty as the notions of “preparatory” and “auxiliary” are not clearly defined. We appreciate the examples illustrating specific cases of preparatory and auxiliary activities – however, the proposed wording in Paragraph 21.2 does not add clarity compared to the previous wording in Paragraph 24. Deleting the statement that “It is often difficult to distinguish between activities
which have a preparatory or auxiliary character and those which have not” unfortunately does not remove the problem.

8. We therefore encourage the OECD to give further and more specific guidance and to develop a robust framework to implement this proposal on an internationally consistent basis in order to prevent substantial additional uncertainty and deriving disputes between businesses and tax administrations.

9. In this regard, BIAC would welcome further clarity in example 22, to allow taxpayers and tax administrations to better understand what it is about the “activities that are performed through that warehouse” that makes them “an essential part of the enterprise’s sale/distribution business.” If an elaboration on that conclusion is not possible, it would be helpful to have a second example setting out a similar fact pattern where the warehousing activities are considered to be preparatory and auxiliary. Establishing a number of indicators to assist in determining whether activities are preparatory and auxiliary would help greatly in practical application, and would mitigate, to an extent, disputes over PE status.

B.2. Fragmentation of activities between related parties

10. Of the two options proposed, BIAC did express a preference for Option I as the narrower and more targeted approach. Therefore, we are disappointed that the OECD has selected the more expansive Option J, which will be difficult to operate in practice, moving away from the widely agreed concept of separate entity reporting. We also believe that it is necessary to specify that it is an explicit requirement that the business activities under consideration are conducted through a fixed place of business in the State. Without such a clear provision, the anti-fragmentation rule could be applied inappropriately to bring in activities genuinely carried on outside a jurisdiction solely due to the provision of services to the enterprise by a connected enterprise which independently met the conditions to constitute a local permanent establishment (and was thus recognized and appropriately taxed locally). Our concerns here are linked to the proposals in Paragraph 32.2 of the Discussion Draft that appear to require the notional assumption of a fixed place of business. This provision, when taken in conjunction with the revised anti-fragmentation rules, could lead to inappropriately deemed PEs in relation to activities which should properly be considered as carried on outside the jurisdiction.

11. Under Option J it will be necessary to monitor the activities of each and every business activity on a worldwide basis and to connect those activities to the activities of all other entities. In large multinational enterprises, this task will be extremely difficult to fulfill. We also believe that more detailed guidance is needed regarding the notion of “complementary functions that are part of a cohesive business operation”. The two examples given in the Commentary could be helpfully expanded.

C. Splitting-up of contracts

12. Although BIAC welcomes the OECD’s attempt to provide clarity to its proposals, further work is required to explain how the two proposed approaches should be practically applied in a variety of circumstances. In addition, many of the concerns raised by BIAC’s in its previously submitted comments on Options K and L have not been fully addressed.
13. In this regard, Example E does not provide any clear indication as to how the proposed Principal Purpose Test rule would apply in a more complex set of facts and circumstances. Without greater clarity, the proposals will create uncertainty for non-abusive commercial arrangements. Enhanced clarity could be delivered by providing examples of business reasons for the spitting of contracts that would be considered to not represent artificial avoidance of PE status.

14. With respect to the alternative provision, clarification is required to ensure that combining multiple time periods should only be done in cases of abuse.

15. Furthermore, this provision includes a requirement to determine “whether the conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with that person or related persons” (emphasis added). More detailed guidance and definitions of key terms (for example “logical consequence”) would be required for practical application. Given the subjective nature of the alternative provision, if definitions or guidance prove difficult, examples could be used to illustrate how the rule would apply in practice.

16. Moreover, BIAC continues to believe that the minimum time-presence of 30-days suggested is too short and would be difficult to administer and monitor. All parts of an MNE may not be fully aware of all the activities of the group as a whole.

17. The alternative provision introduces the term “connected activities” to determine whether different periods of time should be combined. The guidance provided by the Discussion Draft to determine which activities should be considered to be connected is broad and subjective. Clear illustrative examples would be helpful to better understand the intended application.

D. Insurance

18. BIAC welcomes the acknowledgement that no specific rule for insurance enterprises should be added to Article 5, and that any PE concerns relating to insurance activities should be approached in the same was as for other businesses (i.e. through the more general changes proposed to Art. 5(5) and 5(6)).

E. Profit attribution to PEs and interaction with transfer pricing

19. Again, BIAC welcomes the OECD’s decision to undertake further work on its profit attribution guidance, which will assists taxpayers and tax authorities in understanding difficult questions concerning taxable income as more PEs are determined as a consequence of the lower threshold. We have also suggested undertaking further work on the language of the Commentary in 2016 to ensure that the proposals are as objective and practicable as possible. This would provide the time required to ensure that high-quality and coherent recommendations are delivered.

20. Aligning the work on the Commentary and profit attribution principles would provide opportunities to have real-time discussions between government delegates and the broad stakeholder community on how attribution principles will apply in the context of the Commentary, and whether, more often than not, those updated principles will result in an increase in taxable profits, over and above what has already been declared under Article 9.
principles (where there are already taxable entities). Although the OECD expects its new PE rules to be enacted through its Multilateral Instrument, it is likely that tax administrations will begin to attempt to apply any new Commentary as soon as it is finalized. In that context, aligning the work on the Commentary and profit attribution guidance would promote consistency. As is noted in the revised discussion draft, clear guidance is needed for all sectors “to ensure that businesses and tax authorities take a consistent approach.”

21. Agreeing to profit attribution principles is a notoriously difficult area of international taxation, and many years were required to develop the guidance. Full and ongoing stakeholder input will be required throughout the development of this work to ensure that the new guidance is fit for purpose.

F. Other Comments

22. As previously mentioned, BIAC urges the OECD also to consider the likely indirect tax impacts which will result from lowering the PE threshold, and in particular the potential consequences for VAT. The creation of new PEs will likely lead to requiring additional VAT registrations which will add - both for businesses and tax authorities - significant costs and complexity in terms of compliance and tax collection, as well as increasing the risk of disputes due to the lack of legal certainty especially in the context of conflicting establishment definitions and force of attraction rules.

23. Additionally, we encourage the OECD to include explicit language in its proposals to cut the common link between PE determinations and VAT registrations by stressing that “The term “permanent establishment” as used in the OECD Model Income Tax Treaty is a distinct concept from the “VAT establishment” term used in the International VAT/GST guidelines, such that the existence of one should not in itself result in the other. In addition, while companies might have to register for VAT in order to comply with their national VAT obligations, such registration in itself should not trigger the creation of a permanent establishment for purposes of Article 5. BIAC understands that there is agreement between Working Parties one and nine that such a link should not exist, but that there is a preference to wait until after the 2015 Action 7 work is completed before making this clear in the guidance to Article 5. We believe that this point should be clarified as soon as possible.
Dear Ms de Ruiter

Revised Discussion Draft on BEPS Action 7:
Preventing the Artificial Avoidance of PE Status
International Oil Storage and Global Supply Contracts

We are writing in response to the OECD’s Revised Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status. This letter is a follow up to our letter of 6 January 2015 in which we highlighted how the proposals will have a material impact on commercial transactions in the oil and gas sector around oil storage and the distribution of oil products to international customers. This letter is intended to provide further clarification and recommendations for change to the Discussion Draft.

A. Oil Storage

Summary

Our concern is that the proposed changes to Art 5(4) create considerable uncertainty as to the status of oil storage as an activity of a "preparatory and auxiliary" character. BP trades oil and oil products with customers in more than 100 countries carrying out an important role in the delivery of energy in the global economy. The nature of the industry often means that the supply of oil and oil products involve slim profit margins.

Opening up new markets, often in developing economies, is challenging and the proposed changes to the definition of a permanent establishment (PE) will create further uncertainty and risk. As a consequence of pricing this risk into a project’s economics, these projects will compare less favourably than other ventures in the competition for capital.

Consideration should also be given to the consequential impact on the balance between supply and demand of oil and oil products if suppliers cancel future projects and the impact this will have on the price of those products.
Furthermore, the proposals will mean that the compliance obligations of our business will increase by imposing many additional tax registration requirements (PEs). It is our view that the new PEs created are unnecessary and would neither bring into the charge to tax profits that are not already subject to tax or alter the distribution of taxable profits between countries.

BP’s policy is that intra-group transactions are carried out on arm’s length terms that correctly reward economic business activities. If countries seek to attribute profits to the newly created PEs, BP will suffer double taxation. This will be a significant compliance cost for BP and will impose a significant burden on Tax Administrations who will have to process the additional tax returns and resolve instances of double taxation through international tax treaties.

If such double taxation cannot be removed, either through the Mutual Agreement Procedure under double tax treaties or via credit for double tax, the low margins earned by this type of business will mean operations will quickly become uneconomic. This will precipitate a review of the business with the risk that it will cease.

Examples

In many countries BP is not involved in the local distribution of oil products to customers. Local distribution clearly constitutes a fully taxable commercial operation which would not fall to be treated as “preparatory or auxiliary”. This compares to markets where there are local distributors operated by 3rd parties and BP is purely involved in the delivery of oil products into local storage often at coastal facilities – see figure 1 below.

Figure 1: Third Party Storage and Third Party Distribution

In the scenario described in figure 1 all functions of the trading company are conducted in country A and the trading profit is correctly taxed in that country. Likewise, the functions of the Distributor and Storage Operator are conducted in country B and taxed there accordingly. There is no need to assert that the holding of hydrocarbons in storage is a PE of the Trading Company. Profits are already correctly taxed in the appropriate jurisdictions.
If the “preparatory and auxiliary” exemption in Art. 5(4) was found not to apply then a PE would need to be registered in Country B of the Trading Company but given the functional activity of the company it is unclear what, if any, profit should be attributable to the PE.

Figure 2: Related Party Storage and Related Party Distribution

In cases where BP has a locally taxed distribution business that owns the storage facility it is unnecessary to assert a PE as again the correct income is taxed in the appropriate countries– see figure 2 below:

Applicability of the “preparatory or auxiliary” exemption

The storage of hydrocarbons is only one part of a trading company’s activities. The core value creating activities of the Trading Company are necessarily carried out from central locations. These activities include the negotiation and conclusion of contracts with customers, the analysis of market information to understand price risk, chartering of ships, the acquisition of pipeline capacity and the recording of transactions and invoicing customers. All of these activities are underpinned by IT systems at the central locations.

The core buying and selling of product in many instances will not necessarily require storage. Transactions of physical product can involve the trading of cargoes held in ships, the transmission along pipelines and the use of rail and road networks. The key decision making and organisation of the necessary logistics is by necessity remote from the location of the physical product. As described in the above examples the management of the hydrocarbons is carried out by independent companies, whether those hydrocarbons are located on ships, pipelines or in storage facilities. These companies whether related or unrelated are taxed according to where their activities are carried out.

The mere holding of hydrocarbons in these facilities should rightfully be categorised as “preparatory and auxiliary” to the core trading functions of the Trading Company and should not constitute a PE.
Are the storage facilities “at the disposal” of the Trading Company?

Paragraph 22.2 of the Revised Commentary in the Discussion Draft sets out the existing interpretation of Article 5 indicating that an enterprise that does not have a facility at its disposal will satisfy Art 5(4)(a) and thus fail to be treated as “preparatory or auxiliary”.

We specifically refer to the statement where an enterprise is merely receiving transmission or transportation services and does not have the facility at their disposal.

We would like to highlight that although a Trading Company decides the quantities of hydro-carbons that go into a storage facility, the Trading Company will not have access to the facility, except for pre-arranged inspections to ensure the facility meets the applicable safety standards.

Impact to BP

In terms of scale BP estimates that additional direct tax registrations may be required in up 20-30 jurisdictions, with similar effects for indirect taxes. The resulting compliance burden would add significantly to the costs of such transactions and may well make many of them uneconomic.

The nature of the industry often means that the supply of oil and gas involves slim profit margins. Opening up new markets, often in developing economies, is challenging and the proposed changes to the definition of a PE, as noted earlier, will create further uncertainty and risk. In the competition for capital these projects will compare less favourably than other ventures if these changes are made.

Recommended Changes to the Commentary

In light of the comments above we would recommend the following changes to the Revised Commentary.

Para 22.2

The extension of para 22.2 to “facilities such as cables or pipelines and associated storage facilities” in order to clarify that the customer of the operator of the cable, storage facility or pipeline whose property is temporarily stored, transmitted, or transported does not have them at their disposal. As consequence there is no PE of the enterprise.

Para 22.3

The extension of para 22.3 to include the following example. Oil storage where a facility is operated in State S to hold hydrocarbons for RCo, an enterprise of State R, where periodic access is allowed to RCo for the purposes of ensuring the facility meets the company’s applicable standards. In this case the facility is not
at the disposal of RCo and subparagraph b applies so RCo does not have a PE in State S.

Furthermore, it is important to ensure that the reference to independent company in para 22.3 is not solely construed as meaning unrelated companies but can also include a related company that operates the facilities so long as the enterprise whose property is stored does not have the facility at its disposal along the lines described above.

B. Supply of Oil Products to International Customers

It is our understanding that the objective of the OECD proposals is to tackle structures that have been designed to erode the taxable base of a state in which sales are taking place. However, as currently drafted the suggested changes to para 5 of Article 5 of the OECD Model Tax Convention go much wider than the intended scope and impact commercially negotiated international business models that are already taxed in the appropriate countries. The proposed changes in the Revised Discussion Draft would require a fundamental reworking of BP’s model for supplying jet fuel and marine products to international customers at costs running into the tens of millions of dollars.

This can be demonstrated by explaining the business model in the International Aviation and Marine fuel businesses. These business activities are undertaken by incorporated entities, the profits of which are included in the statutory accounts and tax returns of the companies that undertake the economic activities. The business models adopted are not driven by tax avoidance but the need to deliver oil products to customers around the world. We are concerned that the proposals outlined in the discussion draft to address avoidance from the use of commissionaire structures and the overreliance on exemptions in para 5 of Article 5 of the OECD model convention will result in the creation of PE’s of companies that are not the target of the proposed changes.

Using an aviation business as an example, a company (say UK) may negotiate and conclude a global contract in its own name to provide fuel to a global UK airline at whichever airport around the world the customer requires. The benefit of this type of contract is that the fuel supplier and airline does not have to enter into separate contracts in each country where there is a refuelling need.

In these circumstances, when a UK airline is refuelled in the UK the profit or loss of delivering jet fuel to the customer is taxed by the UK company. Similarly, when the UK airline is refuelled in another jurisdiction (say Germany) it is that country which taxes the profits arising from the difference between the cost of fuel and the price earned with the customer. This is because the non-UK delivery rights of the sales contract is assigned to the supply companies around the world in return for an arm’s length marketing fee. This fee is subject to transfer pricing review. This is a common way in which such global contracts are structured and is not limited to the oil and gas sector or even airline contracts – see figure 3.
Under OECD option B, specifically the operation of para 5(b), the business model described above will create a PE of each of the supply companies in the UK where the global contract is negotiated and concluded. For example, the German company will have a PE in the UK for that portion of the global contract attributable to the delivery of Jet Fuel at German airports. In the example shown in figure 3 this will create 4 PEs in the UK for Germany, France, US and China. Similarly, global contracts are negotiated and concluded by the French Company with French airlines meaning that the German company has a PE in France on that portion of the global contract attributable to delivery of Jet Fuel at German airports to French airlines. A business model that has airports in 50 countries would create 49 PEs in each country, plus the tax registration of the original company; or in other words 2,500 taxable entities (50 times 50).

The creation of PEs in these situations will not result in additional profits being taxed globally but will result in many more disputes between the two countries on the allocation of profit between the country of incorporation and that of the PE. Both taxpayer and tax authority will, unnecessarily, suffer significant additional compliance costs, specifically people with the requisite capability.

We have not estimated the costs of operating under such a model but have concluded that to address the increased compliance burden a fundamental re-work would be required possibly towards more of a central single trading model costing tens of millions of dollars. Such a redesign would be as a direct consequence of the changes proposed under Article 5 set out in the Revised Discussion Draft.
Recommended Changes to the proposed Article 5(b)

We consider that the above proliferation of PEs could be avoided if the following words marked below were added to the proposed para 5(b) of Article 5 as follows.

5.(b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, unless the underlying profit from the sale of that property is taxed in the jurisdiction in which the property is physically delivered;

This would mean that as long as fuel sales are taxed in the jurisdiction in which the physical delivery takes place no PE will arise in the jurisdiction in which the sales contract is negotiated and/or concluded. It will however mean that structures that seek to tax sales in low or no tax jurisdictions remote from the physical delivery of the product will continue to create a PE as we understand is intended.

C. Indirect Tax Considerations

It is also necessary that the OECD considers the indirect tax consequences and impacts of any changes to the definition of PEs. There is a lack of clarity between the definition of PE for corporate tax purposes and that of fixed establishment for indirect tax and in many countries a PE for corporate tax triggers indirect tax registrations.

In addition to the additional compliance burden, creation of new PEs will add significant confusion around supply chains for indirect tax purpose creating operational complexity as well as increased risk of disputes. Where a UK trading company has an indirect tax registration in an overseas country, a new corporation tax PE may impact its existing local indirect tax status e.g. becoming resident from non-resident, impacting taxability of transactions and its working capital requirements.

We would be happy to provide further information or even meet with the OECD should there be any questions on the above.

Yours sincerely

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Submitted by email: taxtreaties@oecd.org  

June 12, 2015  

Ref: OECD DISCUSSION DRAFT: Preventing the Artificial Avoidance of PE Status (BEPS Action 7)  

Dear Mrs. de Ruiter:

The Brazilian National Confederation of Industry (CNI) thanks the OECD for the opportunity to provide comments on its New Discussion Draft on Action 7 (Preventing the Artificial Avoidance of PE Status) of the Base Erosion and Profit Shifting (BEPS) Action Plan issued 15 May 2015 (the “New Discussion Draft”) and takes the opportunity to offer comments on Action 7 in its entirety so as to provide adequate context. The comments offered by CNI in the attached report focuses on technical and policy issues which are particularly sensitive to Brazilian Industry yet which are relevant to all nations.

CNI is the largest and highest-level representation of industry in Brazil with a mission to promote a favorable business environment, enhance competitiveness and promote sustainable development. CNI represents 27 state federations of industry, over 700,000 manufacturing companies and 2,000 sectorial associations, encompassing issues such as economic policy, infrastructure, environment, SME development, labor relations, and international negotiations. CNI develops an active process of dialogue and influence with the National Congress and the Executive. With the Judiciary, the organization has the power to propose measures to ensure that laws are empowered by the Constitution in any respect that affects the industry’s interest. CNI also operates a vast high quality network of professional qualification, education, management training and promotion of entrepreneurship through three entities it oversees: the National Industrial Training Service (SENAI), the Industrial Social Service (SESI) and the Euvaldo Lodi Institute (IEL).

CNI will remain engaged in the BEPS Project and hopes to contribute further with the OECD and the G20 in the discussion of this and all other Action items.
**Comments on OECD/G20 BEPS Project – Action 7: Preventing the Artificial Avoidance of PE Status**

Brazilian-headquartered multinational enterprises (MNEs) that are members of CNI have significantly expanded their global presence and footprint in the recent past, and operate complex global value chains with massive presence in Europe, Asia, Africa and the Middle East, and North America, and substantial trade across such regions. The potential ramifications from the proposed changes under the BEPS Project might differ in different areas of the world as, we fear, different nations will tend to interpret or enforce the proposed changes according to their national tax policies and traditions. In particular as the changes to PE definitions go hand-in-hand with the proposed changes to transfer pricing definitions under Actions 8, 9 and 10 of the BEPS Project (which are particularly sensitive to potentially inconsistent enforcement and interpretation).

We offer our comments in this report using the following structure:

I. General Commentary on the Proposed Changes under Action 7;

II. Enforcement and Interpretation Issues Affecting Industry within Brazil;

III. Enforcement and Interpretation Issues Affecting Brazilian Industry in China, India, and in Developing Countries;

IV. Enforcement and Interpretation Issues Affecting Brazilian Industry in Europe and North America.

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1 The author of this report is Mr. Romero J.S. Tavares, Esq., International Tax Policy Advisor to CNI, Head of the Centro de Estudos em Tributação Internacional, Researcher (DIBT/Ph.D.) and Lecturer at the Institut für Österreichisches und Internationales Steuerrecht of Wirtschaftsuniversität Wien (Institute for Austrian and International Tax Law of the Vienna University of Economics and Business). The author can be reached at romero.tavares@wu.ac.at. This report was independently reviewed by the officers of Multinational Enterprises that are members of CNI.
I. General Commentary on the Proposed Changes under Action 7

Brazil remains as a significant exporter of commodities, and also of diverse manufactured goods, and Brazilian MNEs that expanded globally represent very diverse sectors of industry (e.g., oil and gas, mining, steel, food and beverage, aviation, engineering services, etc.). The expansion of Brazilian MNEs occurred most markedly in the last two decades, a period during which international tax concepts and standards were well established, tried and tested by MNEs that originated in the U.S. and in Western Europe.

Several Brazilian-headquartered companies remain as global exporters, with direct sales out of their Brazilian operations and little presence (e.g., “rep offices” and storage) in several countries around the world. For Brazil’s emerging MNEs and traditional exporters, rules regarding the existence or not of tax nexus [the existence or not of Permanent Establishments (PEs)], were and still are determinant factors in the design of their global footprint.

Accordingly, any changes to expand the definition of PEs such as intended under Action 7 would likely cause a retraction of activities abroad by Brazilian exporters (in order to avoid undue compliance costs and a potential “force of attraction” of Brazilian-source profits abroad), thus diminishing international trade and investment (and global welfare). Whereas in the case of Brazil’s MNEs such expansion of PE definitions would increase the cost of operating abroad (e.g., increase compliance costs, trigger potential transfer pricing litigation and double-taxation and/or loss utilization issues), and cause structural changes in scenarios that are not at all artificial – and thus that are not the object of the BEPS Project.

One way or the other, a potential effect of the proposed changes is a shift of income into high-tax “source” jurisdictions that are in essence Brazil’s export markets (both to Brazilian-based exporters as well as to Brazilian MNEs that structure their foreign-base sales through “hubs”), and this represents a loss of tax revenue to the Brazilian Federal Government as well. In the case of exporters it would be a direct loss to Brazil, as Brazilian taxpayers would be deemed to have PEs and foreign-source income subject to foreign taxes (which would entitle them to foreign tax credits in order to avoid double-taxation in Brazil as per domestic laws) in scenarios where they have at present only Brazilian-source income and Brazilian taxes paid. In the case of MNEs, foreign-based sales are typically managed and controlled out of controlled subsidiaries (i.e., supply-chain hubs) located in Western European
countries that are subject to relatively lower corporate income taxes as
compared to the larger export markets (within Europe as well as in China,
India, the U.S. and other countries) and, accordingly, foreign earnings are
typically taxed in Brazil at year-end as per Brazil’s anti-deferral laws or are
tax-deferred under a tax treaty. Hence, any shift of income out of such
active supply-chain hubs into the U.S., Western Europe, China and India
would result in a reduction (or erosion) of the Brazilian tax base.

If the aim of the BEPS Project is to curb “artificial” structures that seek to
avoid PE characterization, that should be done via the Commentary to the
current definitions of Article 5 of the OECD Model Convention (as any such
artificial or abusive structure should not be legitimate via proper
interpretation and application of the current treaty definitions). This
technical solution is preferable from the viewpoint of Brazilian Industry.

(a) Artificial avoidance of PE status through commissionnaire arrangements
and similar strategies

The OECD Discussion Draft under Action 7 asserts that “Commissionaire and
similar strategies” are often artificial schemes that give rise to BEPS
concerns which would warrant changes to PE definitions. First of all, it is
imperative for the OECD to define what it means by “similar strategies”, so
as to diminish the subjectivity and uncertainty that results from such an
open-ended statement. Brazilian Industry would expect that such “similar
strategies” are not contract or toll manufacturing arrangements, or limited-
risk distributorships, as any BEPS concerns on such other arrangements and
distributorships would be better addressed under the transfer pricing Actions
8, 9 and 10, as opposed to Action 7.

The report defines “commissionaire” strategies as follows: “A
commissionaire arrangement may be loosely defined as an arrangement
through which a person sells products in a given State in its own name but
on behalf of a foreign enterprise that is the owner of these products.
Through such an arrangement, a foreign enterprise is able to sell its
products in a State without having a permanent establishment to which such
sales may be attributed for tax purposes; since the person that concludes
the sales does not own the products that it sells, it cannot be taxed on the
profits derived from such sales and may only be taxed on the remuneration that it receives for its services (usually a commission).”

In many countries of civil law tradition (such as Brazil and most of Latin America), and in many developing nations, such “split” of legal title and beneficial ownership of inventory is not feasible, or it would otherwise be equivalent to limited-risk distributorships (i.e., legal title and ownership would be equivalent for tax purposes). In countries of common law tradition, and also in most of Western Europe, however, commissionaire models can indeed have the results reported by the OECD. Therefore, the issue that is addressed by the OECD in this instance is not quite as global and far-reaching as it appears (as it would not affect source-taxation in most emerging and developing nations), and most particularly as the aim of the BEPS Project in this Action 7 is to curb artificial commissionaires, and not to affect legitimate arrangements.

The OECD reports that the main trigger of PE status in commissionaire arrangements under current law is the power to conclude contracts (i.e., an “agency” matter), and hence broadening the scope and meaning of such agency rule would address the BEPS concerns raised by artificial commissionaire arrangements. Dependent agents constitute PEs, and the Action 7 Discussion Draft seeks to expand the definition of such agency, and also to limit the exception to such PE rule applicable to independent agents.

Accordingly, in setting forth recommendations related to artificial avoidance of PE status in the context of commissionaire arrangements, the OECD provides some options (“A”, “B”, “C” or “D”) to broaden the scope of such PE provisions through significant alterations to Article 5 of the tax treaties currently in force (through Action 15), to the Model Convention, and hence to future bilateral treaties. The options are:

A. Add a reference to contracts for the provision of property or services by the enterprise; replace “conclude contracts” by “engages with specific persons in a way that results in the conclusion of contracts”; strengthen the requirement of “independence”;

B. Add a reference to contracts for the provision of property or services by the enterprise; replace “conclude contracts” by “concludes contracts, or negotiates the material elements of contracts”; strengthen the requirement of “independence”;
C. Replace “contracts in the name of the enterprise” by “contracts which, by virtue of the legal relationship between that person and the enterprise, are on the account and risk of the enterprise”; replace “conclude contracts” by “engages with specific persons in a way that results in the conclusion of contracts”; strengthen the requirement of “independence”;

Or

D. Replace the phrase “contracts in the name of the enterprise” by “contracts which, by virtue of the legal relationship between that person and the enterprise, are on the account and risk of the enterprise”; replace “conclude contracts” by “concludes contracts, or negotiates the material elements of contracts”; strengthen the requirement of “independence”.

In our view, all of the options above would result in significant subjectivity in interpretation and, thus, would likely cause protracted litigation in several countries or otherwise trigger double-taxation. In order to effect any one of these changes the OECD would need to significantly expand on the commentary and also to succeed in enhancing Dispute Resolution procedures under Action 14 of the BEPS Project (ideally going beyond Mutual Agreement Procedures and into Mandatory and Binding Arbitration).

Should one of the options be selected, however, it is our view that Option B is the only one that seems technically feasible and not entirely inconsistent with traditional international tax law concepts.

Under Option B, Paragraphs 5 and 6 of Article 5 of the treaties would be redrafted 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 and, in doing so, habitually engages with specific persons in a way that results in the conclusion of contracts which, by virtue of the legal relationship between that person and the enterprise, are on the account and risk of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if
exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

6. Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent acting on behalf of various persons and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one enterprise or associated enterprises, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to these enterprises.

It is necessary for the OECD to define in its Commentary what constitutes the “material elements of contracts” so as to diminish the risk of inconsistent or incoherent interpretation by different countries – still the letter of the law above will be interpreted autonomously by numerous countries and can give rise to excessive subjectivity and hence double-taxation. Thus, as we noted, Dispute Resolution must be enhanced and enforced under Action 14 in order for this change to be minimally practicable.

Options A and C, attribute force of attraction to activities that result in the conclusion of contracts (i.e., replace “conclude contracts” by “engages with specific persons in a way that results in the conclusion of contracts”). Any and all business activities conducted by short-term business travelers, and all preparatory and auxiliary activities carried out by exporters abroad, and in fact all activities of any business enterprise are carried out so the enterprise ultimately concludes contracts. That does not mean that any and all activities carried out abroad should attract income from the ultimate contract to be concluded by different persons, entities, or agents, and a later point in time. This proposed reference is, therefore, utterly unfeasible and technically inaccurate in our view.

Option D is a variant of Option B, however, in Option D there is excessive uncertainty regarding the definition of contracts that are in-scope (i.e., replace the phrase “contracts in the name of the enterprise” by “contracts which, by virtue of the legal relationship between that person and the
enterprise, are on the account and risk of the enterprise”). Again different countries may interpret this extensively and unilaterally, which could trigger multiple instances of double-taxation.

(b) Artificial avoidance of PE status through the specific activity exemptions

The reference to “specific activity exemptions” is a reference to the list of exceptions included in Art. 5(4) of the OECD Model Tax Convention, according to which a permanent establishment is deemed not to exist where a place of business is used solely for activities that are listed in that paragraph. In our view, these exceptions must be interpreted appropriately, and their limited force of attraction should not be expanded through re-definition of PEs in general — here, again, any concerns regarding “artificial arrangements” should be resolved via proper interpretation, otherwise changes to the definition of “preparatory and auxiliary activities” and of other exceptions would give rise to incoherent profit attribution in end-markets that seem to place excessive value on the factors observed within their boundaries (e.g., China and India would likely overvalue their sales markets or labor factors). This is beyond the declared scope of the BEPS Project and could harm global trade and investment.

Furthermore, a “principal purpose test” (or general anti-abuse rule, i.e., treaty GAAR) discussed under Action 6 might reinforce this solution as it is cited in the Action 7 Discussion Draft; however, such PPT GAAR limiting the application of a bilateral tax treaty and denying treaty entitlement should only be applicable through Mutual Agreement Procedures with Binding Arbitration. That is, the exception to PE under Article 5 could only be denied by one country if the other country also deems a situation to be artificial and abusive, using a common standard to be consistently developed by the OECD through the BEPS Project and corresponding Commentary to a new Model Convention to be presented by the OECD upon conclusion of the Project; as such one treaty partner would not be permitted to unilaterally override the treaty by inconsistently and unilaterally interpreting what constitutes “treaty abuse” and by assessing a PE which is not recognized by the other state.

Understanding that the exceptions are not restricted to preparatory or auxiliary activities is a necessary measure which should be supported by
Brazilian Industry. Conversely, addressing situations or artificiality or abuse of such exceptions via new PE definitions seems inappropriate or contrary to the stated intent of the OECD regarding the BEPS Project insofar as “these actions are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income.”²

By suggesting the language or standards of the United Nations (or expanding such standards) with respect to the word “delivery” in subparagraphs a) and b) of paragraph 4 of Article 5, or in addressing the exception for purchasing offices, the OECD seems to now significantly change the allocation of taxing rights on cross-border income out of residency states and into source states (or consumer markets).

As noted in the Discussion Draft: The term “permanent establishment” is deemed not to include a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise; b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery.

The OECD now states that “it is difficult to justify the application of these exceptions where an enterprise maintains a very large warehouse in which a significant number of employees work for the main purpose of delivering goods that the enterprise sells online.”

We do not understand this rationale and why it differs in online sales versus offline sales or any sale, as a new PE “trigger” related to warehousing could significantly harm global trade in the entire global economy (and as the OECD recognizes under Action 1 of the BEPS Project the digital economy cannot be ring-fenced and differentiated from the economy as a whole). This new language and position of the OECD seems like a political departure from the technical concept of value-drivers stemming from a functional analysis and traditional stance of the OECD, and signals an intent to allocate substantial value-creation weight to the location of customers and of inventory, as opposed to the functions, activities, assets, and risks that underlie and compose such value-creation. What is a “large warehouse” in relation to the total assets and capital of a multinational enterprise engaged in the same value chain? What is a “significant number of employees” in such a warehouse, in relation to the total workforce engaged in such value

² Discussion Draft, paragraph 3, page 10.
chain and in relation to high-value-added activities carried out elsewhere? The language and approach of the OECD in this stance seems to navigate uncharted and treacherous waters, particularly in countries with aggressive transfer pricing policies that traditionally deviate from the Arm’s Length Principle and from OECD TP Guidelines, and/or countries that are not OECD Members. The same can be understood from the exception related to purchasing functions.

The fact of the matter is that these activities (storage for delivery, and mere purchasing) could hypothetically represent nexus; however, under a proper application of the Arm’s Length Principle, the force of attraction of such activities with respect to the underlying income would be minimal (i.e., there would be very little income attributable to these activities), and would, therefore, not justify the additional compliance cost and administrative burden of a PE. This is the rationale for having the exception there in the first place, as it is coherent with the object and purpose of the PE article in the context of the OECD Model Convention as a whole, and we believe these reasons remain valid.

Brazilian Industry therefore should not support changes to the exceptions under Article 5 through which “delivery” and “mere purchasing” would be trigger the recognition of a PE. Particularly for the Brazilian exporters of commodities (e.g., oil, agricultural and mining products) which are often stored at port facilities globally, the additional costs associated with eliminating the PE exception for “delivery” would represent a non-tariff barrier to international trade. Regarding “purchasing” activities, a new definition would create inefficiencies to global value chains and, quite likely, ultimately increase prices and burden end-consumers, or reduce the overall competitiveness of Brazilian enterprises vis-à-vis local competitors. Either way, these measures that would harm global trade, and represent a protectionism of local (national) industries and producers from the source-countries.

The issue related to fragmentation of activities between related parties should clearly be dealt with through revisions to the Commentary. Such fragmented activities can only be deemed artificial if they disrespect the current object and purpose of Article 5, as it currently stands. A change to the definitions of Article 5 should not be done if the aim is to curb “artificial” practices that should not be viewed as legitimate in light of current treaty law, if properly interpreted.
Brazilian Industry includes conglomerates of entities that are related yet that are engaged in different global value chains. A new definition of PE aimed at artificial fragmentation could impose an undue burden on entities that albeit related are not engaged in a single cohesive operation within the source country. For example, some large infrastructure multinationals headquartered in Brazil operate in civil engineering, in oil and gas, and also in mining and production of Portland cement. These activities are often managed and operated within separate business units. Each of these units could have activities in the same jurisdiction, in different stages of their global value chains. If the existence of multiple, non-complementary activities could be deemed, under redefined PE rules, to be evidence of a single cohesive operation and thus give rise to a PE in a certain jurisdiction, this could exert disproportionate “force of attraction” and would be a departure from economic substance and an artificial allocation of taxing rights to said jurisdiction.

Suppose for instance that the aforementioned civil engineering business unit performs contracts and services to customers in the country, all under separate projects that even if combined would not constitute a PE; suppose the oil and gas (and mining) units maintain storage facilities for in-country delivery; suppose the cement production business unit does produce in country but also exercises a procurement function and purchases chemical additives to other affiliated entities in the group. If all of these unrelated activities could be combined to define a single PE to said corporation, and thus attract profits from civil engineering, oil and gas, mining, and foreign production of cement, the result of the proposed PE changes under Action 7 would be utterly irrational, and absolutely artificial. And it would represent a significant departure from international tax standards, a true shift of taxing rights from residence countries to source countries, as opposed to a measure to address BEPS and to curb abusive transactions.
Additional Comments on the New Discussion Draft of May 15, 2015

In the new discussion draft released wherein additional comments are requested, and to which this position document is addressed, and in the vast majority of comments submitted to the OECD on the prior discussion draft, we see many of the same issues and concerns discussed herein.

The new draft is structured following the same general format of the prior discussion draft, yet it responds to some of the comments submitted to the OECD and it focuses on certain proposals. The original structure was addressed as follows:

"(...) a first discussion draft on Action 7 which described the PE avoidance strategies identified by the Group and which included a number of alternative options on how to deal with these strategies. That discussion draft included:

– 4 options (Options A to D) for changes to Art. 5(5) and (6) of the OECD Model concerning the artificial avoidance of PEs through commissionnaire arrangements and similar strategies;

– 4 options (Options E to G) for changes to Art. 5(4) of the OECD Model (which includes a list of specific PE exceptions);

– 2 options (Options I and J) for changes to Art. 5(4) that would address concerns with fragmentation of activities in order to benefit from the exceptions provided by that provision;

– 2 options (Options K and L) on how to deal with the splitting-up of contracts for the purposes of benefiting from Art. 5(3) of the OECD Model (the rule according to which a construction site is not a PE unless it lasts at least 12 months);

– 2 options (Option M and N) on how to deal with insurance companies that sell insurance in a local market without having a PE in that market."


Accordingly, the new discussion draft addresses comments received by the OECD and makes its proposals under the following headings:

A. Artificial avoidance of PE status through commissionaire arrangements  
   1. Proposals concerning Art. 5(5)  
   2. Proposals concerning Art. 5(6)  
B. Artificial avoidance of PE status through specific activity exemptions  
   1. Proposal concerning Art. 5(4) rule on “preparatory and auxiliary activities”  
   2. Proposal concerning the inclusion of a new anti-fragmentation rule under Art. 5(4)  
C. Splitting-up of contracts  
D. Insurance  
E. Issues related to attribution of profits to PEs and interaction with Action Points on Transfer Pricing

The new discussion draft highlights that “the vast majority” of commentators “who expressed a preference for one of the options” supported Option B instead of A, C, or D. And in many cases such support was caveated or qualified by conditions as to changes or clarifications deemed necessary. This is partly consistent with the view of Brazilian Industry as discussed hereinabove. However, the OECD does not report whether the majority of comments received were even more supportive of not adopting any of the options suggested at all, with “B” as the “least-worst case”.

Brazilian Industry therefore reiterates its view that all of the options including B would result in significant subjectivity in interpretation and, thus, would likely cause protracted litigation in several countries or otherwise trigger double-taxation. In order to effect any one of these changes the OECD would need to significantly expand on the commentary and also to succeed in enhancing Dispute Resolution procedures under Action 14 of the BEPS Project (ideally going beyond Mutual Agreement Procedures and into Mandatory and Binding Arbitration).

The definition of “negotiates material elements of a contract” and “independent agent” suggested for the Commentary would significantly broaden the scope of the rule, as feared and noted in the preceding sections of this report. On the other hand, the new draft distinguishes between low-risk distributors and commissionaires – arrangements with equivalent economic features – and only addresses the latter under Art.5., and refers to
transfer pricing Action 9 (on the debate on capital, risk and re-characterization) for low-risk distributorships\(^3\) (one would interpret the same would be applicable to contract manufacturers as opposed to toll manufacturers), applicable to associated enterprises. The new discussion draft, therefore, continues to signal towards greater (or even formulary) attribution of profits to PEs in commissionaire arrangements between related parties (using a common corporate control standard).

As discussed herein and as noted in many other comments received and acknowledged by the OECD, although there are theoretical grounds to ascertain the existence of a PE in certain broadened scenarios, the level of profits attributable to such PEs should be immaterial in light of the Arm’s Length Principle (ALP); that is, third parties would gladly employ assets and personnel in the source-state equivalent to such PEs under a low-risk, low-margin, service-like arrangement. Hence, such comparable low-margin outsourcing option (that is realistically available worldwide) would attest to the reasonableness and adequacy of equivalent low-margins in related party arrangements. Accordingly, the cost to governments and companies of administering a “multitude” of PEs with immaterial profits would be disproportionately high in light of the potential revenues collected, that is if the ALP is not abandoned in favor of Global Formulary Apportionment (or the unjustified use of Global Profit Splits).

Conversely, if the ALP is abandoned or incoherently applied by different countries that apply such broadened PE notions (and in the absence of Mandatory and Binding MAP Arbitration), corporate tax revenues could hypothetically increase in source-countries as implied in the BEPS discussion drafts. However, the efficiency loss resulting from the excessive administrative burden, associated with incremental cost of formula-based

\(^3\) See p. 16: “32.12 The cases to which paragraph 5 applies must be distinguished from situations 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. In these cases, the person is not acting “on behalf” of these other enterprises and the contracts concluded by the person are neither in the name of these enterprises nor for the transfer to third parties of the ownership or use of property that these enterprises own or have the right to use or for the provision of services by these other enterprises. Where, for example, a company acts as a distributor of products in a particular market and, in doing so, sells to customers products that it buys from an enterprise (including an associated enterprise), it is neither acting on behalf of that enterprise nor selling property that is owned by that enterprise since the property that is sold to the customers is owned by the distributor. This would still be the case if that distributor acted as a so-called “low-risk distributor” as long as the transfer of the title to property sold by that distributor passed from the enterprise to the distributor and from the distributor to the customer (regardless of how long the distributor would hold title in the product sold)”.

corporate taxes that would not otherwise be imposed in third-party scenarios, would serve as an incentive for substantial outsourcing of activities to unrelated parties such as logistics providers and supply-chain solutions companies. This disaggregation of business activities potentially triggered by the disproportionate assertion of PEs can be viewed as distortionary and, hence, damaging to global welfare.

It is particularly concerning the formulary language expressly suggested in the new discussion draft for the OECD Commentary under Art. 5(4) and related definition of “preparatory and auxiliary”⁴:

“21.2 (...) An activity that has an auxiliary character, on the other hand, generally corresponds to an activity that is carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a whole. It is unlikely that an activity that requires a significant proportion of the assets or employees of the enterprise could be considered as having an auxiliary character.”

The first part of the definition of auxiliary can be interpreted in light of a proper analysis of the functions performed, as it regards the nature of the activities performed in the other state (versus the residence state), i.e., “essential and significant”. The highlighted part, however, seems to trump any qualitative meaning of “auxiliary” in this sense, and focuses merely on sheer volume through a formula in the assertion of the existence of a PE. Hence certain low-value-added preparatory and auxiliary activities (that foster international trade) would start to trigger a significant administrative burden which could adversely affect international trade. Furthermore, as discussed above, once such activities are characterized, as per the suggested interpretation of the new discussion draft, as a PE, they could hypothetically exert a disproportionate “force of attraction”.

Regarding the new “anti-fragmentation rule”, the report acknowledges that the “vast majority of commentators” rejected both alternatives I and J. This would be consistent with the view of Brazilian Industry. Nonetheless, the discussion draft presses forward with the suggested rule of Option J.

Brazilian Industry therefore must reiterate: the issue stemming from “artificial” fragmentation should clearly be dealt with through revisions to the Commentary and not through the insertion of a new paragraph 4.1 to Article 5. Fragmented activities can only be deemed artificial if they disrespect the

⁴ See page 24.
current object and purpose of Article 5, as it currently stands, which is a rule of objective nexus (of a particular business activity with the source country) and not of subjective nexus (of a foreign resident with the source country). A change to the definitions of Article 5 should not be done if the aim is to curb “artificial” practices that should not be viewed as legitimate in light of current treaty law, if properly interpreted. That is, if business activities are artificially fragmented, such fragmentation should be interpreted as ineffective to avoid PE status; whereas if the fragmentation effectively occurs (for example, to the point where fragmented businesses could even be replaced by third parties through outsourcing), a fictitious consolidation of separate businesses would be highly distortionary.

Again, Brazilian Industry includes conglomerates of entities that are related persons or even separate part of the same legal entity, yet that are engaged in different global value chains and separate businesses. A new definition of PE aimed at artificial fragmentation could impose an undue burden on entities that albeit related are not engaged in a single cohesive operation within the source country.

II. Enforcement and Interpretation Issues Affecting Industry within Brazil

(a) Inbound FDI – Brazilian-Source Income of Foreign Investors

At the present time there is little incentive for the Brazilian Tax Authority to pursue PE characterization on inbound transactions and FDI, and hence this might be misleading the stance of the Brazilian Authorities that are engaged in the BEPS Project (which may not fully appreciate the impact on outbound FDI which can expose the Brazilian Treasury to a significant loss of revenue in a multilateral context).

From an inbound perspective, nonetheless, Brazil essentially deems “service-PEs” to exist for virtually any and all importation of services, by imposing very high withholding taxes of 25% (or 15% plus an excise tax of 10%) on fees charges into Brazil, as well as a 15% withholding tax on royalties and copyrights, as well as on leases and rents. Additionally, unincorporated branches of foreign persons are, from a regulatory perspective, not generally a feasible form to operate a business in Brazil, and would be regarded as corporate taxpayers anyway.
Thus, the Brazilian Tax Authorities tend to view Brazil as somewhat “immune” to many of the artificial PE structures that are targeted under the BEPS Project (regarding inbound FDI and considering Brazil as a source-country), and would thus generally favor the enlargement of PE definition as it sees no immediate downside to Brazilian tax revenues. Furthermore, such enlargement of PE definitions could reinforce Brazil’s arguments and stance on the appropriate-ness of its withholding taxation policies in general (although such policies are clear barriers to international trade). This stance, if it indeed exists, overemphasizes Brazil’s role as a source-country.

(b) Outbound FDI – Brazilian MNEs Foreign Source Income

Most OECD Members that are developed economies (except the U.S.) operate under territorial (exemption) systems. Therefore, their emphasis on an enlarged definition PEs which could lead to an enlarged jurisdiction of source-countries, and greater allocation of taxing-rights to large consumer markets (e.g., France, Germany, the U.K., Japan, etc.) does not harm the MNEs and the tax revenues from these countries as much as it does potentially harm Brazil. The U.S. and China are major exporters of capital nonetheless they are also the world’s largest consumer markets.

Therefore, Brazil is uniquely positioned at a disadvantage as a country in light of Action 7, as its profits from exports of commodities (and exports from diverse industries) would be attracted overseas to Western Europe, North America, Japan, China and India, without a corresponding increase to Brazilian tax revenues.

Brazilian MNEs operate under a worldwide income tax system at a high statutory rate (34%) and a ruthless anti-deferral statute with limited foreign tax credits. That is, enlarged PE definitions as per Action 7 would necessarily attract Brazil-source (or low-tax foreign-source) income to consumer markets that are high-tax jurisdictions. This is irrespective of whether any artificial arrangements whatsoever exist – and in the case of Brazil they most often do not, particularly as it pertains to exports of commodities from Brazil.
III. Enforcement and Interpretation Issues Affecting Brazilian Industry in China, India, and in Developing Countries

It is notorious that China and India have aggressive Transfer Pricing practices and equally aggressive policy interests with regard to the reform of Transfer Pricing rules under Actions 8, 9 and 10, and also of PE rules under Action 7. Many developing countries could follow in their footsteps post BEPS and adopt not only UN-recommended practices but more aggressive, subjective, and unilateral post BEPS measures to assess the existence of PEs and the allocation of profits out of Brazil and into such PEs.

Brazilian Industry, i.e., Brazilian-based exporters and Brazilian-headquartered MNEs, therefore should expect a significant risk of double-taxation (Brazilian tax “plus”) and of litigation in China, India, and many developing nations, if PE concepts are enlarged under Action 7 and if Brazil maintains its current transfer pricing rules – and even more if the Arm’s Length Principle of Article 9 is significantly changed under Actions 8, 9, and 10 of the BEPS Project.

In fact, it should be in the interest of the Brazilian tax authorities to avoid such an enlargement of PE definitions as it would not increase Brazilian Treasury revenues on inbound FDI while it has the potential to significantly increase foreign taxes imposed on outbound FDI and exports (therefore to significantly decrease Brazilian tax revenues collected from Brazilian exporters and from Brazilian MNEs, due to increased foreign tax credits).

IV. Enforcement and Interpretation Issues Affecting Brazilian Industry in Europe and North America

The issue would be less severe for Brazilian Industry in North America and Western Europe as compared to China and India (and other developing countries), as the income attributable to new post BEPS PEs of Brazilian exporters and of Brazilian MNEs would, one would expect, not be material (provided the Arm’s Length Principle is not significantly changed within Europe and North America under Actions 8, 9 and 10 of the BEPS Project). Still, the additional compliance costs and administrative burden imposed particularly on Brazilian exporters of commodities would represent a barrier
to trade, and harm the competitiveness of exports of Brazilian commodities into the U.S. and particularly Western Europe.

As we discussed hereinabove, an enlarged definition PEs leads to an enlarged jurisdiction of source-countries – and to a greater allocation of taxing-rights to large consumer markets (e.g., the U.S., France, Germany, the U.K., Japan, etc.) and it does not harm the MNEs and the tax revenues from these countries as much as it does potentially harm Brazilian MNEs and Brazil as a nation.

Again if the purpose of the OECD under the BEPS Project is to tackle artificial arrangements and abusive transactions, and not to initiate a “trade war” that discriminates against Brazilian commodities and Brazilian MNEs, the PE definitions of Article 5 should not be altered under Action 7, and instead the OECD Commentary on the Model Convention should be enhanced and amended to tackle abuse (along with the implementation of a PPT GAAR through Mutual Agreement Procedures).
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Submitted by email: taxtreaties@oecd.org


Through its members, BUSINESSEUROPE represents small, medium and large European companies. BUSINESSEUROPE’s members are 40 leading industrial and employers’ federations from 34 European countries, working together since 1958 to achieve growth and competitiveness in Europe.

BUSINESSEUROPE is pleased to provide comments prepared by the members of its Tax Policy Group, chaired by Krister Andersson, on the OECD Revised Discussion Draft regarding the prevention of artificial avoidance of PE status (hereinafter referred to as the Draft).

In the revised Draft the OECD has moved from a series of alternative options to specific proposals under each PE issue and added some additional guidance to various concepts. BUSINESSEUROPE welcomes every effort to provide additional clarity to the OECD Model Tax Convention. However, we are still concerned that the proposals in the Draft will result in a lowering of the PE threshold that goes beyond the specific problems related to BEPS in general and the digital economy in particular.

There is still not enough distinction in the revised Draft between BEPS and the allocation of taxing rights between the source state and the residence state. As stated in our previous comments, any new standards should, in our opinion, be limited to addressing only the former topic. The proposals, as they stand, are likely to result in a dramatic increase in PEs with allocation disputes and double taxation as the end result.

We urge the OECD to develop a test that would exclude bona fide business from being
hit by an increasing number of PEs when already an arm’s length profit is declared for its local activities.

A. Artificial avoidance of PE status through *commissionaire* arrangements and similar strategies

We appreciate the efforts to narrow the concept of “associated enterprises” and also to provide additional guidance as to the interpretation of paragraphs 5 and 6. However, we are still concerned that the proposals will affect not only commissionaire arrangements but also other principal sales structures.

The proposals are based on the presumption that a restructuring of a sales company to a commissionaire structure will substantially reduce the taxable profits in the country of the commissionaire. We believe this to be a transfer pricing issue rather than a PE issue which should be addressed through a proper functional analysis and a discussion about appropriate remuneration.

Extending the PE-concept will most likely give rise to a significant increase in disputes and administrative problems. The notion of a subsidiary as a taxable person should be upheld to the largest extent possible.

B. Artificial avoidance of PE status through the specific activity exemptions

The Draft proposes changes to paragraph 4 of Article 5 by making all the exceptions in the paragraph subject to a preparatory or auxiliary condition.

Although the activities listed in 5.4 in many cases are of a preparatory or auxiliary character, it is acknowledged in para 21 in the Commentary to Article 5 that this is not always the case. There seems to be a lack of consensus between Member States as to the original purpose of the paragraph, i.e. whether it should cover only preparatory or auxiliary activities. Regardless of the original purpose, the Draft clarifies that Working Party 1 has concluded that situations that give rise to BEPS concerns need to be addressed.

To do so, the measure in question has to be sufficiently targeted. Our concern, however, is that the proposed measure and also the specific examples mentioned will not only target BEPS concerns but will also affect traditional businesses with a dramatic increase in PEs as a result. Again, the measure seems to go beyond the intended objective and indeed change the international standards on the allocation of taxing rights on cross-border income.
C. Splitting-up of contracts

To deal with the splitting-up of contracts the Draft proposes two alternatives; the use of a PPT rule (option L) or of an automatic rule (option K).

Although a principal purpose test (would, in principle, give companies a possibility to show that no abuse was intended it would undoubtedly open up for wide application by tax authorities and induce additional uncertainty into the PE test. The example provided in the Draft (Example E) does not give much guidance or assurance as to the application of the PPT rule since it is a fairly clear cut case. In addition, we consider that leaving the decision to tax authorities to determine what is “reasonable to conclude” does not provide much certainty for taxpayers.

The “automatic” approach in option K has its flaws due to the fact that it applies indiscriminately and would also capture situations where there is no BEPS concern. In addition the minimum presence of 30 days is too short and would for many companies result in a PE on every major construction site. Many construction projects run for several years where a company may need to have specialists on the site a couple of days a month during the entire project. In addition, such a threshold could be very difficult to monitor since all parts of an MNE may not be fully aware of all the activities of the group as a whole.

E. Profit attribution to PEs and interaction with Action Points on Transfer Pricing

Since the kind of activities mentioned under paragraph 4 of Article 5 have been recognized not to generate any or very little income, the question of profit attribution to PEs is of utmost importance. Countries are often motivated to create PEs in order to attribute profits to those PEs. We welcome the OECD initiative to provide further guidance in this important area before the end of 2016.

On behalf of the BUSINESSEUROPE Tax Policy Group

Yours sincerely,

James Watson
Director
Economics Department
CBI RESPONSE TO THE OECD PUBLIC DISCUSSION DRAFT ON BEPS ACTION 7: PREVENTING THE ARTIFICIAL AVOIDANCE OF PE STATUS

1. The CBI is pleased to comment on the OECD’s revised Discussion Draft on Action 7: Preventing the artificial avoidance of PE status.

2. As the UK’s leading business organisation, the CBI speaks for some 190,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

3. The CBI continues to support the BEPS programme to update international tax rules to reflect modern business practice, tackle abusive tax structures and target the incidence of double non-taxation. However, we are concerned that if complexity and uncertainty are not avoided, the outcome will be an increase of double taxation and resulting legal disputes, which could have a substantial and negative impact on cross border trade and investment, but also on tax administrations with limited resources.

Overview

4. The CBI welcomes the direction of some of the proposals and is disappointed by some of the others as we stand by the comments in the response to the original discussion draft submitted on 9th January. However, in light of the proposed recommendations of working party 1, we have focused our comments in this letter just on areas where additional guidance could help alleviate some of our concerns or if minor changes of the wording could be achieved to gain greater clarity whilst maintaining the purpose and rationale of Working Party 1 in coming to the conclusions in the revised discussion draft.

5. In making our previous comments that the proposals could lead to a plethora of PE’s with little or no value attached (and note we were not alone in this thought), we made such statements based on applying the existing profit attribution rules to the proposals outlined. Whilst we welcome the fact that the profit attribution rules are to be reviewed, delaying the review until 2016 will mean that the threshold boundaries will be set whilst uncertainty remains whether any profits will be attributable to them. It is important that the impact of changes to the PE definition are fully understood, not only with respect to the increased compliance and risk of double taxation to business, but also to the resourcing and cross border cooperation that will be required of tax authorities going forward based on the proposals outlined. We continue to believe that the proposed changes risk leading to lots of additional permanent establishments being created in cases where the attributable profits are already recognised and fully taxed in the country of the agent, and would ask that the final recommendations exclude such an outcome.
6. In the absence of relying wholly on the transfer pricing changes to deal with commissionaires and similar structures, we welcome that option B was chosen over options A, C or D. However option B will, based on the current proposed draft, lead to many PE’s being created with little or no value attached, we refer to Example 1 in Annex A. We would propose a minor, but important, amendment to ensure that a PE only exists where the discussions actually constitute the agreement of the material elements of a contract in the territory (see proposed wording in our detailed comments below). This would be consistent, and would more closely articulate the actual law, with the proposed guidance in paragraphs 32.5 and 32.6.

7. Whilst we have found much of the additional wording in the guidance on Articles 5(5) and 5(6) useful, we would also recommend that many more case studies are also included dealing with “habitual” and the “material elements of the contract” which cover not just the clear extreme cases at either end of the spectrum, but also how to analyse borderline cases. In our 9th January letter, we included a number of examples which we felt would be beneficial if covered in guidance. We have included these examples again in Annex A to this letter. We have also proposed some additional wording to be added to the guidance notes in 32.5 and 32.6 which we believe will help clarify and provide a more consistent interpretation of the way the new Articles 5(5) and 5(6) are intended to operate.

8. We welcome the proposals and draft guidance to confirm that a dependant agent PE will not automatically be created where a company is dealing with just one customer or if it is acting on behalf of connected companies (when the agent is carrying out sensible levels of similar activities for non-group companies). We also welcome the clarification on the treatment of low risk distributors.

9. In relation to specific entity exemptions, we welcome that Options F,G and H will not be taken forward. In relation to the implementation of Option E, we do believe that the preparatory and auxiliary test should be applied based on the group’s activities and not just the company in question. This is to prevent there being a different answer depending which group company carries out the activities (which would then be entirely consistent with the anti-fragmentation rules being proposed and more closely target the specific BEPS behaviour in question).

10. In relation to fragmentation, Option J does provide for a potential to create a plethora of PE’s (see examples in our detailed comments section) with little or no value and therefore be a significant barrier to foreign trade and investment. In order to manage this position, the key test will be what constitutes a “complementary functions that are part of a cohesive business operation”. Consensus must be reached by the participating states as to what is meant by this term, and a significant number of additional examples (again, exploring grey areas, and not just examples at the two extremes) will be needed to provide business with a certain level of clarity (we have provided two examples to be clarified in Annex A).

11. We have no further comments on the final proposals in respect of the splitting of contracts and specific rules in respect of insurance contracts which in general are consistent with our recommendations.

Detailed Comments

Commissionaire Arrangements and Similar Strategies

12. Whilst we support the choice of Option B over the other options proposed in the original discussion draft, we did have some reservations on Option B to ensure that PE’s were only created where some meaningful value could be attributed to the PE. The proposed commentary for Articles 5(5) and 5(6) does help in this regard, but we would recommend a slight, but important, amendment to the wording of the article itself to ensure that it more tightly articulates intended position and is targeted at real value creation:

We would recommend that instead of the current wording which begins “concludes contracts”, this should be replaced with “concludes contracts, or negotiates and agrees the material elements of contracts”.

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13. This proposal should improve the level of consistency in the application of the rules which could result from the differing emphasis on what is meant by “negotiates the material elements”. A state could claim that “negotiates” refers to simply to undertaking discussions, even though those discussions may not be conclusive on the material elements. However we believe that the threshold for determining a PE should be clearly linked to the agreement of the material elements.

14. “Agrees” is not intended to mean “concludes” in the sense of formal legal agreement, rather it is a reference to the substance of the activity undertaken in the territory.

15. Whilst the additional guidance on Articles 5(5) and 5(6) is useful, as far as it goes, we believe that a greater number of practical examples should be provided on what is meant by “habitually” and “material elements of contracts”. This should provide much more certainty and consistency of application across different countries. Such guidance has normally focused on the clear extremes at either end of the spectrum, whereas many commercial situations can still fall within a grey borderline area (i.e. where a different answer could be given depending on interpretation of the words) – it is these grey areas where guidance on the approach to take is most useful. In our representations to the original discussion draft, we included a number of scenarios which if included in the final guidance would provide greater clarity. In Annex A, we have replicated the examples we requested in our original representations.

16. “In relation to paragraph 32.5, we recommend inserting the following wording in italics to ensure the guidance clarifies the intended change to Article 5(5):

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 that is a relative formality 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. However, it is not intended to apply to situations where, the key elements of the contract negotiated in that State are not agreed to, and are subject to further material negotiations outside the State before being determined. Likewise it will not apply when the material elements have been negotiated from outside of the State but a short visit to the state is made to agree any outstanding issues. In these instances the key ingredients of the contractual relationship have not been negotiated in that State and it is not 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” 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.

17. The commentary on what is meant by “habitually” should be further expanded to explain that it refers to a permanent, largely permanent, or ongoing, level of activity. This is to make clear that international business travel, involving short visits to a territory, can continue without an excessive tax compliance burden arising from assessing the extent of any negotiation that may have taken place during such visits.

18. In relation to the guidance in paragraph 32.6, we recommend including the following wording (in italics) after the first sentence:

…..are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise. The activities themselves must be the substantive agreement of the material elements of the contract and/or concluding the contract. This paragraph applies to a person who acts as a sales force of the enterprise........
This will assist in making it clear that the negotiation itself needs to be material to give rise to a PE ensures value can be attributed to the activity.

We also think it would be helpful to add the following at the end of paragraph 32.6:

*However, this would not be the case where RCO engages in material negotiations with customers of State S from outside State S and notwithstanding SCO liaises with the customer to support the sale by RCO.*

19. Where the OECD has undertaken specific work on sectors, such as Part II and IV of the 2010 OECD paper on the Attribution of profits to PE’s for financial services groups, guidance should promote that the “material elements” of contracts should be those which are linked to the KERTS/SPF’s in that industry (e.g. assumption and management of the risk/business for insurance groups).

20. We believe that the guidance should include a specific paragraph (either before or after 32.6) that explains the difference between the “provision of information” and the “negotiation of contracts”. For example, it would be very common for a group to have an individual located in a territory without a local subsidiary. That individual would be part of the sales team and would be tasked with finding new customers. He would be technically proficient in the products being sold so can provide information to potential customers. Whilst he would have an indicative rate card provided by head office, it would be normal for customers to negotiate actual terms, price, delivery, post sales care etc. and the local sales person has no authority to do this. All such negotiations on the conclusion of the contract happen in the territory of the sales entity.

In the example above, the local person has just provided technical information to the customer. There are material negotiations in relation to the contract but these occur only in the territory of the sales company and not the customer. This is a clear case where a distinction can be drawn with the example provided in paragraph 32.6 (as noted in the revised discussion draft that facts and circumstances need to be considered) where in that example, the only interaction with the customer came in the territory of sales.

So whilst it is acknowledged that in our example, the sales person is part of the sales process and in many cases the sale might not have happened without him, it should be acknowledged that such circumstances should not (based on the facts as outlined) constitute the negotiation of the material elements of the contract. This is clearly done by the sales entity itself. There should be no PE and that any local entity that the sales team person is employed by should be rewarded on a transfer pricing return for the services provided.

21. Our concern over the level of profits that would be attributed to the PE’s can be shown from the example outlined in 32.6 of the revised discussion draft. SCO will be required under transfer pricing rules to charge an arm’s length price for the services it provides. If the current proposals under BEPS Actions 8-10 on risk are carried through, that return under transfer pricing principles could be enhanced if all the market and customer risk is actually managed in substance by SCO. If a PE is created under the revised discussion draft, the profit attributable to the PE for RCO would reflect the assets, functions and risks attributable to the KERTS/SPF’s in the territory of SCO (which would be the activities of SCO). RCO would then be able to deduct the costs attributable to running the PE which will generally be the recharge from SCO. Therefore the only profits that would remain actually chargeable to tax in the PE will only be the differences (if any) between the Article 7 attribution of profits calculation and the Article 9 transfer pricing re-charge from managing exactly the same assets, risks and functions. We do accept that Article 7 and Article 9 do not always come up with exactly the same answer, but the work under BEPS Actions 8-10 are bringing them closer together. This is why we are concerned that there is going to be a significant increase in PE’s, where the threshold tests have become subjective so there could be different interpretations (and potential for double taxation), yet very little (if any) profit would actually be attributable to it. The example in 32.6 should be cross referenced into the commentary on Article 7 to explain the differences in the profits attributable to the PE compared to the transfer pricing recharge required (after Actions 8-10 have been brought in).

22. We also welcome the clarification on the treatment of low risk distributors.
23. Paragraph 34 of the draft guidance appears to be arriving at a transfer pricing conclusion, i.e. on what is attributable to the permanent establishment. We believe that should be considered as part of the future work on profit attribution, and perhaps should be omitted from the commentary on Article 5 for present purposes.

**Dependent Agent**

24. We welcome the proposals and draft guidance to confirm that a dependant agent PE will not automatically be created where a company is dealing with just one customer for a short period of time (depending on facts and circumstances). We also feel it is important that the dependent agent rules should not automatically apply if an agent is acting on behalf of connected companies (when the agent is carrying out sensible levels of similar activities for non-group companies). Whilst the wording appears to allow for this treatment, we would welcome an explicit statement in the guidance that this can be the case and the type of factors which should be taken into account.

25. That said, paragraph 38.5 of the draft guidance appears to state the opposite of what would be expected. If a company acts as a distributor for third parties, and also acts as agent in distributing similar products for connected parties we would expect the company to be regarded as acting in the ordinary course of its business when distributing the products for connected parties. In addition the activities for third parties are important in demonstrating the independence of the agent, as they will potentially demonstrate the economic independence of the agent, depending upon the facts and circumstances – such as the scale of the activity (which is a different point from that made in paragraph 38.7 of the draft guidance). We believe that the commentary should confirm these aspects more explicitly.

26. For example, a PE should not exist where the agent is acting in the normal course of its business, providing similar services to third parties on similar terms. The services provided to third parties should represent a significant amount of the business of the agent.

27. The CBI welcomes the confirmation in paragraph 33.1 that the presence in a territory must be more than transitory in nature. Whilst we accept that an explicit frequency test may not be appropriate, a worked example outlining the approach and factors to take into account would be.

**Specific Activity Exemptions**

28. In drafting the implementation of Option E, we would ask that a PE only arises if the following tests have been met.

- The activity is an integral part of the group’s activity
- There is insufficient substance in the company, and
- The activities are not taxed in another jurisdiction.

29. In the first part of the test is to ensure that the measurement of preparatory and auxiliary is by reference to the whole group’s activity. This is now critical to ensure consistency with the anti-fragmentation rules to ensure a different treatment does not apply depending which company in the group carries out the activity.

30. For example, a warehouse may not be preparatory or auxiliary to a distribution company in a global supply chain, but it would be preparatory or auxiliary if looking at the whole group if that group was a full manufacturer or extractive group – In this example there would be a PE in the distribution company but no PE if the warehouse was in the manufacturer/extracting company. Having a different treatment makes no sense in addressing BEPS and would be incoherent alongside an anti-fragmentation rule which aims to provide a consistent treatment regardless of the entity in which the activity takes place.

31. If there is sufficient substance in the other territory, then one would expect transfer pricing rules to already provide a sufficient return (probably to a service company) – therefore by asserting a PE, would only be attributing profits already allocated to that territory. As with our comments on Article 5(5), we therefore have significant concern about both the benefit of creating a PE in such cases, and the
attendant compliance burden.

32. We accept that there could be substance, but if the profits are not taxed locally due to the specific exemptions, then the profits may not be taxed anywhere. Therefore we have recommended the subject to tax test (which can be applied to any group company) to provide tax authority protection to allow a PE to be asserted if the profits integral to the group are not subject to tax anywhere.

33. Given the extension of the preparatory and auxiliary test, much more detailed guidance (other than two paragraphs) should be provided to give certainty to business and consistency in treatment between tax authorities. Although it was a concept that was in the existing treaties, with objective tests covering a number of activities that could fall into a grey area around the new proposals, the existing definition did not attract the same level of scrutiny to what will be required going forward. Again, we request that a number of detailed examples looking at the grey areas (and not just the extremities) be included in the guidance. We have included in Annex A, some of the examples we requested in our representations and would request that these (or similar ones) are included in any final guidance.

34. We have reviewed the proposed guidance and have received a number of concerns from our members regarding the example given in relation to paragraph 22.3. In almost all commercial contracts, there will be some right of access to the goods in storage for inspection and maintenance. The example provided in 22.3 outlines the condition that there is unlimited access. What happens when there is some access but it is limited? – Where is the threshold or would any access be treated as non-preparatory and auxiliary. Again, in many situations, having such a clause is important for quality control, but it is not a key value driver for many businesses and therefore would normally be considered to be preparatory or auxiliary to the trade in question (especially looked at in the context of the group activity). However, the example given seems to make it a black or white test (i.e. unlimited access to goods equals non-preparatory activity – even if there were no actual inspections in the year). Again, we think the example should be worded in a way which allows the full facts and circumstances of the group to be taken into account and outline an approach and key factors rather than providing a definitive answer which may not be consistent with the words in the Article itself. We have included some new examples (11 & 12) in Annex A of a situation that we feel would be useful to be included to bring out this point in more depth.

35. The proposed adoption of Option E to make all the activity tests subject to preparatory and auxiliary do now bring into focus some of the existing commentary on Article 5(1) which may not have been required before. Whereas before, a group may have been able to rely on Article 5(4) to provide an objective test by which to confirm there is no PE, bringing in subjectivity in both the extension to preparatory or auxiliary and the fragmentation test is likely to mean a lot more focus on the primary definition of permanent establishment in Article 5(1). One concept which relates to Article 5(1) – not in the text of Article 5(1) itself, but is bought in through the commentary – is whether a property is at “your disposal”. As outlined in the paragraph above, this has given cause for concern in relation to the example given in paragraph 22.3 and will be particularly relevant for short term business visits for employees from other group companies (see examples in relation to fragmentation). Again, this will now be given much more focus if Option E is implemented, so we would ask that further thought is given to what is meant by at “your disposal” and whether in light of the proposed changes, that is still a term fit for use, or will the existing definitions and examples narrowly tie the interpretation to create a plethora of PE’s to which little value can be attached. Further clarity would also be required under Article 5(1) if the concept of a virtual PE is taken forward under BEPS Action 1.

**Fragmentation**

36. The CBI accepts the need for anti-fragmentation rules to (quoting from paragraph 30.1 of the proposed guidance) “prevent an enterprise or a group of connected enterprises from fragmenting a cohesive business operation into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity”. This wording (especially “in order”) does imply that the purpose of the transaction should be taken into account to distinguish BEPS behaviour (i.e. the deliberate structuring with a main purpose of taking profits outside of the charge to tax). A key feature of the international tax system is that no force of attraction should apply except in cases of abuse and therefore there should not a PE created just because the group already has substance under another
business line, or through other commercial arrangements. These rules should only apply where groups deliberately structure themselves purely to avoid a PE for tax purposes, otherwise on a pure wide interpretation of the wording of Option J, they could create a plethora of PE’s (especially in relation to short business trips) which would be attributed little or no value.

37. If proposal 3 is taken forward in its existing format, the key test will be what constitutes a “complementary functions that are part of a cohesive business operation”. As noted above, a wide interpretation could lead to a plethora of PE’s. A narrow interpretation may be capable of delivering a more targeted set of rules. Consensus must be reached by the participating states as to what is meant by this term, and a number of examples (again, exploring grey areas, and not just examples at the two extremes where the conclusion is obvious) will be needed to provide business with a certain level of clarity. Again, we have included in Annex A the examples we requested in our representations be included in the guidance.

38. If we take a wide extreme interpretation, a “cohesive business unit” could be interpreted as any action within a MNE group. This argument is based on the premise that MNE’s must have some commonality and synergies to form part of an overall MNE group. If this was the interpretation intended, it would mean that any employee travelling to a country for just one day where the MNE group already had a presence (PE or resident company) would create a PE for his employing company.

39. For example, a group CEO of a MNE which has resident subsidiaries in 100 countries – the CEO spends 1 day a year in each territory where there is a subsidiary. As the CEO is likely to be talking about the group strategy and how the local country fits into that strategy, the proposed wording could be argued as constituting complementary functions in a cohesive business operation. Under 4.1 b), the combined activities of the CEO and the subsidiary do not constitute preparatory and auxiliary activities as the subsidiary is a full local operating and sales company. If the local tax authorities claimed that the parent company had a fixed place of business through having access to the subsidiaries premises, the activities of the subsidiary automatically taint the activities of the CEO (and any other business visitor in the year). Such an interpretation would mean the group parent company has 100 PE’s in different countries created by just one day’s work in each one. This is clearly unworkable and we do not believe is intended by the rules (based on the opening paragraph in 30.1)

40. In order to address the above, the guidance could give specific examples like this which could show that these rules would not create a PE because either:

- A de-minimus could be included in the fixed place of business test so that a small number of days at a group company does not create a fixed place of business in the first place (so there is no reliance on Article 5(4)).
- The activities of the CEO (stewardship) should be treated as part of a different cohesive business unit to the local activities of the local operating subsidiary.

41. As noted above, the anti-fragmentation proposals puts a lot of pressure on the criteria for a ‘fixed place of business’ as once you have one then the anti-fragmentation rule is liable to draw a company in whenever services are also received from a local PE or sub. We would also note Para 32.2 of the Guidance in this respect - which suggests a notional assumption of a fixed place of business in the dependent agent context. That would seem to automatically and inappropriately give rise to a PE in a wide range of cases when viewed together with the anti-fragmentation rules.

Splitting of Contracts

42. The CBI supports the use of the principle purpose test as the main mechanism for dealing with the deliberate split of contracts. This enables the full facts and circumstances to be considered. We have no further comments to make on this issue.

Insurance
43. The CBI had recommended that there should be no further specific rules for insurance companies and therefore welcomes the direction taken by the OECD in respect of the revised proposals.

44. We trust that you will find the above comments helpful in understanding the potential impact of the proposals outlined in the Discussion Draft. We remain committed to ensuring that each BEPS Action achieves its stated goals, whilst ensuring that genuine business transactions are not unduly impacted.

45. We remain at your disposal should you wish to discuss the issues we have raised in this paper in more detail. Please contact neil.anthony@cbi.org.uk for more information.
Commissionaires/Dependent PE

Example 1 – Umbrella Contracts

A number of our members have confirmed that one of their key ways of doing business with other multi-national groups is for the parent company of each group to enter into a contract with the parent company of another group for the supply of goods. However, this contract will also cover the activities of each subsidiary in local territories when supplying the local subsidiaries of the other group.

Examples include an oil and gas group whose parent company enters into agreements with an airline to provide fuel for aircraft wherever a plane is located. The local subsidiaries will then supply the fuel under the contract. Under the proposals outlined in the discussion draft, each local fuel supplier would have a PE in the parent country, and would have to file a tax return even though the parent company already receives an arm’s length return for its work in concluding the contract at group level.

Another of our members in a different industry would estimate that due to similar group level arrangements, around 100 new UK PEs would be created.

It is our view that entering into umbrella contracts like this should not constitute BEPS behaviour as the arm’s length income is appropriately received and taxed in the parent country. However, the proposals outlined in Options A to D will create numerous PEs in the home jurisdiction and therefore significantly increase compliance for no change in the allocation of taxable income.

Example 2 – local sales support for group sales functions

A sales support office based in the source country acts exclusively on behalf of foreign affiliates and provides local expertise in relation to the foreign affiliates’ regional market and customer base (linguistic support, market intelligence, competitor analysis etc.). Employees of the sales support office attend customer meetings alongside employees of foreign affiliates and routinely pass information (including quotations and orders) between regional customers and foreign affiliates. Despite the local sales support office having no direct involvement in the conclusion/negotiation of contractual terms between foreign affiliates and customers, the subjectivity of the proposed Article 5(5) could result in the creation of a PE through even the vaguest of connections between the local office and the negotiation/ conclusion of contracts by one or several foreign affiliates. Again, this seems likely to significantly increase compliance for no change in the allocation of taxable income.

Example 3 – Buy-sell and other back to back arrangements

A local affiliate of a foreign manufacturer provides repair services (including the provision of replacement parts) to regional customers. The foreign manufacturer holds parts in a local third-party warehouse to minimise lead time. The local affiliate procures parts from the foreign manufacturer’s stock in the local warehouse that it uses in its repairs. The local affiliate engineers carry out the repair and take all risk on the labour element of the contract. However, the local affiliate acts as a limited risk distributor in relation to the parts holding no obsolescence, warranty or inventory holding risk and receiving only a small margin on all the parts it sells. Whereas currently the local affiliate would not be considered a dependent agent of the foreign manufacturer as it did not conclude contracts in the name of the foreign principle, under all options, it might now be considered a dependent agent PE of the foreign manufacturer owing to the flow-through contractual arrangements for the parts (being on the account and risk of the foreign manufacturer) and the fact that it is acting exclusively on behalf of the foreign manufacturer in relation to parts supplied.

Back to back arrangements are common in commodity trading markets and these could also be affected under the same analysis.

Example 4 – Financial services regulatory requirements
Within regulated financial services, such as banking, typically only certain entities are regulated to carry on specific activity e.g. the provision of bank accounts, or the issue of investment products. Also, a wide range of regulated financial services require the provider to hold an appropriate amount and quality of regulatory capital. An associated entity should not be prevented from being independent simply because it introduces business for execution by a suitable regulated entity or entities within the same group, especially when it is not regulated, or does not have the regulatory capital to undertake the business. It is expected that the local associated entity would be rewarded appropriately for transfer pricing purposes in respect of any functions it carries out in introducing business for execution by another group company. Again, the proposed changes to Article 5(5) will potentially increase compliance costs for no change in the allocation of taxable income.

**Example 5 – Local customer contact**

We believe that the commentary on Article 5(5) should provide detailed definitions and clear guidance as to what is meant by the terms “habitually” and “negotiates the material elements of contracts”. We are concerned that any ongoing regular contact with clients could be construed as an activity resulting in the conclusion of a subsequent contract (e.g. would it be said that the good customer service provided on the first contract was a key factor in a second contract being awarded even though the customer services function is already being properly remunerated on an arm’s length basis?).

**Example 6 – International business travel**

An employee of a multi-national company travels to Country X for a short visit, which includes meeting various potential customers. Customer X (resident in Country X) subsequently enters into a contract for a service provided to customer X by a member of the MNE resident in Country Y. That service was originally discussed when the travelling employee met the customer whilst visiting Country X. Will it be said that the employee’s engagement with the customer when visiting Country X amounted to negotiation of the material elements of a contract? We don’t believe this should be the case because of the nature of the interaction that took place in Country X, i.e. that interaction was not directly connected to the negotiation of the contract. Also, if employees of the MNE group company resident in Country Y undertake relatively few visits to Country X, that should not be regarded as habitual engagement. We believe that the commentary on Article 5 will need to make clear that customer interactions of the type described in this paragraph do not constitute a PE.

**Example 7 – Invoicing Agent**

A large MNE operating across the globe has determined that there are operational and commercial benefits from the use of a single invoicing agent throughout the supply chain. This simplifies the external face to its 3rd Party customers but also brings operational simplicity. The entity providing the invoicing activity is remunerated for its activities, but in this case, does not have the same purpose as a traditional commissionaire arrangement. Any definition of commissionaire would need to be clear that it would exclude such invoicing agents where the appropriate functional, risk and asset tests would align with their remuneration as these arrangements do not constitute BEPS behaviours.

**Example 8 – Growing business foreign sales operations**

A growing medium sized company has one sales person responsible for a number of countries (say a UK headquartered group employs a salesman in Germany who is responsible for sales across all of mainland Europe). The sales person sources customers and takes the sales relationship so far before handing over to the UK parent to conclude the contract. Under existing rules, there is no need for tax filings in each individual country (e.g. 20 different countries) where total sales in each one would not be profitable enough to cover the tax compliance cost in each jurisdiction.
Considering the OECD’s proposals, there is activity in each jurisdiction that could potentially caught by each option. The existing test is an important de-minimis to allow the business to operate in different territories for a few days profitably. If such proposals are implemented, greater emphasis will be placed on the word “habitual” by both tax administrations and by companies, particularly medium sized businesses which may wish to manage their compliance burden through maintaining a de-minimis level of activity. Although this wording is in the current OECD discussion draft, it is not well tested due to the objective test of actually concluding contracts. We would request that specific examples are given showing what is meant by this term especially regarding short term sales visits and calls made to customers whilst travelling in another country.

**Preparatory & Auxiliary**

**Example 9 - Company v group activities**

In a multi-national group, different functions are carried out in different entities for management and operational reasons. Take an example where a multinational company has set up a distribution company and has established warehouses in a number of jurisdictions. It is part of a large manufacturing group which develops, manufactures, markets and distributes all of its own products. In the context of the group, an individual warehouse for final delivery of goods to the customer would be a preparatory or auxiliary function with little or no value provided. However, in the context of the company, that warehouse is the business of the company and therefore could not be preparatory or auxiliary in nature.

We request that the OECD specifically and clearly addresses this situation in guidance and suggest that consistency with the developments on anti-fragmentation should be achieved.

**Example 10 (Preparatory and Auxiliary) – Warehousing (1)**

Taking the circumstances currently set out in paragraph 22.3 of an independent logistics company operating a warehouse in State S storing goods belonging to an enterprise of State R. The enterprise of state R is an internet retailer and the goods are stored ready for delivery to customers (delivery is also carried out by an unconnected third party). An employee of the enterprise in state R is responsible for managing the relationship with the independent logistics company and as such makes regular visits to the warehouse in State S to monitor performance; share best practice and agree process improvements. During these visits the employee will also inspect the relevant areas of the warehouse to check that goods are being stored correctly and that appropriate processes are being followed. The contract between the two parties give the enterprise the right to carry out these checks. Would the OECD consider that under these circumstances that a permanent establishment exists?

**Example 11 (Preparatory and Auxiliary) – Warehousing (2)**

As with example 10, however the enterprise of state R is also given access to the goods in order to carry out quality assurance testing. Would this change the answer above? Furthermore if these two examples were to be considered “unlimited access etc.” would the activities mentioned be considered preparatory or auxiliary and therefore not be considered a permanent establishment.

**Example 12 (Preparatory and Auxiliary) – Warehousing (3)**

Oil companies deliver oil products and gas into many countries which often require the use of storage facilities. Consider an Oil Company based in country A supplying oil products to country B. The entrepreneurial trading activity (sourcing the product and agreeing the sale into country B) as well as all the back office functions (including sourcing ships, agreeing freight rates, berthing times and demurrage, contract administration, tank rental accounting and systems support) are conducted in country A where the trading profit is correctly taxed. The activities of the storage operator (often the owner of the tanks) are conducted in country B and taxed there accordingly. There is no need to assert that the holding of
hydrocarbons in storage is a PE of the Oil Company. Profits are already correctly taxed in the appropriate jurisdictions.

If the “preparatory and auxiliary” exemption in Art. 5(4) was found not to apply then a PE would need to be registered in Country B of the Trading Company but given the functional activity of the company it is unclear what, if any, profit should be attributable to the PE.

**Fragmentation**

**Example 13 - Centralised Supply Chain**

In an increasingly globalised world, it often makes commercial sense to centralise as much of the supply chain as possible in one location. This is particularly relevant in trade blocs and where there are products that are globally or regionally similar.

In a highly centralised supply chain, the only activity which generally must remain local is the conversion of raw materials to finished product even this being limited to narrow production slots. Toll manufacturing, in which the raw materials and subsequent finished goods are owned by the foreign enterprise and conversion is undertaken by the local company is a common business model.

Ordinarily, the exemption at subparagraph (c) of paragraph 4 would apply, i.e. the maintenance of a stock of goods...solely for the purpose of processing by another enterprise. Clarification is required as to what constitutes a ‘business activity’ under proposal I and J. If there is no clear guidance, then MNEs face uncertainty and potentially erroneous enquiries where stock holding for processing, previously an acceptable practice, is considered a ‘business activity’ and hence a PE is created for the foreign enterprise.

**Example 14 – short business trips**

Clarification is needed where an employee of a group company in country X visits a group company in State Y for a short business trip e.g. an engineer performing services for a few days – would this automatically create a PE for the company in country Y by the fact that the activities in the Company in country Y are significant? It is unclear from the discussion draft as to whether the fact that the Company in country X has no fixed place of business still means that there would be no PE, or the fact that another company in the group in country Y would have to also be considered as a complementary function for a PE to exist? This is common practice, but the compliance costs and burden would be significant compared to the tax at stake for a few days’ work. This should not be considered BEPS behaviour.
Opinion Statement FC 10/2015

on the revised OECD Discussion Draft on

preventing the artificial avoidance of PE status (BEPS Action 7)

Prepared by the CFE and AOTCA

Submitted to the OECD

in June 2015

The CFE (Confédération Fiscale Européenne) is the umbrella organisation representing the tax profession in Europe. Its functions are to safeguard the professional interests of tax advisers, to assure the quality of tax services provided by tax advisers, to exchange information about national tax laws and professional law and to contribute to the coordination of tax law in Europe. The CFE is registered in the EU Transparency Register (no. 3543183647-05).

AOTCA (The Asia-Oceania Tax Consultants’ Association) was founded in 1992 by 10 tax professionals’ bodies located in the Asian and Oceanic regions. It has expanded to embrace 20 leading organizations from 16 countries/regions.

AOTCA and CFE unite almost 500,000 individual tax professionals in 37 countries (19 OECD member states).
1. Introduction

The following comments relate to the OECD’s Revised Public Discussion Draft “Preventing the artificial avoidance of PE status” (hereinafter, the “Discussion Draft”), published on 15 May 2015, pertaining to Action 7 of the OECD/G20 BEPS (Base Erosion and Profit Shifting) Action Plan. They complement the joint CFE and AOTCA Opinion Statement FC 1/2015 of January 2015 on the OECD Discussion Draft of 31 October 2014.

We will be pleased to answer any questions you may have concerning CFE’s and AOTCA’s comments. For further information, please contact Piergiorgio Valente, Chairman of the CFE Fiscal Committee, or Rudolf Reibel, Fiscal and Professional Affairs Officer of the CFE, at brusselsoffice@cf-e-eutax.org.

2. General comments

CFE and AOTCA welcome the efforts made by the OECD so far to update the permanent establishment (PE) framework as well as the opportunity granted to business, tax advisers and other stakeholders to express their concerns or suggestions with regard to the Discussion Drafts released and the proposals under discussion.

Nonetheless, some unsettled issues with regard to the specific preferred proposals included in the current Discussion Draft still create concern.

In particular, in our view unless current proposals are further amended, they are liable to generate, as a final outcome, an unprecedented rise of disputes involving PE-related double taxation and allocation issues. And there are still some misgivings related to the fact that the Draft proposals may reduce the PE threshold, which exceeds by far the scope of BEPS-related issues and targeted e-economy questions as well.

3. Specific comments to the issues proposed in the Discussion Draft

Section A. Artificial avoidance of PE status through commissionaire arrangements and similar strategies

CFE and AOTCA welcome the selection of option B over the other three options included in the previous Discussion Draft, as well as the “general support for the changes proposed, under all options, to the independent agent exception of paragraph 6. It was agreed, however, that the concept of associated enterprises used in paragraph 6 should be replaced by a narrower concept and that paragraph 6 should not automatically exclude an unrelated agent acting exclusively for one enterprise.” (§21 of the Discussion Draft). Moreover, CFE and AOTCA endorse the further interpretative clarifications related to paragraphs 5 and 6 (e.g., on the meaning of several of the expressions or legal terminology used in the selected option) that were included in the current Discussion Draft.

Nevertheless, some concerns still remain, due to the fact that any impact from the said proposals might not be strictly limited to commissionaire arrangements, but to other key sales structures as well.

Some of the changes to the Commentary on Article 5 are not entirely clear and the examples go beyond what would be expected from the main proposal.

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2 http://www.cfe-eutax.org/node/4092
Such is the case explained in the proposed amendment to paragraph 32.6 of the Commentary on Article 5 (p. 17 of the Discussion Draft), where there is no actual negotiation by the employee on the material elements of the contracts, which are standard elements. The explanation for this is far from satisfactory (“the negotiation of the material elements of the contracts is limited to convincing the account holder to accept these standard terms”). If a sales person who does not conclude a contract and does not negotiate its material elements meets the conditions for a permanent establishment to exist, this should be explained in paragraph 32.1. The same applies to paragraph 32.7. It is not explained how the enterprise can perform obligations that were contractually binding another person. Lastly, paragraph 34 raises some doubts as to its compatibility with paragraph 32.1 (“the PE exists to the extent that the person acts for the latter, i.e. not only to the extent that such a person concludes contracts or negotiates the material elements of contracts”). In paragraph 32.1 it seems that all conditions must be met (the person must act on behalf of the enterprise but also such person must habitually conclude contracts and the contracts must be in the name of the enterprise), while in paragraph 34 it seems irrelevant that the second and third conditions are not met.

Furthermore, the CFE and AOTCA fear that the more general rule included in the second part of subparagraph b) can generate further disputes and increase uncertainty. Further examples are welcome, since the ones included under the proposed paragraph 38.10 of the Commentary to Article 5 seem not entirely satisfactory.

However, given that the proposals at issue basically revolve around the concept that a sales company, restructured as a commissionaire, is expected to significantly cut down on taxable profits in the commissionaire’s country, CFE and AOTCA are convinced that such question does not relate to PEs but rather to transfer pricing matters; as such the entire issue would require a due functional analysis and relevant deliberations to resolve upon adequate remunerations.

As may be reasonably expected, any extension of the PE concept is liable to raise serious administrative issues along with a spiralling number of disputes – all of which is rather worrisome for CFE and AOTCA. The recommended approach should be to continue endorsing – as much as possible – the concept that a subsidiary is to be regarded (and treated) as a taxable entity. This approach ensures that certainty and clarity which all stakeholders require, and does not hamper or impact foreign investment.

Section B. Artificial avoidance of PE status through the specific activity exemptions

CFE and AOTCA welcome the guidance provided on the definition of preparatory or auxiliary condition, as well as the related examples that were provided.

Proposed draft amendments to paragraph 4 of Article 5 recommend that all exceptions under the said paragraph become subject to either a preparatory or an auxiliary requirement (option E of the previous Discussion Draft).

In CFE’s and AOTCA’s view, this provision would not strictly impact on BEPS issues but would also entail negative consequences for all traditional enterprises, as its final outcome might be a sweeping rise of PEs. The measure, once again, clearly goes well beyond the originally intended purpose and would actually go as far as changing international standards established for the allocation of taxing rights of transnational income.

Section C. Splitting-up of contracts
It is CFE’s and AOTCA’s understanding that further work will be needed to address the topic of “Splitting-up of contracts”, as the current Discussion Draft does not provide any answers to some of the concerns already outlined on occasion of the previous Discussion Draft.

The two possible alternatives suggested in the Discussion Draft to properly treat contract splitting: (i) option L (i.e., application of a principle purpose test rule), or (ii) option K (i.e., application of an automatic rule) present some implementation difficulties; they may not be easily monitored and may engender some legal uncertainty (as already expressed in CFE’s and AOTCA’s comments submitted previously3).

As far as the principal purpose test is concerned, CFE and AOTCA agree that it would, theoretically, grant companies the opportunity to prove that there was no abusive intent, while it would surely allow for extensive application by the tax authorities and create (even) greater uncertainty in connection with the application of the PE test.

CFE and AOTCA are not satisfied with the example provided in the current Discussion Draft, as in CFE’s view, it is far too simple and does not provide much guidance.

In addition, as already outlined by CFE and AOTCA, the “automatic” approach provided under option K seems unreliable as it could be applied in an arbitrary manner and would thus “catch” non-BEPS situations as well.

For the sake of greater clarity:

- Further examples should be provided for the PPT test;
- The suggested 30-day minimum presence should be reconsidered since it seems too short a term as, in such case, a PE would be identified for all companies with major construction sites. Besides, such kind of limited term may not be easily monitored by reason that some MNE constituents may not have any knowledge of the group’s global activities;
- The expression “logical consequence” (“(...) whether the conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with that person or related persons”) should be reviewed since it lacks the aimed objectivity, and examples would be advisable.

Section E. Profit attribution to PEs and interaction with Action Points on Transfer Pricing

CFE and AOTCA welcome the decision contained in the following text “(...) based on the many comments that have stressed the need for additional guidance on the issue of attribution of profits to PEs, it has been decided that follow-up work on attribution of profits issues related to Action 7 will be carried on after September 2015 with a view to providing the necessary guidance before the end of 2016, which is the deadline for the negotiation of the multilateral instrument that will implement the results of the work on Action 7” (§ 57 of the Discussion Draft).

Allocation of profits to the PE is a fundamental issue. It is absolutely necessary, in order to properly address the changes to the PE definition, to identify the few areas were additions/clarifications are needed, and to coordinate such suggested changes also with the work carried out within Action 9 of the BEPS Action Plan (risks and capital).

3 See footnote 2.
BEPS Action 7:
Preventing the artificial avoidance of PE status

12 June 2015
Dear Madam

BEPS Action 7: Preventing the Artificial Avoidance of PE Status

Thank you for the opportunity to comment on this public discussion draft.

Our organisation

Chartered Accountants Australia and New Zealand is a professional association with over 100,000 members. We engage in advocacy and thought leadership in areas that affect the domestic and international economies. We actively work to advocate for sound public policy in the financial, regulatory and taxation areas.

In formulating our submissions, we take a best practice, public policy perspective. We recognise Governments’ and other international bodies’ legitimate right to set tax policy direction. Our public policy perspective means we endeavour to provide comment free from self-interest or sectoral bias.

Our submission

Our key concern about the revised discussion draft is in relation to the proposed changes to commissionnaire arrangements. In our view the revised draft does not define the mischief(s) accurately and therefore there continues to be a real risk of ‘overreach’. The changes may have a detrimental effect on the global economy or unfairly disadvantage smaller or emerging economies.

We are comfortable with the revised proposals in relation to the specific activity exemptions, splitting up of contracts, insurance, and profit attribution and interaction with Action Points on Transfer Pricing.

Commissionnaire arrangements

We are disappointed that the proposed changes to commissionnaire arrangements have not been targeted more narrowly. In our view the statement made in paragraph 13 of the revised discussion draft is too broad. It incorrectly assumes that tax is the primary driver for the use of a commissionnaire arrangement. It also ignores the commercial drivers for adopting such a business structure (cost efficiencies) and the practice of a risk and reward approach.

1 “It is clear that in many cases commissionnaire structures and similar arrangements were put in place primarily in order to erode the taxable base of the State where sales took place.”
We consider a more targeted rule would be more effective in alleviating tax avoidance concerns involving the use of commissionaire structures.

Yours sincerely

[Signature]

Peter Vial  
Tax New Zealand Leader
Introduction

1.1 The Chartered Institute of Taxation (CIOT) is pleased to submit this response to the revised discussion draft issued on 15 May 2015 by the OECD which looks at BEPS Action 7: preventing the artificial avoidance of PE status, following on from an earlier consultation and public meeting.

1.2 The CIOT responded to the first discussion draft (published on 31 October 2014). Whilst we continue to hold the views expressed in that response, we do not, so far as possible, repeat them here.

1.3 The CIOT supports the aims of the OECD to tackle artificial avoidance of PE status in the areas which have been identified. However, we are keen to ensure that the downsides (being greatly increased compliance costs for taxpayers, administration costs for tax authorities and increased disputes) will not outweigh any benefits (being a re-allocation of tax base to the state where the sales and/or activities took place).

General comments on proposals

2.1 Option B was our preferred option of those presented in the first discussion draft to tackle artificial avoidance of PE status through commissionaire arrangements, although we would have preferred an approach targeted at artificial structures only. Whilst Option B and the revised commentary, subject to our comments below, are likely to address BEPS concerns, they also amount to a broadening of the PE concept. This is likely to lead to more disputes over whether a PE exists, more PE’s of low value in non-abusive cases and consequently an increased compliance burden for taxpayers and administration costs for tax authorities.
2.2 Our concerns regarding more disputes over whether a PE exists, more PE's of low value in non-abusive cases and the increased compliance and costs burden for taxpayers and tax authorities, also arise in relation to the decision to recommend Option E to tackle artificial avoidance of PE status through the specific activity exemptions. We recognise that the proposal will significantly reduce BEPS activity aimed at exploiting the specific activity exemptions, but the cost of achieving this will be increased compliance for companies with a small presence in territories. In particular, the revised guidelines do not satisfactorily address the issue of what is an ‘auxiliary’ activity, and it is quite likely that some countries will regard a long term presence involving one or two people undertaking a support activity as creating a PE, even where the profit attribution is very small, or even non-existent. Please see our further comments on Proposal 2 below.

2.3 Inevitably there will be many more PEs, due to the widening of the definition, and affected taxpayers will have to consider profit allocation and resulting reporting requirements. We envisage that in the majority of circumstances, arrangements which would be treated as a PE under the amended rules as proposed would either not be allocated a profit, or any allocation would be trivial. This is why, we repeat the suggestion in our earlier response that there is a monetary threshold for sales, below which a PE will not arise. In our view a threshold and a de minimis level should be considered.

2.4 We also take this opportunity to reiterate our hope that governments will provide sufficient resource to ensure effective and efficient resolution of the greater number of disputes which will arise. Ensuring that there are robust processes to solve disputes effectively and as efficiently as possible is of vital importance to ensure that the objective of the BEPS process to tackle profit shifting does not, in fact, lead to a damaging increase in double taxation.

2.5 We welcome the conclusion in Part D that no specific rule should be added to Article 5 for insurance enterprises. We understand, however, that the updated commentary on interpreting Articles 5(5) and 5(6) continues to present challenges for a number of insurance businesses models, with the effect that PEs could be created for tax (but not regulatory) purposes where there is no Key Entrepreneurial Risk-Taking (KERT) function and, therefore, there would be no or minimal additional profit to be attributed to any PE. We encourage continued engagement with the insurance sector to ensure that these businesses are not inappropriately impacted.

2.6 We also welcome the conclusion in Part E that follow-up work on attribution of profits issues will continue after September 2015 and into 2016, thus taking into account the complementary work being undertaken in respect of Actions 8-10.

3 Proposal 1: Changes to paragraphs 5 and 6 of Article 5

3.1 It is important for the OECD Model Treaty text and guidance to be as clear as possible to minimise the risk that states interpret whether or not there is a PE differently and the cost and inconvenience of dealing with disputes.

3.2 Proposal 1 To avoid ambiguity, please could paragraph 5 say:

Article 5 ‘…habitually concludes contracts and/or habitually negotiates…’

New Even though the point is to some extent dealt with in guidance, it
paragraph 5 would be preferable not to have ambiguity in the main text.

Alternatively, this could also be drafted as ‘…habitually either concludes contracts and/or negotiates…’.

The point is that the language needs to be clear that ‘habitually’ applies to both limbs.

3.3 Proposal 1 Guidance Para 32

The comment:

‘Such persons … need not be residents of, nor have a place of business in, the State in which they act for the enterprise’

Would benefit from more guidance to explain when a person might be habitually ‘acting in a Contracting State’ without being normally located there.

3.4 Proposal 1 Guidance Para 32.4

‘Also, a contract may be concluded in a State even if that contract is signed outside that State; where, for example, the conclusion of a contract results from the acceptance, by a person acting on behalf of an enterprise, of an offer to enter into a contract made by a third party, it does not matter that the contract is signed outside that State’

As drafted, we find this confusing.

It may be that it is intended to mean that, where a contract is brought into being by oral acceptance or acceptance by conduct and paperwork is subsequently generated to record the contract, the place where the contract is concluded is where the oral acceptance/conduct took place.

If so, the tax analysis would be following the natural legal analysis and it would be useful to have this point covered in the guidance to prevent arguments based on where deals are ‘booked’.

However, the reference to the contract being signed could also be read as referring to a signature that brings the contract rights into being. If so, the guidance seems to be saying that a contract can come into being at a different time for paragraph 5 purposes than under general commercial law. If this is intended it should be more clearly stated.

We wonder whether the guidance is intended to cover the situation where the terms of a transaction have been decided and final form documents are taken to a different territory for execution (as was once the practice in the UK to avoid stamp duty). There is, however, no need for the ‘concludes contracts’ limb of paragraph 5 to be stretched to cover this behaviour as this situation ought to be picked up by the ‘negotiates material elements’ limb.

Some clarification of the intention of this sentence would be welcome.

3.5

Similarly, it would be helpful if the guidance could confirm that where the contract has been negotiated outside State X, but a representative of the foreign company comes to State X to sign the contract, that does would not of itself give rise to a PE.

For example, a company based in State Y negotiates with a third party in State X to licence intellectual property. The negotiations are conducted by telephone and e-mail with the State Y company using
lawyers in State X. When the contract terms are agreed, a director of the State Y company who is the regular signatory for the State Y company travels to State X and signs the contract.

This situation should not give rise to a PE.

However, in terms of the language of paragraph 5, there is a person (the director) acting in State X on behalf of the State Y company and that person is someone who habitually concludes contracts (and may also negotiate them) in the name of the State Y company.

The key wording from paragraph 5 is ‘and in doing so’ which must refer to ‘acting in a Contracting State’ to an extent that can be described as habitual (as opposed to the concluding of contracts being habitual, no matter where); but it would be useful to have this point dealt with explicitly.

The comment below on paragraph 33 also refers to this point.

3.6 Proposal 1 Guidance Para 32.5 and 32.6 There seems to be an underlying assumption that all of the material terms of a contract will be negotiated from one location. This may well be true for commoditised products sold on standard terms and priced by reference to a rate sheet, but may well not be the case for more complicated transactions where, for example, the legal team may well be in a different location from the sales team (which themselves could be in multiple locations).

Understandably, the guidance takes the line that this will depend on the facts in particular cases.

Is it possible for the guidance to say that where the negotiation limb of paragraph 5 gives an inconclusive result, one can look to the place where the contract was concluded as a tie-breaker?

3.7 Proposal 1 Guidance Para 32.9 The guidance here seems to say that a contract can be ‘in the name of’ someone where exactly the opposite is legally the case which could lead to confusion. It is not necessary to stretch the meaning of sub-paragraph a) in this manner to include the agent for an undisclosed principal when that situation would fit neatly into sub-paragraph b).

3.8 Proposal 1 Guidance Para 33 This paragraph seems to be dealing with three separate points:

(i) the contracts must relate to the ‘business proper of the enterprise’;

(ii) the activity of concluding contracts and/or material elements must habitually take place in the relevant State

(iii) attending or even participating in negotiations is not necessarily the same as concluding contracts or negotiating material elements (although clearly a factor to be considered).

It would be less confusing for these points to be reflected in separate paragraphs.

For element (i) the reference to ‘internal operations’ needs to be clarified. Presumably it is intended as a reference to operations of an administrative nature as opposed to intra-group sales of goods and services.

Element (ii) presumably links to the ‘in doing so’ wording noted above. Generally, it would be helpful to have more commentary on
the amount of activity required in the territory of the potential PE, for example, to deal with the situation of an agent based in a particular territory, say Singapore, but who spends the great majority of his/her time travelling to a variety of countries to negotiate deals on behalf of (say) a UK parent.

For element (iii), any further guidance that could be given on the distinction between ‘participating in negotiations’ and ‘negotiating material elements’ would be welcome.

Generally, the concept of ‘negotiating’ seems to be blurred given the comments at the end of paragraph 32.6 where it seems that ‘negotiation of material elements’ can take place even though the contract terms are non-negotiable.

3.9  Proposal 1
Guidance
Paragraph 38.10
This part of the guidance is dealing with the back-up connection rule where ‘based on all the facts and circumstances, one [enterprise] has control of another or both are under the control of the same person’.

The guidance could be clearer as to what sort of control is envisaged. The examples given: indirect participation or a special arrangement seem to be focussed on control of voting power without a direct shareholding.

However, there are other forms of control such as board control or de facto or economic control. It is important to understand whether the OECD does or does not intend to include these alternative forms of control as this is an area which could easily lead to disputes.

4  Proposal 2: Making all the subparagraphs of Article 5(4) subject to a ‘Preparatory or Auxiliary’ condition

4.1  Proposal 2
Guidance
Paragraph 21
The Guidance comments:

‘It is recognised that such a place of business may well contribute to the productivity of the enterprise, but the services it performs are so remote from the actual realisation of profits that it is difficult to allocate any profit to the fixed place of business in question.’

How does this rationale interact with transfer pricing principles which have ways of allocating profit to internal group services? *It might be better to drop the language about allocating profits and simply rely on a concept of remoteness from direct profit earning activities.

4.2  Proposal 2
Guidance
Paragraph 21.1
‘Essential and significant* as a test for auxiliary activities may cause difficulties.

For example an accounts department is normally essential to a business and one would hesitate to call it insignificant. However, in terms of generating turnover or dealing with customers, it could fairly be described as ‘auxiliary’.

Remoteness from supplies of goods and services and/or customer interaction may be a more useful criterion.
5 The Chartered Institute of Taxation

5.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members’ experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT’s comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT’s 17,000 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

The Chartered Institute of Taxation
12 June 2015
Marlies de Ruiter  
Head Tax Treaties Transfer Pricing and Financial Transactions Division  
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Submitted by email: taxtreaties@oecd.org

Confederation of Swedish Enterprise – Comments on the OECD Revised Discussion Draft entitled “BEPS Action 7: Preventing the Artificial Avoidance of PE Status 15 May 2015 to 12 June 2015”

Dear Marlies,

The Confederation of Swedish Enterprise is Sweden’s largest business federation representing 49 member organizations and 60 000 member companies in Sweden, equivalent to more than 90 per cent of the private sector.

The Confederation of Swedish Enterprise is pleased to provide comments on the OECD Revised Discussion Draft regarding the prevention of artificial avoidance of PE status (hereinafter referred to as the Draft).

In the new Draft the OECD has moved from a series of alternative options to specific proposal under each PE issue. Some additional guidance has been added in order to increase predictability as to the interpretation of various concepts. Every effort to provide additional clarity to the OECD Model Tax Convention is naturally positive and of interest to business. However, our main concern from the previous Draft remains, namely that the proposals in the Draft will result in a lowering of the PE threshold that goes beyond the specific problems related to BEPS in general and the digital economy in particular.

In our view, there is still not enough distinction in the Draft between BEPS and the allocation of taxing rights between the source state and the residence state. As previously stated, we believe that any new standards should be limited to addressing only the former topic. The proposals, as they stand, are likely to result in a dramatic increase in PEs with allocation disputes and double taxation as the end
result. We urge the OECD to develop a test that would exclude bona fide business from being hit by an increasing number of PEs.

A. Artificial avoidance of PE status through commissionaire arrangements and similar strategies

Proposal 1: The Draft proposes changes to paragraphs 5 and 6 of Article 5 by the following amendments:

(Para 5.5): Add a reference to contracts for the provision of property or services by the enterprise; replace “conclude contracts” by “concludes contracts, or negotiates the material elements of contracts”;

(Para 5.6): strengthen the requirement of “independence”

We appreciate the efforts to narrow the concept of “associated enterprises” and also to provide additional guidance as to the interpretation of paragraphs 5 and 6. However, we are still concerned that the proposals will affect not only commissionaire arrangements but also other principal sales structures.

The proposals are based on the presumption that a restructuring of a sales company to a commissionaire structure will substantially reduce the taxable profits in the country of the commissionaire. As we have stated in our previous comments, we believe this to be a transfer pricing issue rather than a PE issue which should be addressed through a proper functional analysis.

Extending the PE-concept will most likely give rise to a significant increase in disputes and administrative problems. The notion of a subsidiary as a taxable person should be upheld to the largest extent possible.

B. Artificial avoidance of PE status through the specific activity exemptions

Proposal 2: The Draft proposes changes to paragraph 4 of Article 5 by making all the exceptions in the paragraph subject to a preparatory or auxiliary condition.

Although the activities listed in 5.4 in many cases are of a preparatory or auxiliary character, it is acknowledged in para 21 in the Commentary to Article 5 that this is not always the case. There seems to be a lack of consensus between Member States as to the original purpose of the paragraph, i.e. whether it should cover only preparatory or auxiliary activities. Regardless of the original purpose, the Draft clarifies that Working Party 1 has concluded that situations that give rise to BEPS concerns need to be addressed.

To do so, the measure in question has to be sufficiently targeted. Our concern, however, is that the proposed measure will not only target BEPS concerns but will also affect traditional businesses with a dramatic increase in PEs as a result. Again, the measure seems to go beyond the intended objective and indeed change the international standards on the allocation of taxing rights on cross-border income.

C. Splitting-up of contracts
Proposal 4: To deal with the splitting-up of contracts the Draft proposes two alternatives; the use of a PPT rule (option L) or of an automatic rule (option K).

Although a principal purpose test would, in principle, give companies a possibility to show that no abuse was intended it would undoubtedly open up for wide application by tax authorities and induce additional uncertainty into the PE test. The example provided in the Draft (Example E) does not give much guidance or assurance as to the application of the PPT rule since it is a fairly clear cut case.

The “automatic” approach in option K has its flaws due to the fact that it applies indiscriminately and would also capture situations where there is no BEPS concern. In addition the minimum presence of 30 days is too short and would for many companies result in a PE on every major construction site. Many construction projects run for several years where a company may need to have specialists on the site a couple of days a month during the entire project. In addition, such a threshold could be very difficult to monitor since all parts of an MNE may not be fully aware of all the activities of the group as a whole.

E. Profit attribution to PEs and interaction with Action Points on Transfer Pricing

Since the kind of activities mentioned under paragraph 4 of Article 5 have been recognized not to generate any or very little income, the question of profit attribution to PEs is of utmost importance. Countries are often motivated to create PEs in order to attribute profits to those PEs. We welcome the OECD initiative to provide further guidance in this important area before the end of 2016.

On behalf of the Confederation of Swedish Enterprise

June 11, 2015

Krister Andersson
Head of the Tax Policy Department
Dear Ms de Ruiter

Re: New discussion draft on BEPS Action 7 (Prevent the Artificial Avoidance of PE Status)

We welcome the opportunity to comment on the above document issued on 15 May 2015.

Artificial avoidance of PE status though Commissionaire arrangements
The revised discussion draft proposes that Option B is the most suitable response to BEPS concerns regarding the use of commissionaire arrangements as anti-avoidance vehicles given the four options set out in the original discussion document.

The inclusion of the term “negotiates the material elements of contracts” should deal with our concerns that preliminary or interim discussions of the terms of a contract should not trigger a PE in the State where such discussions occur. However, clarity on what broadly constitutes the “material elements of contracts” would be helpful.

Our members have observed that various layers of negotiations can occur before the material elements of the final contract are reached. Therefore, the inclusion of the word “final” before “contract” in paragraph 5 and in the commentary would put the matter beyond any doubt.
Artificial avoidance of PE status through the specific activity exemption

The revised discussion draft adopts Option E out of the four options put forward by the original consultation document to address concerns surrounding the availability of an exemption from PE status for the activities listed at subparagraphs (a) to (d) of Article 5(4) of the OECD Model Treaty.

According to the revised draft, these activities will only be exempt if they are of a preparatory or auxiliary character. We still consider that this amendment will disproportionately impact smaller countries due to the creation of multiple PEs for businesses with low value activities operating on the periphery of larger markets. Clarity for businesses is critical to making business decisions. Therefore the proposed measure will also increase uncertainty and disputes particularly for smaller economies stemming from the use of the “preparatory” or “auxiliary” tests.

As per our submission on 8 January 2015, we recommend that Option E should be prefaced with a statement in paragraph 4 of Article 5 that the specific activities in subparagraphs (a) to (d) in article 5(4) continue to be eligible for exemption unless those activities are core to the business activities of the enterprise. We suggest the use of the following wording to achieve this “form a significant and essential part of the enterprise as a whole”.

Profit attribution

We note that follow-up work will be carried out in September 2015 on the attribution of profits issues related to Action 7. We reiterate our concerns that changes to the definition of PE will unfairly impact economies with small domestic markets and any work carried out on this matter by the OECD must not facilitate challenges by larger nations to the taxing rights of smaller nations. There should be appropriate stakeholder input for the purposes of developing a fair approach to profit attribution.

You may wish to note that this response is from a representative body. The Consultative Committee of Accountancy Bodies – Ireland is the representative committee for the main accountancy bodies in Ireland. It comprises Chartered Accountants Ireland, the Association of Chartered Certified Accountants, the Institute of Certified Public Accountants in Ireland, and the Chartered Institute of Management Accountants, which represent a combined membership of some 40,000 accountants. Brian Keegan, Director of Taxation at Chartered Accountants Ireland (brian.keegan@charteredaccountants.ie, +353 1 6377 347) may be contacted if any further details in relation to this letter are required.

Yours faithfully

Paul Dillon, Chairman, CCAB-I Tax Committee
BEPS Action 7 Preventing Artificial Avoidance of PE Status

Marlies de Ruiter  
Head, Tax Treaties  
taxtreaties@oecd.org

These commentaries have been prepared by Dr. Cristián Gárate LL.M. acting as professor of tax law at the University of Chile and principal partner of Protax Chile.

1. General Failure of OECD-BEPS Approach

The main problem of the OECD-BEPS approach is that, in the context of the 21st century Economy, a more comprehensive notion of PE must be incorporated in the OECD Commentaries looking at the evolution of the PE concept, from its inception until its present applications.

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Looking at these PE concepts from an evolutionary perspective some alternative measures must be introduced in the negotiation of Double Tax Conventions and in its OECD Commentaries in order to deal more effectively with a balancing of interests between source taxation and resident taxation with respect to taxable presence. Furthermore, this balancing of interest must be "clear from the principles" so that practitioners from developing and developed nations have a guideline to operate the real cases in a business environment.
From an holistic viewpoint the following measures should be addressed in the context of Action 7 OECD- BEPS related to Permanent Establishments: a) Extraterritorial fragmentation of services to avoid PE status (Intrinsically Services to Goods PE Rule); b) Artificial Subcontracting of activities in multijurisdictional context (General Anti Subcontracting Services Rule); c) Multijurisdictional coordination for the application of domestic Income Taxation and VAT taxation to PEs (No dichotomy of VAT/Income Tax Law PE Treatment Rule); d) The use of third country jurisdictions to split functions, risks and assign intangibles to avoid PE or SubPE constitution (PE/SubPE Consolidation Rule); e) The use of third country jurisdictions to split revenue (Anti-Attribution PE Rule); f) The use of third jurisdictions in Triangular Situations (PE payer / PE payee Rule); g) The use of time mismatches to avoid PE configuration (Antifreezing PE Rule); h) The use of domestic laws to enhance tax compliance in a NO PE status; i) A new chapter to distinguish activities as scientific research and innovation depending on their substance as determined by the Frascati Manual and Oslo Manual (Scientific Research PE)

The following explanations allow to overview the aforementioned proposed rules and target situations related to PE in the context of Action 7 OECD BEPS.

a) Extraterritorial fragmentation of services to avoid PE status (Intrinsically Services to Goods PE Rule);

This proposal introduces a measure for the avoidance of situations were artificial arrangements are made, so that substantial payments from a source jurisdiction are qualified as extraterritorial services (5-7), Royalties (12) or Other Income (21), with respect to goods (tangible or intangible) sold by associated companies in this same source jurisdiction or in other third countries.

Thus, if substantial payments are made from a source country A which derive from indivisible or intrinsically functions (i.e. APPs, aplications, data base access, upgrades, downloads, embedded functions, other cloud devices, on line services obtained from digital or tangible sources in that country A for the operation of goods or the sale of products) these payments should be assessed and attributed to constitute a PE. The aforementioned since these payments conform functionally and economically an intrinsically basic operative system for goods with presence in the country of source.

b) Artificial Subcontracting of activities in multijurisdictional context (General Anti Subcontracting Services Rule);

This proposal introduces a measure for the avoidance of situations were artificial arrangements are made so that core or auxiliary activities are subcontracted by an extraterritorial service provider to avoid the application of article 5 (3), 5 (4), 5 (5) and 5 (6) of the Model Convention.

In general fragmented provision of services rendered by related companies which conform a "cohesive provision of services" in the source country, should be treated as a unitary or consolidated provision of services for PE purposes. Thus, if a parent company renders a service in one source jurisdiction and subcontracts a subsidiary, an associated company, or even its PEs or Sub PEs in order to complete
those services, the aforementioned subcontracting companies should be treated congruently under the same rules, as being part of a consolidated PE service project in the source country.

c) Multijurisdictional coordination for the application of domestic Income Taxation and VAT taxation to PEs (No dichotomy of VAT/ITL PE Treatment Rule);

This proposal introduces a measure for the avoidance of situations were artificial arrangements are made so that no Income Tax Law (ITL) and/or no Value Added Tax (VAT) are triggered from transboundary operations. In some jurisdictions the domestic treatment of Income Tax is not aligned with the domestic treatment of VAT. Hence, the treatment of services provided or rendered by business from abroad to the source country, which do not constitute a PE according to the main PE definitions provided in domestic and/or Double Tax Treaties (DTT), may exempt the operation from Income Taxes according to domestic law or as provided by article 5 and 7 of DTT. However, under certain circumstances it is possible that the same services are subject to VAT provided that they are used or operated in the source country. In these cases, in order to avoid a mismatch of tax treatment between VAT and Income Tax in the source country a unitary VAT and ITL treatment should be followed.

Thus, if no Income Tax is applicable, but VAT is triggered (or vice versa) the whole operation should determine the application of both taxes in a compatible manner for taxpayers of the source country under a VAT/ITL mirror treatment PE rule.

d) The use of third country jurisdictions to split functions, risks and assign intangibles to avoid PE or SubPE constitution (PE/SubPE Consolidation Rule);

This proposal introduces a measure for the avoidance of situations were artificial arrangements are made so that the practice of fragmenting risks, functions or assets in order to create various independent PEs or independent SubPEs in third jurisdictions should not be acceptable for the resident and source country. In some cases, the practice involves using a PE and then assigning risks, functions, intangibles or human resources into a Sub PEs in a third jurisdiction, without a legitimate business reason other than attaining a non taxable, exempted or deferred income tax benefit.

e) The use of third country jurisdictions to split PE revenue: Anti-Attribution PE

This proposal introduces a measure for the avoidance of situations were artificial arrangements are made so that third jurisdictions are not used as pivot countries to allocate revenue from PE operations which is: a) non taxable; b) exempt; c) consolidated with losses from other SUB PEs operations abroad; c) deferred: according to domestic tax rules of the source, resident or third country.

Hence, any tax benefits granted in a third jurisdiction which is attributed to a PE constituted in the source country, which allow a tax treatment which is not granted in the same PE jurisdiction or resident jurisdiction, without a legitimate business reason, should not be acceptable as part of an anti-attribution PE rule.
f) The use of third jurisdictions in Triangular Situations (PE payor / PE payee Rule)

This proposal introduces a measure for the avoidance of situations where artificial arrangements are made so that the domestic rules of the source jurisdiction were the PE operates are not used in order to erode the tax base of the source or resident country. This is obtained by using mismatches in revenue recognition or expense recognition, such as placing operations in third countries where the income is attributed to the PE with different recognition matching (accrued-received-attributed); expenses recognition (paid-expended-attributed); and use of transparent companies.

Accordingly DTT tax benefits should be expressly denied in these situations

g) The use of time mismatches to avoid PE configuration (Antifreezing PE Rule);

This proposal introduces a measure for the avoidance of situations where there is a practice of shutting down a PE during a freezing time and then reopening the same or different activities in the same jurisdiction.

h) The use of domestic laws to enhance tax compliance in a NO PE status

This proposal introduces a measure for the enhancement of tax compliance in situations where artificial arrangements are made so that a NO PE status is obtained by means of using any of the situations which allow for a NO PE qualification under Article 5. In these cases, jurisdictions should enhance compliance measures (NO PE formulary) compatible with the application of Double Conventions in order to control the use of NO PE status in the country of source.

i) New chapter to distinguish activities as scientific research and innovation depending on their substance as determined by the Frascati Manual and Oslo Manual (Scientific Research PE)

This proposal introduces a measure for the avoidance of situations where artificial arrangements are made so that the taxonomies of basic research, applied research and experimental development (OECD Frascati Manual) as well as Innovation (OECD Oslo Manual) are correctly assessed to determine the existence of PE or NON PE and to help to attribute profits commensurate with those activities.

Not all Research and Development and Innovation activities are per se ‘preparatory or auxiliary’. 21st century is based in the Knowledge Economy, accordingly the characterization of the main taxonomies of R & D must be observed in a transversal way by OECD member countries, to determine the real substance of R & D character in the context of tax assessment. This is crucial for PE taxable presence and for PE attribution of profits which serves well for developing and developed jurisdictions.

2. Specific Revised DD Action 7

2.1. Commissionnaire Arrangements

The option taken by the OECD provides a condition which sets a maximum threshold for taxable presence. This unintended effect is linked to the fact that taxable
presence depends on the activity of the agent who must have powers to ‘negotiate the material elements’ of contracts, making all efforts just absurd to set a workable legal and workable economic de minimis parameter.

This is just a nonsensical subjective approach which does not help the interpretation of contracts in relation to its tax consequences in a source jurisdiction. In continental jurisdictions following Roman Law the "elements of a contract" are determined in the respective sections of the Civil Code, so that if just one of the material elements of a contract is not negotiated, then there should be no taxable presence in the source country since no contract is attained at all. Also, from an economic viewpoint the criteria sets an anticipated tax planning paradise for multinationals were corporate fragmentation structures will now have a safe harbor in the OECD Commentary, if various functions which are not qualified as material elements are segregated from the main business activities.

2.2. The OECD Failure to Address 5 (4) Negative List: Scientific Research

The previous OECD Commentary described particular categories of activities or operations that were characterized as mere examples for the application of the preparatory or auxiliary test contained in Article 5, paragraph 4, letter e)1. The examples given have been moved from paragraph 23 and include fixed places of business solely for scientific research, if such activities had a preparatory or auxiliary character.

Following the OECD Commentary, several denominations such as scientific activities or scientific research activities may be found in Double Taxation Treaties signed by different countries.2

In particular, the explanations contained in the previous OECD Commentary, Article 5, paragraphs 21, 23 and 24 contained a confusing mixture of both legal and economic concepts, which were drafted in a way which produced conflicts of interpretation in the practical application. At present, considering a static interpretation of OECD Model Commentaries, these conflicts of interpretation allow for artificial

1 OECD Commentary to Article 5 paragraph 4, N° 23: “Examples are fixed places of business solely for the purpose of advertising or for the supply of information or for scientific research or for the servicing of a patent or a know-how contract, if such activities have a preparatory or auxiliary character.”

2 An example of various applicable provisions found in Article 5, 4, letter e) of the OECD Model:

“e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise (Germany – Malaysia)

e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise.(Netherlands – Korea)

\[
\begin{align*}
e) & \text{ the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise (France-UK).} \\
e) & \text{ the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise (UK-US).} \\
ed) & \text{ the maintenance of a fixed place of business solely for scientific research, for the enterprise (India-Belgium).} \\
ed) & \text{ the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information or for scientific research, being activities solely of a preparatory or auxiliary character in the trade or business of the enterprise (UK – India).}
\end{align*}
\]
arrangements in the context of BEPS in order to qualify as "analogous" to scientific research activities with no taxable presence and no PE constitution.

It resulted clear by reading the triple operative criteria set forth from an economic viewpoint in paragraph 23 of the OCDE Commentary: a) **Axiomatic Productivity**; b) **Proximate Profitability**; c) **Certain Allocability**; that some important activities could eventually be dismissed from the negative list if strictly followed. Conversely, looking at the double operative criteria set forth from a legal viewpoint in paragraph 24 of the OCDE Commentary: a) **Essential and b) Significant**; the same activities could be included in the negative list. This posed an unsolved conflict of interpretation from a legal and economic standpoint which is included in all OECD Model tax treaties including these commentaries.

In order to give a precise academic study of activities of utmost importance which require absolute clarity of treatment from a conceptual and practical viewpoint the following Table summarizes the practical outcomes for the tax treatment of Research, Development and Innovation (R & D & I) according to the definitions which these activities have in the OECD Frascati Manual and OECD Oslo Manual, in spite of a strict use of both legal and economic criteria described originally in paragraphs 21 to 24 of the OECD Commentary to article 5 (4) as set before the proposed changes.

<table>
<thead>
<tr>
<th>DTT Business Profits OECD Article 5, 4), e) Preparatory &amp; Auxiliary</th>
<th>Triple Economic Criteria OECD Commentary, Art. 5, par 23</th>
<th>Dual Legal Criteria OECD Commentary, Art. 5, par 24</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Preparatory TEST</strong>: Latin praeparare, from prae ‘before’ + parare ‘make ready’. Prepare: Verb 1 make ready for use or consideration. 2 make or get ready to do or deal with something.</td>
<td>a) <strong>Axiomatic Productivity</strong> b) <strong>Proximate Profitability</strong> c) <strong>Certain Allocability</strong> Only R &amp; D &amp; I categories of <em>fundamental research and applied research</em> qualify for PE Negative List. Development and Innovation could have proximate profitability and certain allocability, failing the threshold of being preparatory.</td>
<td>a) <strong>Essential</strong>: Adjective.1 fundamental; central. 2 absolutely necessary. Categories of R &amp; D &amp; I such as <em>fundamental research and applied research</em> could be distinguished as not being fundamental operations and qualify for PE Negative List. Development and Innovation activities could qualify as essential operations for the business being excluded.</td>
</tr>
<tr>
<td><strong>Auxiliary TEST</strong>: Latin auxiliarius, from auxilium ‘help’. Adjective, providing supplementary or additional help and support.</td>
<td>a) <strong>Axiomatic Productivity</strong> b) <strong>Remote Profitability</strong> c) <strong>Uncertain Allocability</strong> Arguably, categories of <em>fundamental research, applied research, development and innovation</em> could match the criterion of being auxiliary in the sense of providing low margins of additional productivity, remote profitability and uncertain allocability, in order to be qualified for the PE Negative List.</td>
<td>b) <strong>Significant</strong>: Adjective 1 extensive or important enough to merit attention. 2 having an unstated meaning; indicative of something. All categories of <em>fundamental research, applied research, development and innovation</em> would fall out the PE Negative List considered as activities entailing some extent of significant auxiliary support for the business activities of the enterprise as a whole.</td>
</tr>
</tbody>
</table>

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5 Oxford University Dictionary and Black’s Dictionary.
In light of the information contained in the Table the operative criteria contained in OECD Commentary, Article 5, paragraphs 21, 23 and 24 was confusing guidance. However, the changes proposed by the OECD leave the situation in a worst scenario, since without any deep thought the operative criteria has been partially deleted instead of perfected. Experience tells academic and practitioners that OECD deletion can be worst than OECD Copy& Paste.

It is unconceivable that the OECD does not open a specific paragraph in the OECD Commentary in an area of whose conceptual and practical treatment should clarified for tax purposes and be in line with other important definitional scientific documents such as the OECD Frascati Manual and OECD Oslo Manual. It is also incredible that the operative criteria set forth for the characterization of R & D & I activities is not lined up with good definitions for tax purposes which clarify the application of the preparatory and auxiliary test.

In light of the information contained in the Table the operative criteria contained has been changed and in the present R DD of the OECD Commentary, Article 5, paragraphs 21, 23 and 24 are absolutely misleading guidance in an area of whose conceptual and practical treatment should clarified for tax purposes and be in line with other important definitional scientific documents such as the OECD Frascati Manual and OECD Oslo Manual.

As a result of the proposed changes multinationals separation and fragmentation of activities will not be restricted to preparatory or auxiliary activities, since the wording of these tests now consist in two proposed separate concepts which do not have an objective interpretation. These words have their own meaning in legal French and English but they have not been correctly defined as separate concepts in their tax dimension for international transactions. Hence, these concepts will operate as golden loopholes for the separation, fragmentation and establishment of activities without attaining the threshold of a PE in developing countries. This is precisely the case of R & D & I activities which will be left in a tax paradise situation with respect to taxable presence.

Hence we suggest that a new commentary is drafted in order to clarify the criteria behind the “preparatory and auxiliary test”, in particular looking forward all BEPS Actions which are directly related to Research & Development & Innovation activities contained in Article 5, 4, letter e) and f) of OECD Model.

Please take a careful thought to paragraph 21of the R DD. The decisive criterion to evaluate the P&A test is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. This is tautological! What is essentially and significantly not preparatory?? What is essentially and significantly not auxiliary??
Please read your proposed R DD 21.2: As a general rule, an activity that has a preparatory character is one that is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole. Is this logical in English?

Please read your proposed R DD 21.2: Since a preparatory activity precedes another activity, it will often be carried on during a relatively short period, the duration of that period being determined by the nature of the core activities of the enterprise.

What does the time of execution of an activity have to do with its preparatory character? Does this make sense in the Digital Economy where information is transmitted in seconds between servers located in different jurisdictions?

Please read your R DD 21.2: An activity that has an auxiliary character, on the other hand, generally corresponds to an activity that is carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a whole. It is unlikely that an activity that requires a significant proportion of the assets or employees of the enterprise could be considered as having an auxiliary character.

Is this logical? What does “proportion of the assets?” or “proportion of the employees mean?”

Please read your R DD 21.2: Examples are fixed places of business solely for the purpose of advertising or for the supply of information or for scientific research or for the servicing of a patent or a know-how contract, if such activities have a preparatory or auxiliary character. [that last sentence has been moved to paragraph 23] This sentence has been moved from its location to another paragraph which is not paragraph 23 and taken absolutely out of the context were it was used as example.

In summary, this proposed changes contain very confusing guidance with respect to taxable presence within the country were a PE should be constituted with respect to Research, Development and Innovation, which are the key activities that move the Economic Growth of 21st Century. In one sentence, the OECD is giving leeway for international tax planning of R&D&I.
Dear Marlies,

BEPS Action 7: Preventing the artificial avoidance of permanent establishment status

Thank you for the opportunity to comment on BEPS Action 7: Discussion Draft on Preventing the Artificial Avoidance of Permanent Establishment Status published on 15 May 2015 (the ‘Discussion Draft’). These comments are written from the perspective of the UK.

The permanent establishment article in double tax treaties is required to ensure that each country has appropriate taxing rights over cross-border trading activities. For this to be effective as a policy the rules need to be as clear as possible. The proposed changes introduce considerable uncertainty and will serve to disrupt the ‘international norm’ that has been established by practice over many years. Whilst this may be an appropriate response in cases that involve ‘artificial avoidance’ facilitated by modern ways of doing business, the proposals will affect all businesses trading internationally. Therefore it is essential that there is a clear ‘boundary’ between countries’ taxing rights in relation to trading profits that both businesses and tax authorities can apply. The lack of such a clear boundary is likely to lead to increased disputes between tax authorities and businesses and between different tax authorities, with clear potential for double taxation.

There will also be an additional compliance burden on businesses and additional administrative burdens on tax authorities with, in many cases, little or no additional tax to be paid in the permanent establishment state. These consequences are not insignificant, and the timetable for the BEPS project is not sufficient reason for them to be overlooked.

Changes to prevent artificial avoidance should be targeted to ensure that businesses which are not ‘artificially’ avoiding permanent establishment status can rely on the article in double tax treaties. There needs to be clarity in the wording of Article 5 itself in relation to key concepts rather than these being introduced in the Commentary (with the inherent problems of the Commentary’s lesser legal standing). This is particularly important in relation to determination of a fixed place of business where it is critical whether a site is ‘at the disposal’ of a non-resident company (as indicated by the Commentary examples), but where ‘at the disposal’ is not part of Article 5 itself. This could be remedied by the inclusion of ‘and which is at the disposal of the enterprise’ in paragraph 1 of Article 5. Similarly, if, as stated in the Discussion Draft, the policy intention is that buy-sell distributors do not create a permanent establishment of a principal, this should also be set out in the Article itself. We think it would be helpful if the wording was changed to ensure that ‘habitual’ should be clearly associated with negotiation as well as with the conclusion of contracts, rather than simply mentioning the point in the Commentary.
Where the Commentary adds particular value is in relation to the examples and guidance around the interpretation of the Article in specific circumstances. Whilst the examples given in the draft Commentary are helpful, it would be useful to have separate examples where a different conclusion is drawn on the same point, based on facts given. For example, a counter example to paragraph 32.6 of the proposed Commentary concluding there has not been ‘negotiation’ would be helpful. Further explanation and examples are necessary in relation to the meaning of ‘negotiate’, clarifying ‘material elements’ in different circumstances and identifying the scope of what falls within ‘complementary functions that are part of a cohesive business operation’. A similar point could be made in relation to warehouses and ‘preliminary and auxiliary’.

Examples that include the changing status over time of a business expanding into new markets (such as the commonplace fact pattern included in page 4 of our letter of 9 January 2015 in response to the earlier discussion draft on this topic) would also be helpful in determining at what point the threshold for a permanent establishment is reached. The compliance burden and uncertainty created by the proposals is likely to be of particular concern to smaller, expanding, and newly-international businesses, so an example in this area would provide practical and timely assistance.

The commitment to undertake further work to clarify and expand the guidance on the attribution of profit to permanent establishments that are not in the financial services sector is appreciated. Inconsistent application of the rules on the attribution of profit to permanent establishment by different tax authorities would increase the risk of disputes and potential double taxation, and increase compliance and administration costs for businesses and tax authorities. This is of particular significance given the likely increase in the number of permanent establishments as a result of the proposals.

The increased number of permanent establishments may also result in a number of cases where little or no tax will arise in the state of the permanent establishment, based on the principles in the OECD’s 2010 Report on the Attribution of Profit to Permanent Establishments, but additional tax compliance and administration requirements will still need to be met. Further consideration should be given to appropriate de minimis limits (whether by revenue, time or frequency). This would be an important safeguard and would help balance compliance burdens and enforcement costs with the tax at stake, and will particularly benefit smaller businesses and those expanding overseas for the first time. We agree with the G20/OECD in its conclusions with regard to there being no substantive reason for industry-specific rules in relation to the insurance sector.

Further comments regarding specific aspects of the proposals are set out in the appendix. We have as requested attempted to keep this response as short as possible.

If you would like to discuss any of the points raised in this letter, please do not hesitate to contact either me (bdodwell@deloitte.co.uk) or Alison Lobb (alobb@deloitte.co.uk).

Yours sincerely

WJI Dodwell
Deloitte LLP
Appendix

A. Artificial avoidance of permanent establishment status through *commissionnaire* arrangements and similar strategies

The Discussion Draft states that it is not the intention of the BEPS work on permanent establishments to address ‘low-risk distributor arrangements’ (paragraph 22), which will be covered by the work on the transfer pricing of risk and capital. The proposed Commentary (paragraph 32.12) suggests, reasonably, that buy-sell distributor arrangements should not create a permanent establishment of a non-resident entity. It goes on to suggest that this would be the case ‘regardless of how long the distributor would hold title in the product sold’. This should be considered in light of arrangements whereby a distributor takes title to products from another entity, for example a non-resident, at the point at which it sells those goods to its customers. The proposed Commentary indicates that such arrangements should not create a permanent establishment of the non-resident in the country of the distributor. However, the proposed revised Article 5 (paragraph 5b) is not so clear in that a permanent establishment exists where there is ‘the transfer of the ownership of… property owned by that enterprise’. It would be helpful if this could be clarified to minimise uncertainty.

The proposed changes to the model tax treaty definition of independent agent and associated revisions of the Commentary are likely to lead to an increase in the compliance burden for groups operating in the regulated financial sector, together with an associated administrative burden for tax authorities, including the risk of disputes and potentially double taxation. Such groups typically have substantial operations in the main financial centres but remote cross-booking between the centres is frequent. Remote booking is typically driven by a need to manage the regulatory capital of the group in the most efficient manner. Remote booking may give rise to permanent establishments under the current rules. The proposed revisions appear to make it less likely that entities that employ staff engaged in remote booking will be independent agents, resulting in a proliferation of permanent establishments even if these are regulated entities in their own right with significant numbers of staff and material revenues generated from transactions with unrelated parties. The following changes are particularly challenging in this regard:

- The change from ‘agent of independent status’ to ‘independent agent’;
- The elimination of the reference to economic independence in paragraph 37 of the current Commentary;
- The removal of the specific reference to brokers from both the model tax treaty and the Commentary.

B. Artificial avoidance of permanent establishment status through the specific activity exemptions

The concept of ‘at the disposal’ is not in the permanent establishment Article of the model treaty but has been included in the Commentary for many years, and the meaning and use of ‘at the disposal’ in the Commentary has been the subject of dispute and debate over a long period. The examples in the proposed Commentary place critical reliance on the meaning of ‘at the disposal’ (see below). To ensure consistent interpretation of double tax treaties by businesses, tax authorities and courts, this would be an appropriate opportunity to include ‘and which is at the disposal of the enterprise’ in paragraph 1 of Article 5 of the revised model tax treaty.

Example 22.4 in the proposed Commentary relies on ‘at the disposal’ to indicate whether toll manufacturers (with differing fact patterns) create a permanent establishment. As a point of principle, the answer will be the same regardless of whether the toll manufacturer is a related or unrelated party. Paragraph 22.3 considers an independent logistics provider and notes there is no fixed place of business where the premises are not ‘at the disposal’ of the non-resident company, unless the non-resident has ‘unlimited access’ to part of the warehouse. Again, the principle will apply whether the logistic provider is a related or unrelated party. The example in paragraph 22 of the proposed Commentary concludes that warehousing of goods, based on the facts given, would create a permanent establishment as the activities are not preparatory or auxiliary. In this
example, there is no consideration of whether there is fixed place of business ‘at the disposal’ of the non-resident (although this would appear to be the case based on the facts given). It is important to emphasise the consistent application of ‘at the disposal’ in all the examples in this section of the Commentary, and consider whether activities are preparatory or auxiliary only where there is a fixed place of business at the disposal of the non-resident.

Other – VAT/GST
It would be helpful to include explicit language in the Commentary to make it clear that the term “permanent establishment” as used in the OECD Model Income Tax Treaty is a distinct concept from the “VAT establishment” term used in the International VAT/GST guidelines. Further, whilst companies might have to register for VAT in order to comply with their national VAT obligations, such registration in itself should not trigger the creation of a permanent establishment for purposes of Article 5.
Subject: Comments on the OECD Revised Discussion Draft on BEPS Action 7 “Preventing the Artificial Avoidance of PE Status”

Dear Mrs de Ruiter,

The European Banking Federation (EBF) welcomes the OECD’s attempt to provide further clarity on its proposals. Nevertheless, further work is required to give additional detailed guidance and clarification for practical application, especially concerning the impact on banks and the whole financial sector which would arise from the proposed changes.

The EBF remains concerned that the current proposals for preventing the artificial avoidance of permanent establishment (PE) status
- go beyond the intention of the project to tackle base erosion and profit shifting through a wider reconsideration of the allocation of taxing rights between the PE country (source country) and head office country (residence country);
- show a lack of clear principles or consensus on the interpretation of standards;
- include undefined terms;
- substantially lower the threshold for what constitutes a PE;
- would lead to an increase in disputes with the local/national tax authorities which would be difficult to resolve, at least on double taxation issues and potential disputes between jurisdictions if both source and residence countries sought to apply taxing rights to the same activity.

We do not believe that this would be a desirable outcome.

We encourage the OECD to develop a sufficiently robust framework on an internationally consistent basis in order to prevent uncertainty and ensuing disputes between businesses and tax administrations. Furthermore, we suggest limiting BEPS opportunities by giving clarity for practical application.
Artificial avoidance of PE status through commissionaire arrangements and similar strategies

Commissionaire and similar arrangements are frequently employed in non-abusive cases. Allowing multinational enterprises, especially banks, the possibility to work via properly implemented and business-driven commissionaires (brokers, general commission agents) is therefore only fair. There is consequently no reason to broaden the scope of the Agency PE provision.

The EBF remains concerned that the proposed measures will not only impact commissionaire arrangements, but also a wide range of arrangements providing marketing and/or sales functions.

The new Agency PE definition is to be brought fully into line with the legal agency concept. Deviations from the legal agency concept will inevitably lead to legal uncertainty and will almost certainly lead to court cases where the outcome might not be what the OECD and governments have in mind with the BEPS project.

Reference to the banking sector, especially brokers or general commission agents:

When the question arises as to how much taxable profit should be allocated to an Agency PE, general transfer pricing rules would be better able to resolve this in a satisfactory manner. The determination of allocable taxable profit should be based on functions and risks, but only if the functions are really materially performed and the risks are actually materially managed in the correct legal entity. What about the commissionaire? The commissionaire is a civil-law type of agent without the power of representation. A commissionaire in a multinational enterprise (MNE) environment is typically a group company (legal company) with a marketing and/or sales function. No risk is taken on. From a business perspective, one cannot claim that a commissionaire is an artificial set-up. From a tax perspective, however, one could argue that a commissionaire is an agent who very much resembles the agent in the future Agency PE definition in Article 5(5) of the OECD Model. If an agency concept is introduced which is devoid of civil law or common law definitions, it might be considered a reasonable approach to include the commissionaire in the Agency PE definition. In our view, however, this would violate the core of the Agency PE concept, namely the legal agency concept.

Furthermore, the addition of the notion in paragraph 5 of Article 5 “negotiating the material elements of contracts” could lead to the recognition of a permanent establishment each time, for example, a sales force negotiates the material elements of the contract. This notion is far too subjective and open to interpretation: this could lead international groups to declare a permanent establishment in each country where you find one or more sales representatives resulting in a cumbersome and unnecessary administrative burden disconnected from the aim of BEPS. We think that the transfer pricing methodology is far more relevant.

Artificial avoidance of PE status through the specific activity exemptions

The proposed wording does not add much more clarity than the previous wording. Deleting the sentence “It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not” provides no new insight.
To avoid uncertainty and with the principle of the unity of the legal framework in mind, the EBF suggests that the OECD give additional guidance and/or clarification and uses the regulatory framework (especially for banks) to define the threshold for the existence of a PE (for banks and other parts of the financial sector).

Regulatory law is of fundamental importance when it comes to judging whether or not a bank has set up a permanent establishment. Preparatory or auxiliary functions can be performed by a so-called representative office/agency to a certain extent. Representative offices/agencies are not usually set up to process bank transactions (for a definition, see local/national regulatory law). Under most national regulatory legislation, moreover, this would not be allowed. Instead, the main purpose of the representative office/agency is to initiate and maintain business contacts for the head office (residence office). The function is of a preparatory and auxiliary nature (see Article 5(4) of the OECD Model) and does not mean that a PE has been set up.

Article 5(4) of the OECD Model does not set a clear-cut threshold showing where a preparatory or auxiliary activity ends and where a main activity starts. This absence of absolute clarity is problematic, especially with respect to the question of whether the alleged preparatory activity goes so far that tax authorities can claim it is actually being performed by a PE.

In principle, we believe it is essential that the criteria set out in Article 5(1) and (4) of the OECD Model for determining the existence of a PE are not undermined by creating a PE agency.

We therefore reject example 30.3. The described activity in State S of the bank resident in State R – namely the verification of information provided by clients – is not an artificial avoidance of PE status, but is of an auxiliary nature. The activity in State S is business-driven, or to be more precise represents compliance with regulatory requirements; there is no risk attached to the activity (no key entrepreneurial risk function). From the point of view of attributing income, this activity is not a tool to shift risk and as a result shift profit. Example 30.3 undermines the wording and sense of the general criteria for determining PE status.

**Splitting-up of contracts**

Undefined terms like “logical consequences” in the sentence, “whether the conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with that person or related persons” give no objective guidance for practical application. Furthermore, specific guidance regarding the service-PE concept is needed.

**Issues related to attribution of profits and interaction with Action Points on Transfer Pricing**

The proposals will probably lead to a significant number of new PEs. Clear guidance is therefore needed for all sectors “to ensure that businesses and tax authorities take a consistent approach”.

For the banking sector, we believe most inappropriate profit shifting by means of shifting risk could be solved by a clear analysis of the elements of attributing income. It would be sufficient to indicate the relevance of the key entrepreneurial risk functions. We suggest referring to the 2010 OECD Report on the Attribution of Profits to Permanent Establishments, Part ii (Banks) and Part III (Global Trading of Financial Instruments).

Final remarks
States should endeavour to make tax effects on profits and losses more symmetrical in order to ensure that private investors, particularly in the banking sector, can make efficient investment decisions. As things stand, the aim appears to be:

- to extend the definition of permanent establishment on an unsound, and therefore inadequate, basis; and

- to ultimately benefit from the taxation (at source) of (high-risk) investments or activities while simultaneously disallowing full compensation of financial losses at national/local level and the mere shifting of risk within a multinational entity (risk premiums, contractual shifting of risk).

Yours sincerely,

Wim Mijs
European Business Initiative on Taxation (EBIT)

Comments on the OECD's Discussion Draft on

BEPS ACTION 7:
PREVENTING THE ARTIFICIAL AVOIDANCE OF PE STATUS
Dear Marlies,

EBIT welcomes this opportunity to provide comments to the OECD on the revised Discussion Draft on “BEPS Action 7: Preventing the Artificial Avoidance of PE Status” (hereinafter “the Discussion Draft”).

• EBIT generally supports the OECD’s ongoing work to address artificial avoidance of PE status and to eliminate double non-taxation through PEs and ensure that tax is properly charged on activities that are valuable and integral to MNC’s business operations. Whilst we support many of the recommendations and clarifications in the Discussion Draft, we also have a number of serious concerns.

• EBIT’s Members note in particular that the OECD’s latest revised proposals replace the OECD’s earlier alternative approaches on a number of significant PE issues by a set of specific and definitive proposals which are largely focused on widening the scope of the dependent agent rule (and narrowing the scope of the independent agent rule) and narrowing the scope of the specific activity PE exemptions, and preventing abuse of the PE rules by segregating activities across associated entities through the proposed anti-fragmentation rule. All in all, these new proposals will in EBIT Members’ views very significantly expand the scope of existing PE rules.

A. Artificial avoidance of PE status through commissionaire arrangements and similar strategies

• EBIT’s Members are concerned about the proposed amendment to the Commentary on Article 5 (5), which deems a PE to exist if a dependent agent concludes contracts or negotiates material terms of the contract. In particular, in the new paragraphs 32.4, 32.5 and 32.6, this will mean that agents are regarded as falling within the rule when their activity does not involve a substantive role in the process for the conclusion or negotiation of contracts. We consider this to be contrary to the revised Article 5 (5) itself. EBIT also urges the OECD to provide further clarification in the Commentary that, in all cases, the agent must always play a real and substantial role in the process of negotiation or conclusion of contracts if the threshold test in Article 5 (5) is to be met.

• We agree that transfer pricing should be the preferred methodology to address any BEPS concerns arising from limited risk distributors and welcome the clear statement in the Discussion Draft that changes to the dependent agent rules are not intended to apply. However, in our view the proposed wording could still lead tax administrations to take different approaches, with some arguing that the wording of Article 5 (5)(d) catches low risk distributors and others interpreting the treaty in line with the Commentary. The OECD should provide clear guidance on this important point through an amendment to Article 5.
EBIT welcomes the revision to the independent agent test that an agent acting exclusively for one unrelated principal is not automatically excluded from qualification as an independent agent. This test should focus on whether the agent is in any particular case carrying on the business of the principal. The focus should also be on the nature of the agent’s activities, not the relationship between agent and principal (i.e. whether or not related), otherwise businesses would be forced to choose an unrelated party over its own affiliated entity to avoid adverse tax consequences where both agents are fulfilling the same function.

EBIT is also concerned that there is still no clear definition in the OECD guidance of what constitutes an independent agent, and the proposed revisions are in our view not helpful in this respect. In our view, to take away the economic independence test will put far greater emphasis on the “legal” independence test (which looks at the operational independence of the agent however) and will shift the focus from an “entity” perspective in relation to the agent to an “individuals” perspective, namely on the people carrying on the agency functions. EBIT’s Members urge the OECD therefore to clarify the exact requirements of the independent agent test (and their rationale).

B. Artificial avoidance of PE status through the specific activity exemptions

We welcome the fact that the OECD acknowledges in paragraph 21 in the Commentary to Article 5 that the activities listed in Article 5 (4) are in many cases, but not all, of a preparatory or auxiliary character. We note that the Discussion Draft clarifies that Working Party 1 has concluded that situations that give rise to BEPS concerns need to be addressed, but we are concerned that the proposed measures will go much further in practice and will also affect traditional businesses with a dramatic increase in PEs as a result, and alter the existing international standards on the allocation of taxing rights on cross-border income.

However, EBIT is very concerned that the scope of the “anti-fragmentation” rule appears to have been significantly stretched since the earlier Discussion Draft. The new examples, in particular, suggest a shift from an anti-avoidance measure to the introduction of a “force of attraction” where a group has incorporated a subsidiary company in a jurisdiction, and, as a consequence, this would shift the balance of taxing rights between source and residence states.

Also, since a PE has until now been recognised per legal entity, the establishment of a PE at the level of “connected entities” is in our view a sea-change to the current rule (in principle valid in all areas of international tax), and one which will trigger many issues that must be carefully considered before implementation (e.g. assume that related companies A and B each perform activities in State C, which are viewed as a “cohesive business operation”, the question arises under which Tax Treaty will the PE qualification be done? Even if Tax Treaty A-C and Tax Treaty B-C include the revised wording, both legal entities will be considered to have a PE in State C, If A already has a PE in C, will B then be “contaminated” for PE qualification purposes. Also, in the above example, how will the taxable income be calculated? Will this be done in the same way as when the PE were recognised by legal entity (i.e. on a stand-alone basis)?

The first sentence of proposed paragraph 30.1 states that the purpose of the anti-fragmentation rule is to “prevent an enterprise or a group of connected enterprises from fragmenting a cohesive business operation into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity”. In our view, this rule aims to prevent MNCs taking all the aggregated activities performed in a jurisdiction out of the scope of local taxation by fragmentation, in a situation where those activities, taken together, would exceed the PE threshold (and so be subject to tax). We agree that (with appropriate safeguards) effective rules to prevent this should encompass activities performed in a jurisdiction by all group companies resident outside that jurisdiction (not just activities performed by a single non-resident enterprise). However, EBIT Members consider that great care needs to be taken before proposing the automatic inclusion, in that aggregation, of activities performed by related parties
resident in the jurisdiction. This is because an incorporated company carrying out business in its jurisdiction of residence/incorporation will almost certainly exceed the PE threshold by itself. Including the activities of that company in an anti-fragmentation rule pre-judges the outcome of whether the threshold is reached, and turns the anti-fragmentation rule into a force of attraction principle. It effectively means that where an MNC has a subsidiary in a source state, any activity at all, however minor, which is carried out in that state by a related party will trigger a PE of that related party.

- The new proposal in our view creates a presumption that there is a PE and makes it necessary to consider the test in every situation or, in the absence of qualifying for the 5 (4) exemption, would at least lead to a greater incidence of disputes over whether the related party’s premises constitutes a fixed place of business at the taxpayer’s disposal in the source territory. Tax administrations could easily inappropriately interpret against the taxpayer. EBIT Members therefore recommend that an anti-fragmentation rule only apply to the aggregated activity of non-resident related parties in order to retain the coherence of an anti-fragmentation rule as a threshold test. If the activity of residents is to be included as well, EBIT Members call on the OECD to include a carve-out where the combined activity of the non-residents is minimal compared to the (taxed) activity of the residents. This carve-out would help prevent the proliferation of low value PEs. If the anti-fragmentation test is done without carving out the resident companies, it will end up in many cases in a PE. In our view, the problem with the anti-fragmentation rule is that with an end-to-end global supply chain, any two parts of it which happen to be in the same country will almost certainly be presumed by a tax administration to being complementary and cohesive. The anti-fragmentation rule should not operate to add two separate business operations together in a territory just because they are part of an MNC that has an end-to-end supply chain. This is to be distinguished from the situation where a distribution entity is broken down into its component parts, say, with a view to splitting out bits that might qualify as incidental when there is no rational business reason for not having them in the same legal entity in that territory other than the potential tax benefit.

In practice, it precludes an MNC from having a consignment manufacturing arrangement (CMA) with affiliates in a country where the produced goods are on sold, notwithstanding the exception of Article 5 (4). This new PE definition, together with the cohesive character of the activities, may lead to artificial and inefficient structuring of global supply chains.

- Also, the concept introduced in the sentence in the example on page 33 of the Discussion Draft: “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” seems to be a new definition which EBIT urges the OECD to clarify.

E. Profit attribution to PEs and interaction with action points on transfer pricing

- EBIT Members are gravely concerned that the OECD’s proposal for follow-up work on the attribution of profits issues will in practice make it very difficult to address PE threshold and PE profit attribution issues together, which we strongly believe is required. We are particularly concerned that the ongoing work on Article 5 which involves lowering the existing PE threshold will lead to a large number of new low-value PEs where is no additional profit at stake - meaning significant compliance burden, and also many potential disputes over profit allocation (with resulting risk of double taxation), compared with what may be referred to as the corresponding transfer pricing arrangements that would typically otherwise apply in the absence of a PE. EBIT welcomes the commitment to further work on profit allocation and encourages the OECD to take that work forward swiftly. However, if the work on the profit attribution issues cannot be accelerated, we would recommend that final decisions on Article 5 be taken only when the results of the work on the profit attribution are available.
EBIT trusts that the above comments are helpful and will be taken into account by the OECD in finalising its work in this area. We are happy to discuss and remain committed to a constructive dialogue with the OECD.

Yours sincerely,

European Business Initiative on Taxation – June 2015

For further information on EBIT, please contact the EBIT Secretariat via Bob van der Made, Tel: +31 6 130 96 296; Email: bob.van.der.made@nl.pwc.com.

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12 June 2015

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Comments on the OECD Revised Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status

Dear Ms. De Ruiter:

EY appreciates the opportunity to submit these comments to the OECD on the Revised Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status dated 15 May 2015 (RDD).

We acknowledge all of the additional work that has been undertaken to refine the options initially proposed to modify the permanent establishment (PE) standard although we continue to have concerns that the proposals included in the RDD are overly broad and amorphous.

The RDD states that it is not a consensus document yet it is anticipated that Working Party 1 will be asked to finalize the changes to the PE standard this month. At this stage, it is difficult to see how consensus may be reached in such a short time frame, particularly when there is more work to be done, including work on profit attribution as it relates to Action 7. We urge the OECD to take the time to develop narrower and more precise measures to target base erosion and profit shifting (BEPS) and avoid proposals which, if implemented, would create both uncertainty and significant risk of double taxation for global businesses which would undermine one of the central objectives of treaties to facilitate cross-border trade and investment.

Attribution of Profits to a Permanent Establishment

The RDD notes that a large number of comments were received on the October 2014 Discussion Draft
indicating that more work should be done on profit attribution, a point that was acknowledged by the OECD at
the conclusion of the public consultation on Action 7 earlier this year. However, the RDD concludes by stating
that “it has been decided that follow-up work on attribution of profits issues related to Action 7 will be carried
on after September 2015”, the date when the work related to Action 7 is scheduled to be completed.
Attribution of profits to PEs and how such attribution would be affected by the options for changing the PE
standard are however, inextricably linked. Stakeholders, both global businesses and governments, cannot
evaluate proposals, much less reach consensus, for changing the PE standard without first considering the
implications of such changes for the attribution of profits.

EY therefore strongly recommends that the work on Action 7 should be completed in conjunction with the
work on profit attribution as it would be imprudent to attempt to reach agreement on changes to the PE
standard without having fully considered, and fully vetted, the attribution of profit implications of any such
changes. If, as the RDD provides, the work on profit attribution will be undertaken after September 2015,
there should be an opportunity to further refine or modify the proposed changes to Article 5 as a result of this
work.

Further, it will be essential that the dialogue among countries and global businesses continues after
September 2015, with respect to the work undertaken on profit attribution issues related to Action 7. The
RDD indicates that the OECD intends to provide the necessary guidance before the end of 2016, which is the
deadline for the negotiation for the multilateral instrument. Notwithstanding that the development of the
multilateral instrument may be a government-to-government process, this should not preclude continued
engagement with global business on the work related to profit attribution as it relates to Action 7.

The need for clear and precise rules

The consequence of finding that an otherwise non-resident enterprise has a PE in a country is relevant to the
question of whether an enterprise is liable to tax in such country. However, the designation also carries with it
significant tax compliance responsibilities and tax administration obligations. Moreover, in many countries,
deeming a PE to exist creates burdens outside of income tax, including VAT and payroll tax consequences.
Providing a threshold level of activity below which these compliance and administration burdens are not
triggered is essential in order for the PE standard to serve its intended purpose. Thus, the rules must be clear
and objective, and mutually understood by the taxpayer and the tax authorities of both countries involved.
Doubt or disagreement regarding the application of the PE standard would represent a real barrier to cross-
border trade and investment.

The options for modifying the PE standard set forth in the RDD are not consistent with a PE standard that is
clear, objective, and mutually understood. For example, the RDD proposes to adopt Option B that would
include the negotiation of “material elements of contracts”, which, according to the proposed commentary, 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. Although the proposed commentary attempts to provide some clarification, the scope of activities that could be deemed to create a PE under this proposed standard remains uncertain.

Further, the proposed narrowing of the independent agent exemption under Article 5(6) when one person is connected to another is inappropriate. This proposal presumes that connected companies may never be independent of each other regardless of the underlying facts and circumstances. Moreover, although the proposal introduces the concept of a “connected person” for purposes of applying Article 5(6) and defines the term using an objective 50 per-cent test, the proposal also layers a subjective test over the objective test to provide that “[i]n any case, a person shall be considered to be connected to an enterprise if, based on all of the relevant facts and circumstances, one has control of the other or both are under the control of the same person of enterprises.” It is unclear how this proposed rule would apply in practice.

The Proposed Changes to Address “Fragmentation” of Activities

The RDD proposes a new anti-fragmentation rule that would deny the application of the Article 5(4) exceptions to PE status for preparatory or auxiliary activities in certain situations. The proposed commentary illustrates the application of a new rule in Paragraph 4.1 and includes two examples. In Example B a foreign enterprise that has a warehouse in the source State in which it stores a few large goods is not eligible for an exception under Article 5(4) because a connected person that has a store in the source State takes possession of the goods from the foreign enterprise’s warehouse before delivering them to a customer and the foreign enterprise and connected person are part of a cohesive business operation. However, assuming that the transfer pricing for the distribution activity in the source State appropriately reflects the functions, assets and risks undertaken, the source State should be taxing an amount that is an appropriate return based on the distribution activities, without regard to whether the foreign enterprise stores a few large goods in the source State. If the warehouse were to be considered to give rise to a PE under these circumstances, the only additional income that could be found to be taxable in the source State would be an appropriate remuneration for such warehousing function, which likely would be a low percentage cost plus amount. At a minimum, this should be made clear. However, we believe that the proposed rule illustrated by this example should be reconsidered as the burdens associated with the finding of a PE in such circumstances would be disproportionate to the benefits to the source State in terms of increased tax base. Moreover, the implicit assumption in the example that sales and warehousing “constitute complementary functions that are part of a cohesive business operation” is not supported by the facts presented. A determination under the proposed anti-fragmentation rule of what constitutes a “cohesive business operation” would require a much more detailed analysis, which also should be made clear.

More broadly, the options are based on a premise that there is something inherently suspicious about a global business conducting activities in different entities or different locations. This premise fails to recognize that modern global businesses operate with separate business units for myriad legal, regulatory, and commercial
reasons.

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If you have questions or would like further information regarding any of the points discussed above, please contact Barbara Angus (barbara.angus@ey.com), Arlene Fitzpatrick (arlene.fitzpatrick@ey.com), Ai-Leen Tan (ai-leen.tan@ch.ey.com), Jose Bustos (joseantonio.bustos@ey.com), Ronald Van Den Brekel (ronald.van.den brekel@nl.ey.com) or me (alex.postma@ey.com).

Yours sincerely
On behalf of EY

Alex Postma
FFSA’s Comments on OCDE public revised discussion draft on “BEPS Action 7”.

The French Federation of Insurance Companies (FFSA) is a trade association which groups together 234 insurance companies representing 90% of the French market. In particular, its purpose is the promotion of insurance, the defense of the interests of the profession and the establishment of common ethical standards.

The FFSA is supportive of this OECD BEPS aim, which is to prevent the artificial avoidance of PE status. But once again, we would like to stress the need to take appropriate, workable and well targeted measures in order to achieve this goal.

So, we welcome the opportunity to comment on this revised discussion draft.

We support the conclusion of the working party that no specific rule for insurance operations should be introduced and we will focus our comments on proposal 1 (for more convenience; this proposal or the proposal in the document) of this new revised discussion draft and particularly general aspects relating to “commissionaire arrangements”.

For the purpose of this draft, the working party retains option B, with some changes from the previous draft and with additional new commentaries.

The working party, together with its commentaries, define a scope which is too large. From our point of view, they go beyond BEPS issues and modify in a substantial way the current situation. Based on principles which seem to have been inspired from the resale of goods, these new proposals are not adapted to service activities like insurance activities, because they don’t take into account the insurance business’s value chain.

Insurance and reinsurance activities are based on an essential principle: the coverage of risk and the activity related to this risk are located where the capital covering this risk is booked; thus enabling the entity to cope with claims. This approach is acknowledged in the KERT function of insurance as defined in 2010 OECD Report on the attribution of profits to permanent establishments - Part IV relating to insurance according to which the KERT function defined as the assumption of insurance risk by performing the underwriting function is the most likely to affect the profitability of the insurance enterprise. This principle guides the regulatory rules and its respect is vital.

However, the proposal and its relating commentaries don’t take into consideration these principles in the recognition of a permanent establishment. The three following examples illustrate our remarks.
This new proposal maintains uncertainties on the situation and the consequences of permanent establishment relating to intra-group operations of reinsurance. This kind of activity is nevertheless very frequent. By providing additional capacity, intra-group reinsurance allows a local branch to accept risks that it could not have taken, because of its limited capital.

In two other situations of classic insurance and reinsurance activities, the proposals would create multiple permanent establishments, disregarding economic and regulatory relevance. These are:

-the coinsurance of a risk by insurance companies, both of which are member of a same group. In this case, and on the basis of these commentaries, it is possible that, for tax purposes, the co-insurers might be recognized as having a permanent establishment in the state of the joint account administrator.

-the diffusion scheme by a group foreign affiliate of a standardized contract, whose risk is covered by another member of the group. In the commentaries, it is explained that the paragraph 5 “applies to a person who acts as the sale force of the enterprise and in doing so, makes and accepts contractual offers even if standards contracts are used for that purpose”. With regards to this commentary, the Insurance Company would be recognized as having a permanent establishment for tax purposes in the country where the contract is diffused even though the latter does not have any activity in that State.

Under these different situations, the existence of a permanent establishment for tax purposes could be established only because both parties are members of the same group. The same activity executed under the same economic conditions with a third party, would not lead to the establishment of a permanent establishment. Therefore, this concept would go against OECD guideline’s definition of the arms length’s principle.

These examples illustrate how the absence of appropriate commentaries taking into account the KERT function, especially for insurance and reinsurance business, could lead to a proliferation of permanent establishment only for tax purposes. Without KERT functions attached to them, these permanent establishments would have zero or a minimal profit attributed to them. These kind of situations would be extremely burdensome to administrate and with disproportionate costs.

Hence, it is desirable that the definition of permanent establishment for insurance / reinsurance services take into consideration where the KERT function is performed. This situation should be recognized in the commentaries.

Also, in light of these new proposals, it is important to have new efficient dispute resolution mechanisms in place for potential disputes that may arise relating to the proliferation of permanent establishment by different tax authorities.

Yours faithfully,

Mr. François Tallon  
Head of Tax Affairs  
FFSA- Fédération française des sociétés d' assurances

To: Marlies de Ruiter, Head, Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CPTA

Following comments received in January 2015 the OECD released its revised draft of the public discussion on preventing the artificial avoidance of PE status on 15 May 2015 with comments invited by 12 June 2015.

The comments provided below are prepared by the author as representative of Gazprom Marketing & Trading Ltd.

Introduction

Whilst we note that the OECD have addressed a number of the public comments by positively reflecting amendments in the treaty or treaty commentary, there are a number of areas where we are disappointed to see the OECD has decided to ignore comments provided by the public. This sense of disappointment is heightened by the fact that these new proposals significantly increase the circumstances in which a PE will be created. Our areas of concern are concentrated around concluding contracts and preparatory and auxiliary actives.

Concluding contracts

Confirmation that the proposed expansion of the definition from “conclude contracts” to “conclude contracts, or negotiates the material elements of contracts” is only intended to cover the habitual negotiation of contracts (i.e., on a repeated and not an isolated basis) is welcomed, as indeed is the intention to clarify what constitutes material elements of contracts within the commentary. However, the “conclude contracts, or negotiates the material elements of contracts” wording still poses a significant risk of inconsistent interpretation by tax authorities and also creates uncertainty for tax payers. Perceived abuse of concluding contracts is already covered under existing treaty commentary and the additional wording would prejudice genuine commercial negotiations going well beyond circumstances that involve artificial avoidance of a PE. For companies with extensive global operations, the proposal would likely create a significant number of additional PEs without significant profits allocated to them. The resulting additional filing and profit calculation burdens would cause huge compliance problems for companies and tax authorities with little or no impact on tax revenues.

Assuming this language is aimed at capturing situations where the home office merely “rubberstamps” contracts that are negotiated overseas then existing commentary already covers this potential tax avoidance without the need for unnecessary amendments to treaty wording which would only serve to significantly increase the taxation and compliance burden for many companies.
The current rules more or less, and quite rightly, default to the position whereby the taxation rights are allocated to the country where the contracts are concluded, or in other words where the real decisions are taken to enter into the contract. This is a fairly bright line test that works fairly well in practice. The proposals shift this from the decision making to where the (material) negotiating activities take place. This is far less clear and much more problematic.

In the oil and gas business it is very common for independent enterprises to conclude contracts for the supply of commodities that are long term (e.g., 20 years), very valuable (billions of dollars) and often of national importance. Consequently negotiations are often very lengthy and conducted in a number of locations often involving intermediaries or agents. More often than not the meetings are split between the countries where the contracting parties are located or sometimes in neutral territory. We are not aware of any situations where the meetings are cunningly planned to avoid PEs, they are planned to increase the chances of making the best possible deal for all concerned. The sales agreements themselves run to hundreds of pages and cover many different and important commercial considerations. As such it would be very difficult to decide exactly where the “material elements” of the contract are made. Being such material and important contracts they are subject to significant and continuous monitoring by senior management in the home countries. They are also mostly subject to board approval by the respective parties. We are therefore against any rules that would restrict the commercial negotiating process under such circumstances and impose a threat of taxation in countries where such agreements are negotiated. We would therefore request that at the very minimum the new commentary makes this point clear. In fact our preference is to retain the current language in the treaty and the commentary as in our opinion this proposal is a step too far.

The existing test that the contracts should be in the name of the enterprise is proposed to be replaced by a much broader test as to whether the contracts are in the name of the enterprise, for the transfer of property owned by the enterprise, or for the provision of services by the enterprise. This clearly catches commissionaire and similar structures. In this respect we would revert to our original point on this matter that there is a huge presumption by the OECD that commissionaire structures are purely tax motivated structures that should be stamped out. In our experience this is not the case. This proposed change is also likely to negatively affect international trading companies where contracts are concluded by one company and then assigned, for purely commercial purposes, to other entities.

**Preparatory and auxiliary activities**

The current specific activity exemptions were developed on the basis that storage and delivery should always be by default a preparatory or auxiliary activity. Therefore we welcome the proposal to amend wording to clarify this as opposed to alternative options which would have implications far beyond the activities and business structures being targeted. The additional wording outlining the meaning of preparatory and auxiliary is helpful and the confirmation that a stock of goods being stored locally by an independent operator does not create a PE for the non-resident that owns the stock of goods is welcomed. However, we would like to seek additional certainty on what is considered preparatory or auxiliary for storage, display or delivery and confirmation that an international commodity trading company, such as one trading gas, and storing and transporting its product in country prior to its sale is preparatory or auxiliary. The new wording is likely to be
problematic for a number of physical commodity traders that often maintain large warehouse or storage operations in foreign countries that are periodically supplied with product (often by pipeline or from sea) to satisfy demand in the foreign country. We would like any changes to the rules to ensure that the existing basis of taxation for these types of operation is unaffected.

**Fragmentation of activities between related parties**

Removal of “cohesive business operation” from the proposed wording is welcomed, however, the combined activities of “connected enterprises” inadvertently brings into scope large multinational groups that operate entirely independent sub-groups. Additional wording should be introduced to ensure this additional paragraph is intended to capture only companies that are artificially fragmented for tax reasons.

**Conclusion**

We remain extremely cautious about the proposals to increase the scope of taxation through permanent establishments. Although well intentioned the proposals could have a significant negative impact on international oil and gas companies especially in their downstream and trading operations. We do not believe that the intention of these proposals is to catch such arrangements as they are on the whole purely commercially driven. As such we would advise extreme caution before any changes are made to the existing rules.

These comments have been prepared by:

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GFIA Comments on OECD Revised Discussion Draft on BEPS Action 7 (Prevent the Artificial Avoidance of PE Status)

Introduction
The Global Federation of Insurance Associations (GFIA) through its 39 member associations represents insurers that account for around 87% or more than $4 trillion in total insurance premiums worldwide. GFIA is pleased to provide comments on the OECD revised discussion draft on "BEPS Action 7: Preventing the Artificial Avoidance of PE Status" (the "discussion draft"). In general, the GFIA supports the objectives of the OECD BEPS Action Plan to address weaknesses in the international tax environment. Accordingly, we support the broad objectives of the discussion draft in combating aggressive tax planning aimed at preventing the artificial avoidance of Permanent Establishment ("PE") status. However, it is critical that any measures adopted by the OECD are workable, well targeted, and do not result in unintended consequences that negatively impact the efficiency of commercial insurance operations and the availability and cost of insurance coverage for consumers.

General comments
We welcome and fully support the conclusion of Working Party 1 that no specific rule for insurance operations should be introduced.

We welcome the decision to provide additional guidance on the issue of attribution of profits to PEs. The discussion draft notes that follow-up work on attribution of profits issues related to Action 7 will be carried on after September 2015 with a view to providing the necessary guidance before the end of 2016, which is the deadline for the negotiation of the multilateral instrument that will implement the results of the work on Action 7. We recommend that such guidance be released in draft form for public comment, with sufficient time (at least 45 days) for public review and consultation. The need for adequate consultation time is critical given the complexity of this subject.

The revised commentary on interpreting Articles 5(5) and 5(6) to deal with commissionaire arrangements appears to be written in the context of businesses that sell goods. In addition, the commentary does not take into account the relative importance of the functions performed by the business in question – in particular, no recognition is given to where the KERT function (i.e. what drives the profit) is performed. If neither the nature of the business nor the importance of the function are taken into account, the outcome will be numerous PEs being created with nil or little additional profit being attributed. This would result in a disproportionate burden being placed on business. The particular concerns in the insurance context are with respect to:

- sales and marketing of insurance
- non-KERT functions performed by an in-house service company, such as back office processing of applications, claims handling, investment management, and administrative support.
With respect to the sales and marketing of insurance, the collection of premiums alone does not necessarily create value for the insurer. The 2010 OECD Report on the Attribution of Profits to Permanent Establishments Part IV (Insurance) (“Part IV”) notes that sales and marketing is only one of the functions in the insurance value chain. Paragraph 117 of Part IV recognizes that if the person (i.e. agent) collecting the premiums does not make the decision to accept the risks/business associated with the insurance policy, then the collection of premiums does not mean that insured risks/business have been accepted by that person. This is an important point since, as recognised under Part IV, the KERT for insurers is the assumption of insurance risk/business (see for example paragraphs 93 and 94). Accordingly, the KERT function rests with the entity which accepts and manages the risk/business (i.e. the insurer and not the agent).

Part IV provides comprehensive guidance defining and discussing risks, risk management and the allocation of risk in the context of insurance businesses. Accordingly, given the extensive work that has gone into developing Part IV and the limited time remaining to complete the BEPS action plan, we recommend referencing the relevant existing guidance in Part IV for insurers in the commentary on Article 5(5) and 5(6) (for example in paragraph 39). We also suggest that the commentary be extended to ensure that, when consideration is given to whether a PE exists, the relative importance of the functions performed by the business in question should be taken into account.

GFIA contact
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About the GFIA
Through its 39 member associations, the Global Federation of Insurance Associations (GFIA) represents the interests of insurers and reinsurers in 59 countries. These companies account for around 87% of total insurance premiums worldwide. The GFIA is incorporated in Switzerland and its secretariat is based in Brussels.

1 Paragraph 93 of Part IV states in unequivocal terms:

   All facts and circumstances need to be considered to determine which function assumes insurance risk for the enterprise, because the assumption of insurance risk is the key entrepreneurial risk-taking function for an insurance enterprise. Other functions performed by an insurance enterprise may be important and valuable functions and should be compensated accordingly, but these other functions are not functions that form part of the key entrepreneurial risk-taking function.
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FRANCE

12 June 2015

Dear Ms de Ruiter

**OECD Revised Discussion Draft – BEPS Action 7: Preventing the Artificial Avoidance of PE Status**

Grant Thornton International Ltd, with input from certain of its member firms, welcomes the opportunity to comment on the OECD Revised Discussion Draft entitled *BEPS Action 7: Preventing the Artificial Avoidance of PE Status*, issued on 15 May 2015.

Our observations and detailed comments are set out below.

A. Artificial Avoidance of PE status through *commissionnaire* arrangements and similar strategies

The revised discussion draft specifies that Article 5(5) and 5(6) should be modified on the basis of Option B.

**Comment:**

Grant Thornton International Ltd welcomes the Working Party's preference of Option B over Option A.

Negotiation of material elements of contracts

As indicated in our previous comments dated 5 January 2015, the use of the concept of "negotiates material elements of contracts" may lead to significant uncertainty in certain scenarios. For example, it is unclear whether a Permanent Establishment (PE) would be created where the board of directors of an enterprise in a Contracting State has considered and authorised material elements of a contract and requests a local agent in the other Contracting State merely to communicate on its behalf.

The plural form of the phrase "the material elements" raises a number of issues. These issues are outlined below.

It is unclear whether *all* material elements need to be habitually negotiated by the agent in order for a PE to arise.

It is also uncertain whether the negotiation of a single material clause will result in the establishment of a PE. The phrase is ambiguous when read in light of paragraph 38.10 of the Commentary. Paragraph 38.10 provides, by way of analogy, that where the plural form is used, the reference to the "same persons or enterprises...covers cases where there is only one such person or enterprise".
Notwithstanding the above, it is not clear how many material elements must be habitually negotiated by the agent in order to trigger a PE. For example, whilst the agent may negotiate the quantity of the goods or services to be supplied, various other material elements (eg price, delivery terms) may be negotiated by the enterprise itself.

Given the various issues that arise with respect to the interpretation of the phrase "the material elements", we would recommend that the OECD provide further guidance to clarify the above issues.

We note that the proposed Commentary appears to go further than the text of option B, and potentially to use elements of Option A (see for example the wording in Paragraph 32.6). Option A was opposed by many commentators and has been rejected by the Working Party, so we would recommend that the language and examples in the Commentary be modified to avoid any confusion and potential disputes over the creation of numerous potential PEs.

We also note that the various examples in Paragraph 32.6 appear to confuse different aspects of the Action 7 proposals. A key feature of one example given in this paragraph involves a local warehouse from which goods belonging to the enterprise are delivered. It would seem more appropriate to view the existence of the warehouse from which goods are delivered as giving rise to a PE than the activities of the local employees, particularly if locally they only accept offers rather than actually negotiate or make them. If there were no local warehouse, then the activities of the employees do not appear to be "material" to customer contracts.

In addition, Paragraph 32.6 indicates that a PE may be created where a person solicits and receives, but does not formally finalise, orders. Again, it is difficult to see how a PE could arise if the presence of an enterprise of a Contracting State in the other Contracting State was confined to an employee who simply solicits offers from potential clients (but where offers are then made directly to the head office) and is not involved in the negotiation or conclusion of any customer contracts. Whilst the "soliciting" of offers does go beyond merely promoting and advertising goods or services, it may not involve the negotiation or conclusion of contractual terms.

Paragraph 32.6 also does not consider the common situation where the role of local employees is only to explain the material features or benefits of the product or services offered but not to explain the terms of the contract. We assume that such activity in isolation should not give rise to a PE by virtue of being of an auxiliary nature but would welcome confirmation of this point.

Habitual conclusion of contracts

In relation to Paragraph 33.1 of the Commentary, and given the apparent greater emphasis now placed on this concept, we would appreciate further clarification of the meaning of "habitually" (in the new context of the proposed revised Article 5(5)). Specifically, dependent on the overall scale of the wider enterprise's activities, it remains unclear whether the negotiation of material elements of a single contract or a mere handful of contracts could give rise to a PE.

Independent agents

The inclusion of the tests in subparagraph b) of Paragraph 6 of Article 5 helpfully provides a degree of clarity on the meaning of an "independent agent". The revised Commentary suggests that an agent who is not "connected" could still give rise to a PE, if that person acts on behalf of only one enterprise "for a short period of time (eg. at the beginning of that person's business operations). We think that this would impose an inappropriate burden on many businesses while they grow their customer base in a new territory. It may also have a detrimental effect where a business is being wound down. Neither of these circumstances appears deliberately focused on the artificial avoidance of a PE.

It is our understanding that the second part of subparagraph b) essentially complements the first part, such that independence should be tested with reference to all the relevant facts and circumstances. It is therefore inaccurate in Paragraph 38.10 of the Commentary to refer to the second part of subparagraph b) as an "alternative rule". Paragraph 38.10 should instead describe the second part of subparagraph b) as a "complementary rule" or "principle of control".
B. Artificial avoidance of PE status through the specific activity exemptions

List of activities included in Art. 5(4)

The revised discussion indicates that Article 5(4) of the OECD Model should be altered such that each of the exceptions specified therein would be limited to activities that are otherwise of a "preparatory" or "auxiliary" character.

Comment:

Grant Thornton International Ltd welcomes the Working Party's preference of Option E over Option F.

While we acknowledge the OECD's guidance on the meaning of "preparatory or auxiliary" as outlined in paragraph 21.2 of the revised discussion draft, more specific definitions and examples would be needed to achieve clarity and certainty. As outlined in our letter dated 5 January 2015, taxpayers would wish to understand, for example, under what circumstances would a warehouse be characterised as fundamental to a business, and importantly, when it would not.

In addition, we note that Paragraph 21.2 suggests that for an activity to be preparatory, it should generally be "carried on during a relatively short period". For the sake of clarity, we would also welcome additional specific examples of this.

Fragmentation of activities between related parties

The Revised Discussion Draft incorporates an anti-fragmentation rule as originally proposed in the October 2014 Public Discussion Draft.

Comment:

We note that the proposed anti-fragmentation rule will deny the specific activity exemptions where complementary business activities are carried on by associated enterprises at the same location, or by the same enterprise or associated enterprises at different locations.

The approach of combining activity not just of a given legal entity but also of related parties to assert that a PE is created may lead to a material increase in uncertainty. Within the meaning of Action 7 it also leaves substantial room for conflicting interpretation by the tax authorities in individual jurisdictions of the meaning of "cohesive operating business".

In addition, we are concerned that the proposed anti-fragmentation rule would give source countries an ability to ignore or pierce the separate legal personality of substantive legal entities in a manner which was unwarranted by the fact pattern.

While we note that the Commentary contains detailed examples of when the new rule would apply, we believe taxpayers would find it helpful also to have specific examples of situations that are not regarded as artificial fragmentation.

C. Splitting up of contracts

Comment:

We welcome the suggestion that the above matter should normally be dealt with through the addition of an example in the commentary on the Principal Purpose Test provision proposed under BEPS Action 6: Prevent Treaty Abuse.
D. Insurance

Comment:

We welcome the suggestion that no specific rule for insurance enterprises should be added to Article 5 and that concerns relating to cases where a large network of exclusive agents is used to sell insurance for a foreign insurer should be addressed through the more general changes proposed to Article 5(5) and 5(6) discussed under section A above.

E. Profit attribution to PEs and interaction with action points on transfer pricing

The revised discussion draft notes that follow-up work on attribution of profits issues will be carried on after September 2015 with a view to providing the necessary guidance before the end of 2016.

Comment:

We envisage an increase in the number of potential PEs as a result of Action 7 but in many of these cases it appears there should be little or no additional profit recognised in a territory. This uncertainty should be clarified as soon as possible. Additional guidance on the issue of attribution of profits to PEs is needed now, and we are concerned by the delay in updated guidance which suggests that the BEPS project will not be concluded by the end of 2015.

If you would like to discuss any of these points in more detail then please contact either myself or Wendy Nicholls, Partner, Grant Thornton UK LLP (Wendy.Nicholls@uk.gt.com; M: +44(0)7714 069862).

Yours sincerely

Global head - tax services
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Dear Marlies,

GSK welcomes the opportunity to provide comments on the revised discussion draft. We support many of the recommendations and clarifications in the paper. In particular:

- We agree that transfer pricing should be the preferred methodology to address any BEPS concerns arising from limited risk distributors (“LRDs”), and welcome the clear statement that changes to the dependent agent rules are not intended to apply. However we suggest that there is room in the proposed wording for fiscal authorities to take different approaches, with some arguing that the wording of Article 5(5)(d) catches LRDs and others interpreting the treaty in line with the Commentary. An amendment to Article 5 to put the matter beyond doubt would therefore be our preference;

- We welcome the clarification provided by the example at proposed paragraph 22.4 of the commentary, to the effect that the maintenance of a stock of goods for the purposes of toll manufacture is unlikely to constitute a permanent establishment; and

- We share the concerns expressed by many commentators that the rules will lead to a large number of new low-value p.e.s - meaning significant compliance burden, and also many potential disputes over profit allocation (with resulting risk of double taxation). We welcome the commitment to further work on profit allocation and encourage the OECD to take that work forward swiftly.

However, we have significant concerns that the scope of the “anti-fragmentation” rule appears to have significantly expanded since the October 2014 discussion draft. The new examples, in particular, suggest a shift from an anti-avoidance measure – which we would support - to the introduction of a “force of attraction” whenever a group has incorporated a subsidiary company in a jurisdiction. If correct, this appears to us to shift the balance of taxing rights between source and residence states, and we strongly urge you to clarify the position. We suggest below how this could be achieved.

Application of proposed anti-fragmentation rule when a company is incorporated in source state

The first sentence of proposed paragraph 30.1 states that the purpose of the anti-fragmentation rule is to “prevent an enterprise or a group of connected enterprises from fragmenting a cohesive business operation into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity”. In other words, the rule aims to ensure that multinationals should not be able to take all, or substantially all, of the activities performed in a jurisdiction out of the scope of local taxation by fragmentation, in a situation where those activities, taken together, would
exceed the p.e. threshold (and so be subject to tax). In other words, it is a question of whether the p.e. threshold is reached, absent fragmentation.

We agree that (with appropriate safeguards) effective rules to prevent this should encompass activities performed in a state by all group companies resident outside that state (not just activities performed by a single non-resident enterprise). However, we consider that great care needs to be taken before proposing the automatic inclusion, in that aggregation, of activities performed by related parties resident in the state.

This is because an incorporated company carrying out business in its jurisdiction of residence/incorporation will almost certainly exceed the p.e. threshold by itself. Including the activities of that company in an anti-fragmentation rule pre-judges the outcome of whether the threshold is reached, and turns the anti-fragmentation rule into a force of attraction principle. It effectively means that where a multinational group has a subsidiary in a source state, any activity at all, however minor, which is carried out in that state by a related party will trigger a p.e. of that related party.

Example

To take as an example the activity of a toll manufacturer T, based in state X, which is tolling on behalf of an unrelated principal P, based in state Y. The facts are as per the example at proposed paragraph 22.4, such that no PE of P is created in State X. It may be that T manufactures products for sale in states X, Y and Z.

Suppose however that P also distributes products, in state X, via a subsidiary distributor S. Distributor S, using the language from the discussion draft, is a p.e. of itself in State X – but the activities of S do not create a PE of P in state X, and T and S are remunerated for their activities at arm’s length. However when applying the anti fragmentation rule the (limited) activities of P as site T, are added to those of P’s related party (S) such that the toll manufacturing activities create a PE of P in state X. The potential consequences of this are that state X seeks to tax P on the same profit that is currently taxed in the hands of T creating double taxation. There may be other consequences of PE creation such as potential penalties in states where it is not possible for foreign principals to do business in state X via a PE, indirect tax, and regulatory consequences. Any recourse to competent authority to eliminate double taxation is likely to be lengthy and costly when in reality there should be no actual tax at stake.

Proposed safeguards

In the current proposal, the only defence would be for a taxpayer to assert that the activity does not “constitute a complementary function which is part of a cohesive business operation”. We acknowledge that that phrase is derived from the existing commentary on Article 5 at paragraph 27.1. However, the practical burden of proof appears to have shifted. Under the current rules, if a taxpayer was confident that all activity of an enterprise, taken together, would not meet the p.e. threshold then there was no need to consider whether the activity at the different places of business were complementary and part of a cohesive whole. As such, we do not believe it has been often tested in practice. However the new proposal, by bringing into consideration activity which is already subject to local tax, creates a presumption that there is a p.e. and makes it necessary to
consider the test in every situation. It is easy to see how it could be inappropriately interpreted against the taxpayer by a tax authority.

Our preferred solution would be for an anti-fragmentation rule only to apply to the aggregated activity of non-resident related parties. This would retain the coherence of an anti-fragmentation rule as a threshold test. However, if the rule is also to include activity of residents, we would strongly urge the inclusion of a carve out where the combined activity of the non-residents is minor by comparison to the (taxed) activity of the residents. This exception would go some way to preventing the proliferation of low value PEs.

I would be happy to discuss any of the above if you would find it helpful.

Yours sincerely,

Melissa Geiger
SVP Global Tax, GSK
melissa.j.geiger@gsk.com
June 10, 2015

To:
Marlies de Ruiter,
Head, Tax Treaties,
Transfer Pricing and Financial Transactions Division
OECD/CTPA

By Email to: taxtreaties@oecd.org


We respectfully present our comments on the above Discussion Draft.

We are an accountancy firm keen to see reasonable tax paid without harming bona fide exporters.

Background

On May 15 the OECD published a revised discussion draft on preventing the artificial avoidance of PE (permanent establishment) status as “action” 7 of its Action Plan on Base Erosion and Profit Shifting (BEPS). This narrowed down some of the options discussed in an earlier draft of October 31, 2014.

Sales agents and commissionaires

The draft report proposes to deem a foreign enterprise to have a taxable PE in a country regarding its sales to that country if:

- It has a person in that country acting on its behalf;
- who habitually concludes contracts on its behalf;
- or negotiates the material elements of contracts;
- in the name of the foreign enterprise, or;
- for the transfer of ownership or use of property owned by that foreign enterprise, or;
- or provision of services by the foreign enterprise.
Also, the draft report says a PE will automatically arise if the agent is "connected". That would apply if there is 50% control (voting and value) of one over the other or they are under common control.

**Other Specific PE proposals:**

The draft report proposes to clarify that certain PE exceptions will only apply if they are "preparatory or auxiliary".

Preparatory or auxiliary means remote from the actual realization of profit. The decisive criterion is whether the activity forms an *essential and significant* part of the activity of the enterprise as a whole.

It seems that ecommerce operations need warehouses and/or collect user information which may now trigger a taxable local PE for cyberspace operators.

To counter the splitting of activities of a "cohesive business operation" among connected enterprises in a country, an anti-fragmentation rule is proposed.

Also caught is toll manufacturing if the foreign enterprise has unlimited access to inspect and maintain goods stored there. This may affect production outsourced to China, India, Singapore, etc.

**How Much Will Get Taxed?**

If a PE exists, how much taxable profit should be attributed to them? This is complex a transfer pricing issue which the OECD draft report postpones till after September 2015, with guidance expected before the end of 2016.

**Comments:**

The proposals relating to preparatory or auxiliary activities are understandable and may indeed increase tax revenues in a reasonable way. Nevertheless, we await the OECD's proposals on how much taxable profit to attribute to a PE.

However, the proposals relating to commissionaires and agents represent severe overkill and should be dropped. They will hamper many exporters Here's why:

1. **Drafting error:** The OECD draft report apparently has a major drafting error. It says it wants to target commissionaires who sell products in their *own name* (paragraph 9) but in fact targets agents who sell products or services in the name of the foreign enterprise or owned by the foreign enterprise (paragraph 23). The OECD proposal attacks almost every sales agent in the world. It is like taking a sledgehammer to crack the wrong nut! In short, the
OECD's proposals, if adopted will change the face of international trade by wiping out sales agents

2. **Good faith**: The proposals do not exclude bona fide operations by exporters via local agents.

3. **Trade impeded**: Much international trade is via connected persons or companies who know the exporters' product but are part of the local culture. Now, connected and unconnected agents will be a PE risk no matter how fairly they operate. This will impede international trade.

4. **Negotiation issues**: The attack on local negotiations seems unreasonable. Will customers have to fly into the exporter's home country to negotiate? Will emails have to be monitored to ensure this?

5. **Little extra tax**: Little extra tax is likely to ensue. Exporters will merely switch from using sales agents to selling their goods to distributors, including low-risk distributors. The OECD is aware of this (paragraph 32.12).

6. **Against OECD policy**: The OECD itself may be opposed to such proposals. In May 2014, the OECD published a new "Services Trade Restrictiveness Index (STRI)" ([http://www.oecd.org/trade/services-trade-restrictiveness-index.htm](http://www.oecd.org/trade/services-trade-restrictiveness-index.htm)). This measures restrictions on foreign entry and barriers to competition in different countries. The OECD should calculate the impact of its BEPS 6 proposals against sales agents on its own STRI index.

7. **Standard agreements**: If a standard agreement is drafted by in a parent corporation in Country A and used by subsidiary corporations in Countries B to Z, will those subsidiaries in Countries B to Z each have a PE in country A?

8. **Quality attacked**: The taxation of purchasing offices will deter some international trade as such offices are typically used to find useful products and check they are manufactured well. The proposals penalize quality.

9. **Censorship?** Will the taxation of information collection affect news bureau? If so, this may be used as a back-door means of censorship.

10. **Our alternative proposals:**
    a. **Commissionaire proposals**: The present proposals mix up product ownership. The present proposals should therefore be dropped. Any new proposals should be aimed at commissionaires only, not every sales agent in the world.
b. **Auxiliary or preparatory proposals:** We recommend deeming a point of sale to be a PE – this seems far clearer and fairer.

c. **One Stop Shop:** We also suggest implementing a one-stop global PE registration authority similar to the one-stop VAT registrations allowed in a single EU country. Registration and reporting should be simplified, and only necessary once very clear PE threshold criteria have been crossed by offshore-based enterprises.

d. **Onshore exemption:** Onshore enterprises should be automatically exempted from the PE proposals.

e. **SMEs:** Small and medium sized enterprises should also be exempted from the new PE proposals.

* * * * * *

We will be happy to answer any questions arising.

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Yours Truly

Leon Harris, CPA (Israel), FCA(UK)

Harris Consulting & Tax Ltd
To: Marlies de Ruiter, Head, Tax Treaties, Transfer Pricing and Fiscal Transactions Division, OECD/CTPA  
From: Ian Mitchell  
Date: 12 June 2015  
Subject: BEPS Action 7: Preventing the Artificial Avoidance of PE Status - Comments on the Revised discussion draft  

(sent via e-mail to taxtreaties@oecd.org)

Dear Ms. De Ruiter,

I appreciate the opportunity to respond to the request for comments on the OECD Revised Discussion Draft BEPS Action 7: Preventing the Artificial Avoidance of PE Status issued on 15 May 2005, and specifically the proposed changes to paragraph 5 of Article 5 and the Commentary thereon.

As a tax practitioner I am required to assist companies in the interpretation of both the Model Treaty and the Commentary thereon, and in the commentaries and presentations on the Revised Discussion Draft that I have seen there have been some suggestions of a lack of clarity over the treatment of a low-risk distributor of services, whereby one member of a group of companies would be selling to its customers services that have been performed by other group companies. I note the comments in paragraph 22 of the Revised Discussion Draft that any issues relating to such a model will be addressed by BEPS Action 9 (Risks and Capital), but am concerned that the proposed wording in paragraph 5 of Article 5 in combination with that in paragraph 32.12 of the Commentary thereon may leave the position open to challenge.

Specifically I note that whilst paragraph 32.12 starts by stating that “The cases to which paragraph 5 applies must be distinguished from situations 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 enterprise”, the two examples then given both refer exclusively to the sale of property. Thus in relation to low-risk distributors paragraph 32.12 states “This would still be the case if that distributor acted as a so-called “low-risk distributor” as long as the transfer of the title to property sold by that distributor passed from the enterprise to the distributor and from the distributor to the customer (regardless of how long the distributor would hold title in the product sold)”; clearly where a group of companies are dealing in services the concept of transfer of title does not apply, and it has been suggested in some commentaries and presentations that this leaves distributors of services in a much less clear position than distributors of physical goods. Assuming this is not the intent of the OECD, I would request that consideration be given to extending the Commentary at paragraph 32.12 to clarify that paragraph 5 of Article 5 is equally not intended to apply to low-risk distributors of services.

Yours sincerely,

Ian Mitchell
PREVENTING THE ARTIFICIAL AVOIDANCE OF PE STATUS: OECD PUBLIC DISCUSSION DRAFT

ICAEW welcomes the opportunity to comment on the public discussion draft Preventing the artificial avoidance of PE status published by OECD on 15 May 2015.

This response of 12 June 2015 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty’s Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

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ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW’s regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 144,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
INTRODUCTION

1. We welcome the opportunity to comment on the public discussion draft *Preventing the artificial avoidance of PE status* published by OECD on 15 May 2015.

2. We submitted a response, TAXREP 4/15, to the 31 October 2014, discussion draft on this same topic.

GENERAL COMMENTS

Artificial avoidance of PE status through *commissionaire arrangements and similar strategies*

3. In our earlier response we set out our concerns about the various proposals in section A re artificial avoidance of PE status through commisionaire arrangements and similar strategies and expressed our opinion that Proposal A was the least objectionable of the various proposals.

4. We have copied in immediately below our general remarks from that earlier Representation:

“We are concerned that the proposals start from the premise, which we do not believe is always true, that commissionaires are inevitably used as part of an avoidance strategy.

Whether that is the case, or not, has been thoroughly examined by the highest courts of a number of European countries whose legal systems contain the commissionaire concept (French Conseil d'État (Supreme Administrative Court) in Société Zimmer Ltd v Ministre de l'Économie, des Finances et de l'Industrie; Norwegian Supreme Administrative Court in Dell Products(Europe) BV v Skatt Øst;) All these courts have systematically rejected the argument that this is an abuse.

Similarly, in cases where abuse has not been argued, supreme courts have concluded that a commissionaire in itself does not give rise to a permanent establishment (Italian Supreme Court in Boston Scientific v Italian Revenue Agency).

The example set out at paragraph 7, is the Zimmer case.

The statement in paragraph 10 is that in many cases commissionaire structures and similar arrangements are put in place primarily in order to erode the taxable base of the State where sales take place. The assumption is that such arrangements are always for tax avoidance purposes so that some change is necessary to paragraphs 5 and 6 of Article 5 of the OECD Model Convention. There are then four separate proposals for such change, examples A to D.

Notwithstanding what we have said above, if there is to be a change in Article 5 (4), then of the proposals put forward we have less objections to proposal A.”

5. In practice OECD has preferred Option B of the four options put forward and in the Executive Summary to the current discussion draft states:

“When Working Party 1 discussed these comments, it concluded that Option B was preferable to Options A, C and D and there was general support for the changes proposed, under all options, to the independent agent exception of Art. 5(6). It was agreed, however, that the concept of “associated enterprises” used in Art. 5(6) should be replaced by a narrower concept and that Art. 5(6) should not automatically exclude an unrelated agent acting exclusively for one enterprise.”
Artificial avoidance of PE status through the specific activity exemptions
List of activities include in Art 5(4)
6. In our earlier response we supported Proposal E to introduce a general test as to whether activities are of a preparatory or auxiliary character as being the best of the options put forward, and as the latest discussion draft makes clear “Option E was considered to be preferable to the other options”.

Proposal 1: Changes to paragraphs 5 and 6 of Article 5
7. The revised paragraph 6 a) wording will result in a more or less blanket prohibition on an connected person ever being capable of being an independent agent and this is in our view unreasonable and will unduly constrain business. The existence of a PE should be evaluated by reference to what is done and not pre-judged on the basis of the legal relationship between 2 or more parties.

Proposal 3: new anti-fragmentation rule
8. We think that such activities should only be aggregated if they are caught by a motive test and the fragmentation is designed to avoid a PE which would otherwise exist.

9. We are also concerned that the "nexus" test in the proposed anti-fragmentation rule viz that the operations to be aggregated "constitute complementary functions that are part of a cohesive business operation" remains imprecise despite the added example
ICAEW TAX FACULTY’S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person’s tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

By Electronic Delivery

12 June 2015

Marlies de Ruiter  
Head of Division  
Tax Treaties, Transfer Pricing and Financial Transactions  
Centre for Tax Policy and Administration  
Organisation for Economic Co-operation and Development  
2, rue André Pascal - 75775 Paris Cedex 16

RE: BEPS Action 7 Revised Discussion Draft and the CIV Industry

Dear Marlies:

ICI Global,¹ on behalf of our collective investment vehicle (CIV)² industry members, urges that the Base Erosion and Profit Shifting (BEPS) Action 7 Deliverable retain the existing permanent establishment (PE) exemption for information collection. The benefits of this bright-line test are clear. Exempting only “preparatory or auxiliary” information collection, as proposed in the Action 7 Revised Discussion Draft,³ would create the potential for disputes that impose substantial costs on business and governments and yield little if any tax revenues.

We urge in the alternative, if the Action 7 Deliverable exempts only “preparatory or auxiliary” information collection, that the Revised Discussion Draft’s CIV example (in proposed new

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¹ The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$19.6 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

² A CIV is defined for this purpose consistently with the OECD’s Report entitled “The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles” (the “CIV Report”) – http://www.oecd.org/tax/treaties/45359261.pdf. Specifically, CIVs are defined as “funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established.” CIV Report, page 3, paragraph 4. Funds that are not treated as CIVs in the CIV Report (and that are not addressed in our comments) include “investments through private equity funds, hedge funds or trust or other entities that do not fall within the [Report’s] definition of CIV.” Id.

paragraph 22.6 of the Article 5 Commentary) be retained. We appreciate that this example takes into account the concerns that we raised in our January submission\(^4\) and during the March public consultation. Specifically, the clarification will allow CIV asset managers to make in-country examinations of appropriate investment opportunities without worrying that a PE will be created. As we discussed during the public consultation, CIV asset managers might avoid making portfolio investments in developing countries – to the obvious detriment of those countries – if the result was creating a PE in each country in which the managers’ funds invest. No asset manager is going to pursue investment opportunities for its funds in 100 countries if the result is being required to comply, as a resident, with the domestic tax regimes of these 100 countries. By clarifying that this activity continues to be treated as preparatory or auxiliary, the revised discussion draft ensures the capital continues to flow to these countries and that they receive the attendant economic development benefits.

In support of your entirely reasonable request to keep comments “as short as possible,” we would add only that:

- the arrangements that we described in our January submission (such as creating separate business entities to limit securities-law regulatory requirements to the relevant business unit) are not BEPS-related;

- additional examples of activities that do not create BEPS concerns should be provided so that clarity will be enhanced and conflicts will be reduced;

- attribution of profits guidance must be provided promptly to address the additional issues that surely will arise from BEPS Action 7; and

- effective dispute resolution mechanisms – including mandatory binding arbitration – must be incorporated fully into the final BEPS work product.

* * *

We support strongly appropriately-targeted BEPS remedies that do not harm inadvertently the cross-border investment that promotes economic growth. We also appreciate greatly your effort to find consensus when so many competing considerations exist. If we can provide you with additional information regarding our concerns, please feel free to contact me at your convenience.

Sincerely,

Keith Lawson
Deputy General Counsel – Tax Law

cc:  taxtreaties@oecd.org

\(^4\) http://www.ici.org/pdf/28652.pdf
Mexico City, June 12, 2015

Via e-mail
taxtreaties@oecd.org
Ms. Marlies de Ruiter
Head of Tax Treaties, Transfer Pricing and Financial Transactions Division OECD/CTPA

Dear Ms. De Ruiter,

On behalf of IFA Grupo Mexicano, A.C. (Mexican Branch of the International Fiscal Association) kindly find below the comments on the Revised Discussion Draft on Action 7 of the BEPS Action Plan –“Preventing the Artificial Avoidance of the PE Status” (the “Draft”).

A. Artificial avoidance of PE status through commissionaire arrangements and similar strategies

A.1. Paragraph 5

- We concur with the election of Option B over Options A, C and D, in order to modify Art. 5(5) of the OECD Model Tax Convention because of the following reasons:
  - This option is the one that best resolves the confusion on the scope of the current wording of Art. 5(5) pertaining to having and habitually exercising authority to conclude contracts, which through the Commentaries of the OECD Model Tax Convention includes negotiation as well. The foregoing is achieved because Option B specifically provides that the person acting on behalf of the enterprise
should either “habitually conclude contracts” or “negotiate the material elements of contracts”.

- This option is the one that best resolves the misconceptions arising from the current wording of Art. 5(5) that generally provides for PE exposure pertaining to contracts entered into “in the name of the enterprise” which has created confusions for civil law countries where contracts can be entered into both “on behalf and in the name of the enterprise” and “on behalf of the enterprise but in the name of the person”. The foregoing is achieved because Option B clearly establishes through subparagraphs a), b) and c) that PE exposure could exist pertaining to contracts entered into “on behalf and in the name of the enterprise” or “on behalf of the enterprise but in the name of the person”.

- In our comments to the prior Public Discussion Draft, we had observed that subparagraph a) referring to “in the name of the enterprise” should be deleted because subparagraphs b) and c) already sufficed to address subparagraph a) concerns. The foregoing because Option B resolved the misconceptions arising from the scope of the phrase “in the name of” by focusing on the object of the contract entered into by the agent (i.e., property or services to be provided by the enterprise) regardless of whether the contract entered “on behalf of the enterprise” was entered “in the name of the enterprise” or “in the name of the person”. However, paragraphs 32.7 and 32.8 of the proposed Commentary on Article 5 clarify that subparagraph a) refers to the case where contracts are entered into “in the name and on behalf of the enterprise” while subparagraphs b) and c) address the case where contracts are entered into “in the name of the
person but on behalf of the enterprise”. We do agree with this approach taken on the Commentaries, but consider that the text could be misleading and therefore consider appropriate to make a further clarification on the text of Art. 5(5) as follows:

“a) in the name of the enterprise, or

b) in its own name, for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or

c) in its own name, for the provision of services by that enterprise,”

- Paragraph 32.9 of the proposed Commentary on Article 5 provides that the reference to contracts “in the name of” in subparagraph a) does not restrict the application of the subparagraph to contracts that are literally in the name of the enterprise, thereby potentially applying to “certain situations” where the name of the enterprise is undisclosed in the contracts. We consider that this paragraph might be confusing and, therefore, suggest including some examples for clarification purposes.

A.2. Paragraph 6

- We concur with the decision of deleting the phrase “acting on behalf of various persons” and with the inclusion of the phrase “one or more enterprises to which it is connected”. The foregoing because these amendments clarify our concern that an independent agent having only one unrelated client would automatically trigger PE exposure for the enterprise. In this regard, we agree with paragraph 38.6 of the Commentaries on Article 5 clarifying that paragraph 6 will not automatically apply where a person acts for one or more enterprises to which that
person is not connected, but rather this paragraph 6 requires that the person must be carrying out business as an independent agent and be acting in the ordinary course of that business. Although we do not agree with an assessment that independent status is less likely if the activities of the person are performed wholly or almost wholly on behalf of only one enterprise, because in any case the tests of economic and legal dependence must be applied.

- Paragraph 38.7 of the proposed Commentaries on Article 5 establishes, as an example, an objective threshold (10% of concluded sales) to measure whether a person is acting “exclusively or almost exclusively” on behalf of connected enterprises. The proposed threshold could be difficult to apply because it does not refer to a timeframe during which the agent’s sales to enterprises that are not connected should represent less than 10% of the sales that it concludes as an agent. In addition, we consider appropriate to include a clarification in the same paragraph that other objective tests could be sought as well and that failure of passing under this text should not automatically place the agent on second sentence of paragraph a).

- We also concur on the inclusion of a subparagraph b) to paragraph 6 for purposes of clarifying the concept of “connected enterprises”.
B. Artificial avoidance of PE status through the specific activity exemptions

B.1. List of activities included in Art. 5(4)

- We concur with the election of Option E over Options F, G and H, in order to modify Art. 5(4) of the OECD Model Tax Convention so that each of the exceptions included in that paragraph are restricted to activities that are of a “preparatory” or “auxiliary” character.

- The last sentence of the existing paragraph 22 of the Commentary on Article 5, which refers to the collection of information as in the case of a newspaper bureau, is being deleted and is not included in other paragraphs of the referred Commentary.

However, we consider important to include such sentence in paragraph 22.6 of the Commentary, which deals with examples of subparagraph b) of Article 5 (collect information for the enterprise), in order to clarify that the collection of information by a newspaper bureau is considered as a preparatory or auxiliary activity, since the deletion of said paragraph may be misleading.

- Paragraph 22.3 of the Commentary on Article 5, which refers to subparagraph b) (maintenance of a stock of goods or merchandise belonging to the enterprise), establishes a general example of a case in which an activity may fall or not under such paragraph, depending if the activities constitute a preparatory or auxiliary activity, however the activities are not described therein.

For clarification purposes, we recommend to include a specific example, which would be considered as preparatory or auxiliary under subparagraph b), such as the example indicated in paragraph
29 of the Commentary (the display of merchandise during a trade fair or convention would be excepted under subparagraph b).

B.2. Fragmentation of activities between related parties

- The term "connected enterprise" is used instead of "associated enterprise". Although we understand that comments were received regarding the use of the original language, we consider the same to be correct as it is a more technical term than "connected". The term "connected" is too broad and not used in the International Taxation jargon with respect to an "enterprise". It is typically used regarding income i.e. effectively "connected" income. The term "associated" with respect to the term enterprise is commonly used and therefore easier to understand its scope i.e. Article 9 of the OECD Model Tax Convention, Commentaries on Article 7, etc.

- More complex examples to illustrate the application of paragraph 4.1. are welcomed.

C. Splitting-up of contracts

- We are still concerned about the “automatic” approach for the determination of splitting-up of contracts and we consider that the PPT rule would and should suffice in order to address abusive situations in which the split-up is made in order to circumvent the provisions of the Treaty pertaining the creation of a PE.

- Under paragraph 18.1 and in connection to the additional provision to address contract splitting-up, we consider that an exception to the application of the provision should be available, under which the
taxpayer may evidence that such split-up was made for valid business reasons; thus, the provision should not apply. This, in order to allow valid business arrangements to be exempted from the automatic application of the provision, leaving the burden of the evidence to the taxpayer and not to the tax authorities.

*   *   *

The participation of IFA Grupo Mexicano, A.C. is made on its own behalf exclusively as an IFA Branch, and in no case in the name or on behalf of Central IFA or IFA as a whole.

We hope you find these comments interesting and useful. We remain yours for any questions or comments you may have.

Sincerely,

IFA Grupo Mexicano, A.C.
BEPS Action 7: Preventing the Artificial Avoidance of PE Status


I. Introduction and Summary of Comments

These comments are being submitted to the OECD by the Insurance Company Working Group on Base Erosion and Profit Shifting (BEPS)\(^1\), which consists of global insurance and reinsurance companies, in response to the Revised Discussion Draft released on 15 May 2015 by the OECD entitled “BEPS Action 7: Preventing the Artificial Avoidance of PE Status.”

The Revised Discussion Draft is an improvement upon the initial discussion draft of 31 October 2014. In particular, we support the elimination of Option M and endorsement of Option N such that no special rule with respect to insurance businesses is being proposed to be added to Article 5 of the OECD Model Tax Convention. We do have some concerns, however, about Proposal 1, which is based on Option B in the earlier discussion draft.

Specifically, the Working Group believes that the guidance in the Revised Discussion Draft regarding the meaning of the phrase “or negotiates the material elements of contracts,” as set forth in proposed paragraph 32.5 of the Commentary on Article 5, does not provide adequate clarity for insurance companies or tax administrators. Insurance companies typically rely on agents, brokers and representative offices for a variety of regulatory and business reasons. Under the recommended provisions of the Revised Discussion Draft, these commercial arrangements might be considered to give rise to PEs of insurance companies even though there is no artificial avoidance of PE or other BEPS concern.

As discussed in more detail below, we have suggestions as to further clarify the application of the proposals in the Revised Discussion Draft to insurance companies and their agents.

II. Proposal 1 and negotiation of the material elements of contracts

The Revised Discussion Draft includes Proposal 1, which would create a PE when an intermediary habitually concludes contracts or negotiates the material elements of contracts on behalf of a remote seller, unless the intermediary is an independent agent. The Revised Discussion Draft acknowledges that “most of the concerns expressed [in comments on Option B

\(^1\) The members of the Working Group are AIA Group Limited, American International Group; Inc.; MetLife Inc., Prudential Financial Inc., Prudential plc, Swiss Reinsurance Company Limited, and XL Group plc.
as proposed in the 31 October 2014 discussion draft] related to the uncertainty of the concept of ‘negotiates material elements of contracts’."

The phrase in question is ambiguous, because it could mean either mere back-and-forth communications prior to agreement\(^2\) or, alternatively, back-and-forth communications that have culminated in an agreement.\(^3\)

In an effort to further explain the proposed standard, the Revised Discussion Draft includes proposed additions to the Commentary that discuss the meaning of the concept, 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” 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.

In our view, the crucial part of the above paragraph is the second sentence, which looks to whether “the key ingredients of the contractual relationship have been determined in the relevant State.” The use of the word “determined” indicates that the OECD is interpreting “negotiates” to mean back-and-forth communications that have culminated in a final agreement on the material contractual elements in question. This is reinforced by language included later in the Commentary as proposed to be modified in the Revised Discussion Draft that says “The mere fact that a person has … participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has negotiated the material elements of contracts.”

It follows that, in a case where the agent’s communications with the prospective buyer have not resulted in a final agreement but rather in a preliminary proposal to be submitted to the principal for a genuine evaluation (as opposed to routine formal approval or rubber-stamping), the contractual terms have not been “determined in the relevant State.” Rather, in such a case the terms of the contract are determined by the principal at its place of business outside the jurisdiction where the agent and the prospective buyer are located.

In the insurance industry, although face-to-face policy negotiations are conducted between the agent and the policyholder, the insurance company retains the exclusive right to perform underwriting and other review on every contract. In some respects, agents’ and companies’ interests are not fully aligned, with agents seeking to maximize sales commissions, while head office corporate underwriters are responsible for ensuring that the company takes on an

\(^2\) See Black’s Law Dictionary 1136 (9th ed. 2009) (first definition of “negotiate” is to “communicate with another party for the purpose of reaching an understanding”).

\(^3\) See id. (second definition of “negotiate” is to “bring about by discussion or bargaining”).
appropriate level and blend of risk. For example, it is not uncommon for there to be disputes between agents and the head office about the “rating” of a customer, with agents seeking a preferred status to lower premiums and get a sale, while the underwriting team at the head office demands a lower rating and higher premium to correctly price the risk being assumed. Due to this tension, although agents are involved in contract negotiation, they are not authorized to set final policy terms. It is not appropriate to deem the agent’s activities in offering a policy that is subject to genuine head office review and change as a case where the contractual terms are determined at the location of the agent. For these reasons, the OECD should clarify that the agent does not negotiate the material elements of the policy, and thus does not create a PE of the insurance company.

III. Providing clarification in the Commentary regarding application of the proposal in the context of insurance industry regulation and practice

Insurers’ business models are a direct result of the applicable regulatory environment. For example, insurers commonly use a local sales representative or broker that acts exclusively or almost exclusively for a foreign insurer, provides information on insurance products to potential customers, and assists them in purchasing insurance via communications with the foreign insurer. It is important that the Commentary, as it is proposed to be revised, does not create the impression that an insurance PE may be present in such a case even though such arrangements do not involve artificial avoidance of PE status.

Underwriting (KERT) function

As the OECD stated in Part IV of its 2010 report on the attribution of profits to PEs, in the insurance business, there is one key entrepreneurial risk-taking function: the decision to assume insurance risk. Insurance companies do not typically delegate the performance of this function to sales agents or brokers. Therefore, the communications between an agent of the insurance company in a foreign market and a prospective customer in the foreign market do not typically constitute the negotiation of a contract on behalf of the insurance company. Rather, the agent’s communications with the prospective customer may lead the latter to make an offer to the insurance company which will be genuinely evaluated and either accepted or rejected by the insurance company at its place of business.

It would be helpful if the language of the Commentary on Article 5 were refined so as to clarify that a dependent agent is not “negotiating the material elements of contracts” in the circumstances described above.

Other functions

In addition to marketing activities, other functions, such as claims handling, investment management, and administrative support, are often outsourced either to third parties or to affiliated service companies that may not be independent agents under the definition in the Revised Discussion Draft. These affiliates are compensated on an arm’s length basis for their activities. However, under the current language in the draft Commentary, it is not clear that
these affiliates are performing “auxiliary” functions of the type that would not generate PEs for their principals where the affiliates operate.

It would be helpful if the Commentary could clarify that performance by an agent of non-KERT functions, as explained in OECD Part IV, would constitute auxiliary activities that would not result in PE status for the nonresident insurance company principal.

**IV. Alternatively, providing clarification in the Article 7 Commentary regarding adequacy of transfer pricing in accordance with Part IV of the OECD’s 2010 Report**

If the OECD is unable to agree to modify the proposed Commentary with respect to Article 5 as requested above with respect to insurance sales representatives or brokers, an alternative approach to clarifying the tax consequences of using an agent’s services can be found in guidance regarding the UK corporation tax as applied to nonresident insurers. The approach taken by Her Majesty’s Revenue & Customs is to identify the KERT function of risk assumption (underwriting) and attribute the insurance company’s profits and capital to the location where that function is performed, while compensating other activities involved in the insurance company’s business on an arm’s-length basis. Consistent with the OECD’s approach to preventing the artificial avoidance of PEs, the guidance includes the following language:

> The emphasis is on looking at where people are genuinely assuming risk and performing the key risk-taking functions – the substance rather than form, which can be supported by tangible evidence of the reality, rather than, for example, sending contracts for formal approval when the core decision making work is performed elsewhere.

We suggest that the OECD could usefully include similar language in the Commentary to Article 7 if our requested clarification regarding the interpretation of “negotiates the material elements of contracts” in the case of insurance sales representatives or brokers is not included in the Article 5 Commentary. This would make it clear that no profits are attributable to the activities of a dependent agent of a nonresident insurance or reinsurance company in circumstances where the agent is not performing the KERT function of risk assumption.

**Conclusion**

For the reasons stated above, we urge the OECD to clarify the proposed Commentary language as discussed above to provide clarity with respect to the treatment of the common insurance business model involving use of local sales representatives or brokers, as well as other types of agents.

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Insurance Europe supports the aims of the OECD Base Erosion and Profit Shifting (BEPS) Action Plan to address weaknesses in the international tax environment and welcomes the opportunity to provide comments on the revised discussion draft on Preventing the Artificial Avoidance of the Permanent Establishment (PE) Status (Action Point 7).

Specific comments

Insurance Europe welcomes the OECD’s recognition that an insurance-specific option (Option M) is not required in this discussion draft. Similarly, Insurance Europe agrees with and supports the OECD’s choice of Option B as opposed to Options A, C or D.

Insurance Europe believes that the extended commentary provided in view of interpreting Articles 5(5) and 5(6) is a useful addition. However, Insurance Europe would point out that the meaning of “material elements” of contracts and “dependent agent” must be further refined, as otherwise, there may be a risk that for some insurance business models, PEs would be created for tax but not for regulatory purposes with nil or minimal additional profit being attributed. This would therefore represent a disproportionate compliance burden for insurers given that no or minimal profit would be attributed to those PEs.

In order to avoid this, only the presence of Key Entrepreneurial Risk-Taking (KERT) functions in a jurisdiction should create a PE for tax purposes. The main KERT function of insurers is generally the assumption and management of insurance risk/business (i.e. underwriting). This is recognised by the 2010 OECD Report on the Attribution of Profits to Permanent Establishments Part IV (Insurance) (“Part IV”), even though Part IV does not apply when ascertaining whether a PE exists.

In contrast, functions such as sales and marketing of insurance, back-office processing of applications, administrative support, claims handling and investment management are not KERT functions and would have nil or minimal additional profit being attributed. Creating tax PEs for such functions, even if they are remunerated at an appropriate level for the duties undertaken and are not high value, would result in a
disproportionate compliance burden; as such, Insurance Europe believes that tax PEs in such circumstances should not be created.

Insurance Europe would welcome the clear recognition that in an insurance context:

- "Material elements" of contracts should be clearly linked to the assumption and management of insurance risk/business and;
- An appropriately compensated agent performing non-KERT functions (such as sales) is not considered "dependent agent" even if he acts exclusively for one insurer.

In Insurance Europe’s opinion, the fastest and most straightforward way to achieve this recognition is by referencing Part IV in the commentary to Articles 5(5) and 5(6).

Finally, the discussion draft notes that follow-up work on issues related to Action 7 will be done after September 2015 “with a view to providing guidance before the end of 2016”. In this context, Insurance Europe recommends that such guidance be released in draft form for public comments, with sufficient time (at least 45 days) for review and consultation.

Insurance Europe is the European insurance and reinsurance federation. Through its 34 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe’s economic growth and development. European insurers generate premium income of more than €1110bn, employ almost one million people and invest over €8500bn in the economy.
To: Marlies de Ruiter,
Head, Tax Treaties,
Transfer Pricing and Financial Transactions Division
OECD/CTPA

(sent via email to taxtreaties@oecd.org)

3 June 2015

Dear Marlies,

**BEPS Action 7: Prevent the Artificial Avoidance of PE status (Revised Discussion Draft)**

IHG welcomes the opportunity to submit comments on the Revised OECD Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE status ('The Revised Discussion Draft').

**About IHG**

IHG (InterContinental Hotels Group) [LON:IHG, NYSE:IHG (ADRs)] is a global organisation with a broad portfolio of hotel brands, including InterContinental® Hotels & Resorts, HUALUXE® Hotels and Resorts, Crowne Plaza® Hotels & Resorts, Hotel Indigo®, EVEN™ Hotels, Holiday Inn® Hotels & Resorts, Holiday Inn Express®, Staybridge Suites® and Candlewood Suites®. In January 2015, IHG acquired Kimpton Hotels & Restaurants, the world's leading boutique hotel business.

IHG manages IHG® Rewards Club, the world's first and largest hotel loyalty programme with over 84 million members worldwide. The programme was relaunched in July 2013, offering enhanced benefits for members including free internet across all hotels, globally.

IHG franchises, leases, manages or owns over 4,800 hotels and more than 710,000 guest rooms in nearly 100 countries, with over 1,200 hotels in its development pipeline. Over 350,000 people work across IHG's hotels and corporate offices worldwide.

InterContinental Hotels Group PLC is the Group's holding company and is incorporated in Great Britain and registered in England and Wales.

**Our Comments on the Revised Proposals**

1. In accordance with our comments in our 18 December 2014 submission we welcome the decision to amend the specific activity exemptions so that they are all subject to the overriding condition of being preparatory and auxiliary in the context of the particular business model concerned. We also welcome the helpful guidance given concerning the interpretation of ‘preparatory and auxiliary’. We would request however that consideration is given to expanding the guidance and examples, in particular to include examples of situations which are, or are not, ‘preparatory and auxiliary’ when considering the Proposal 1 amendments to Paragraphs 5 and 6 to deal with Commissionaire and similar arrangements. We refer to our further comments in 5. and 6. below.
2. We also welcome the decision to perform further work and provide additional guidance concerning the attribution of profits to PE’s. As is noted in the Revised Discussion Draft (and as we and others have previously commented) there is a belief that some of the Revised Proposals may result in the creation of many new PE’s to which little or no profits are properly attributable. We believe that there is also reason for concern however that, without clear guidance, there are significant practical risks of effective double taxation arising as a result of revenues being attributed to new PE’s but of significant difficulties being encountered in agreeing what are the costs which are properly attributable to earning those revenues.

We note, for example, that many or most of the new PE’s are likely to require methods for allocating costs which are not discrete costs of activities in relation to a single jurisdiction but are broader functional costs relating to multiple jurisdictions. Other difficult transition or longer term issues may arise in connection with deemed local use of pre-existing tangible or intangible capital assets.

3. As commented in our prior submission we recognise that the anti-fragmentation proposals are limited by reference to the requirement that the enterprise under consideration has a fixed place of business in the jurisdiction. Without this the provisions would be liable to inappropriately draw in activities genuinely carried on outside the jurisdiction solely as a result of the provision of services to the enterprise by a connected enterprise which independently met the conditions to constitute a local permanent establishment (and was thus recognised and appropriately taxed locally). We are therefore concerned that Paragraph 32.2 of the Revised Discussion Draft appears (in the contest of the Proposal 1 amendments to counteract commissioner and similar arrangements) to require the notional assumption of a fixed place of business. When that is considered in conjunction with the revised anti-fragmentation rules we believe that may inappropriately deem a PE to exist and thus create local taxing rights in relation to profits which should properly be considered to be earned outside the jurisdiction.

4. We note that Para 32.11 of The Revised Discussion Draft emphasises that ‘property’ covers any type of tangible or intangible property. Our understanding of this and other paragraphs of the Proposal 1 amendments and associated commentary is that they may well result in royalty income currently dealt with under Article 12 being dealt with instead under Article 7. Whereas we do have concerns that standard withholding tax and foreign tax credit mechanisms no longer work as intended in the context of modern commercial business models, that is an issue of double taxation rather than BEPS and we therefore question whether the OECD intends that Proposal 1 should extend the circumstances in which the operation of Article 12 is displaced. We note in this respect that:

(a) Withholding taxes applied under Article 12 operate as agreed mechanisms for sharing taxing rights between jurisdictions whereas Article 7 gives primary taxing rights to the local jurisdiction. The intended target of Action 7 appears to concern local profits being diverted overseas so as to wholly escape intended local taxation and not circumstances where Article 12 gives the opportunity to both jurisdictions to tax on an agreed basis;

(b) In our view there are many cases in which a lower local tax charge would apply under a notional PE and profit allocation approach than under a withholding tax approach. Whereas that lays behind our corresponding belief that the withholding tax and foreign tax credit systems are somewhat broken, we do not think that the broader international tax system would benefit if an Article 7 basis of taxation is an unintended outcome whose ramifications have not been fully considered; and

(c) Whatever the disadvantages of withholding tax systems we do believe that they have the significant advantage for developing countries of simplicity compared to complex PE profit calculations.
We therefore recommend that careful consideration is given to whether the Proposal 1 changes may inadvertently disrupt the intended application of Article 12 in relation to normal non BEPS business activity. As indicated we would however hope that, as a post BEPS Action, the OECD will be able to give further consideration to whether, in the context of modern business models and fact patterns, standard withholding tax and foreign tax credit systems are likely to result in increasing levels of effective double taxation.

5. Our 18 December submission expressed concern that Proposal 1 type amendments may bring into question whether profits from long term service contracts, where the substantive performance of those contracts during their lifetime was clearly conducted from outside the jurisdiction, might be inappropriately attributed to the jurisdiction of the service recipient as a result of local activity to identify contractual opportunities. We would hope that expanded ‘preparatory and auxiliary’ guidance could address these types of issues.

6. Equally, either in the context of ‘preparatory and auxiliary’ guidance, or in the context of future guidance concerning the Proposal 1 related attribution of profits to a local PE, we believe it is important to consider grey circumstances rather than clear black or white ones. Our point is that the concerns leading to Proposal 1 appear to relate to systemic/structured arrangements whereby all, or a clearly defined segment, of local business is driven by the activities of a single local intermediary. There are however significant concerns that Proposal 1 type provisions may extend beyond structured BEPS arrangements to impact normal commercial arrangements. Those are likely to be less uniform and present significant difficulties in relation to identification and attribution of revenues, costs and profits.

For example, we would imagine it is commonplace for enterprises involved in cross-border service provision to have a variety of different recurring routes for identifying and concluding opportunities to do business with a jurisdiction rather than just one- and to quite properly be in a position where there is currently no local PE of the enterprise itself. That would however generally be in circumstances where there are already associated entities and independent agents who are appropriately taxed locally with respect to their services. Applying Proposal 1 to that type of non-uniform fact pattern would lead to a need for separate consideration of each of those routes for finding business, and potentially some form of contract by contract attribution of additional revenues and costs [including those of the agents] as either being attributable to, or not attributable to, a new PE.

In summary whereas we welcome various aspects of the Revised Discussion Draft we believe that significant further consideration is needed in connection with Proposal 1 in order to avoid it having unintended and unforeseen impacts which extend well beyond BEPS type arrangements. That consideration needs to include both its scope and the associated profit attribution issues. Although we welcome the commitment to perform additional work in relation to profit attribution it seems to us that that work should be performed before, and not after, any decision to introduce Proposal 1.

We hope that these comments are of constructive assistance to the OECD’s continuing considerations. We would be happy to expand on them, or provide future input in relation to profit attribution issues, as necessary.

Yours faithfully,

C.P. Garwood
Head of Tax
INTERNATIONAL ALLIANCE FOR PRINCIPLED TAXATION

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June 12, 2015

VIA E-MAIL

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
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France
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Re: Comments on Revised Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status

Dear Ms. de Ruiter:

The International Alliance for Principled Taxation (IAPT or Alliance) is a group of major multinational corporations based throughout the world, and representing business sectors as diverse as consumer products, media, telecommunications, oilfield services, transportation, computer technology, energy, pharmaceuticals, beverages, software, IT systems, publishing, and electronics. The group’s purpose is to promote the development and application of international tax rules and policies based on principles

1 The current membership of the IAPT is made up of the following companies: Adobe Systems, Inc.; Anheuser-Busch InBev NV/SA; A.P. Møller-Mærsk A/S; AstraZeneca plc; Baker Hughes, Inc.; Chevron Corporation; Cisco Systems, Inc.; The Coca-Cola Company; Exxon Mobil Corporation; Hewlett-Packard Company; Johnson Controls, Inc.; Juniper Networks, Inc.; Microsoft Corporation; Procter & Gamble Co.; RELX Group plc; Repsol S.A.; TE Connectivity, Ltd.; Thomson Reuters Corporation; Transocean Ltd.; Tupperware Brands Corporation; and Vodafone Group plc.
designed to prevent double taxation and to provide predictable treatment to businesses operating internationally.

The Alliance appreciates the opportunity to provide input to the OECD with respect to its Revised Discussion Draft on BEPS Action 7, Preventing the Artificial Avoidance of PE Status released on May 15, 2015. Our comments are set forth in the Annex to this letter.

The Alliance would be pleased to respond to any questions or to provide further input as the work of the OECD on this item continues.

Sincerely yours on behalf of the Alliance,

Mary C. Bennett
Baker & McKenzie LLP
Counsel to the Alliance

Annex: Comments on the May 15, 2015 Revised Discussion Draft
ANNEX

INTERNATIONAL ALLIANCE FOR PRINCIPLED TAXATION

COMMENTS ON MAY 15, 2015 REVISED DISCUSSION DRAFT ON BEPS ACTION 7,
PREVENTING THE ARTIFICIAL AVOIDANCE OF PE STATUS

JUNE 12, 2015
IAPT Comments on the May 15, 2015 Revised Discussion Draft on BEPS Action 7, Preventing the Artificial Avoidance of PE Status

1. Executive Summary

1. While we appreciate that the Revised Discussion Draft (RDD) took into account prior comments to some extent, we are concerned that the proposals are over-broad and still leave a great deal of uncertainty, and we are dismayed that profit attribution consequences were not considered in setting the new PE thresholds.

2. We urge transparency regarding countries’ positions on the new thresholds and confirmation of the lack of alignment between direct tax and VAT PE standards.

3. Regarding the proposed changes to Article 5(5), we suggest:
   - Clarifying that “habitually” modifies “negotiates”;
   - Identifying the specific material elements of a contract that, at a minimum, must be negotiated by the person acting in a Contracting State on behalf of a foreign enterprise;
   - Eliminating over-broad and unclear proposed Commentary language that confuses mere promotional or marketing activities with “negotiating” contracts;
   - Clarifying the scope of the contracts covered by the new proposals (e.g., by clarifying and including in the Model text itself the distinction between persons acting on behalf of the foreign enterprise and persons acting on their own behalf); and
   - Removing the incorrect assumption that the presentation of standard terms to a potential customer, followed by the latter’s indication of an intent to be bound by those terms, necessarily constitutes either the negotiation or conclusion of a contract;

4. Regarding the proposed changes to Article 5(6), we suggest:
   - Limiting the status of “connected” person to cases involving a greater than 50% ownership requirement; and
   - Reversing proposed changes to the existing Commentary guidance on the meaning of “independent” that have no support in the form of changes to the text of Article 5(6).

5. Regarding the proposed changes to Article 5(4), we suggest:
• Reconsidering the decision to subject all the listed activities in Article 5(4) to the “preparatory or auxiliary” condition, instead of a more surgical approach designed to target the activities that are of most concern and that are most likely to be capable of attracting material profits;

• Confirming that the same criteria apply in determining whether premises constitute a “fixed place of business” of the foreign enterprise in both the related and unrelated party context;

• Reaching consensus on a clearer explanation of how to distinguish an activity that is an “essential and significant” part of the business of an enterprise from one that is not;

• Clarifying what it means for a place of business through which activities are conducted to be one which “may well contribute to the productivity of the enterprise, but the services it performs are so remote from the actual realisation of profits that it is difficult to allocate any profit to the fixed place of business in question”; and

• Providing further clarification on the preparatory or auxiliary character of the previously per se exempted activities in common factual situations.

6. Regarding the proposed changes to deal with the fragmentation of activities between connected persons, we suggest:

• Including an amendment that would call off the application of the anti-fragmentation rule in situations where legitimate commercial, regulatory, or similar business considerations motivated the separation of activities into different group members, such that avoidance of PE status was not a principal purpose of the structure;

• Limiting the status of “connected” person to cases involving a greater than 50% ownership requirement;

• Providing a more precise and appropriately targeted interpretation of the existence of “complementary functions in a cohesive business operation” which justifies the aggregation of activities conducted by separate persons;

• Ensuring that it is only the activities of a foreign enterprise in a territory that are considered in determining whether the grouping of fragmented activity constitutes a PE; and

• Providing guidance on:
  
  o Whether there is any limit on how many degrees of separation there can be between two affiliates’ activities in order for them to be liable to be aggregated;

  o How much profit is attributed to each PE created by the aggregation;

  o What guarantee the MNE group (and treaty partners) will have that the host State will not tax more than 100% of total profit; and
Whether there is a mechanism for resolving the potential disputes with multi-country implications that could arise.

7. Regarding the proposed changes to address the splitting-up of contracts, we suggest:

- Reinstating (and incorporating into the Commentary) the following points from the October 2014 Discussion Draft which did not reappear in the RDD, i.e. that:
  - The provision’s opening words “for the sole purpose” emphasize that time periods spent by associated enterprises are merely aggregated for the purpose of deciding whether the 12-month period has been exceeded, not for the purpose of attributing the activities of one enterprise to the other; and
  - The reference to “different periods of time” means that any day where the two enterprises are carrying on activities at the place that constitutes the building site or construction or installation project will not be counted twice; and

- Providing clear guidance on the appropriate application of the AOA to contracts that cover design, engineering, and/or manufacturing activities conducted primarily outside the source State (e.g., in the case of turnkey contracts), in order to prevent over-reaching by certain tax administrations.

8. Regarding the attribution of profits to PEs, we suggest:

- In order to achieve good guidance in the proposed September 2015-December 2016 timeframe and to bring to the exercise a holistic understanding of both the AOA and the elements of the newly created PEs, getting a joint working group of WP1 and WP6 delegates engaged early on this and setting out a framework for obtaining business input on an ongoing basis; and

- Confirming that the existing principles of the AOA will continue to apply unless and until supplemental guidance is adopted which modifies them in any way.

2. General comments on the RDD

9. We appreciate the opportunity to comment on this RDD and the fact that some prior comments were taken into account in a number of respects.

10. We still, however, find the various options selected by Working Party 1 (WP1) both over-broad and unclear in many respects. Our prior comments on these options still stand. The drafting efforts made by the OECD to provide clarification generally fall short and fail to address common situations that are likely to give rise to controversies. We believe this set of proposals will put considerable pressure on the need to improve significantly the mechanisms for resolving disputes.

11. While we are pleased that further work will be done after September 2015 to provide clarification on the attribution of profits to PEs, we were disappointed this analysis was not done before deciding on
options to lower the PE threshold, as we continue to believe that the creation of PEs which will attract little if any profit will act as a barrier to international trade. It will create costly compliance obligations for taxpayers and costly returns processing obligations for tax administrations, all with little potential revenue at stake.

12. We note that this is not a consensus document, and we hope countries’ positions will be transparent and that all participating countries will reflect any objections they have through reservations, observations, or positions.

13. Clarification should be added to the Commentary to note that the definition of a PE for income tax purposes is different from the definition of a fixed establishment for VAT/GST purposes, and no assumption should be made that the existence of such a PE creates the existence of such a fixed establishment or vice versa; in particular, a VAT registration should not be considered as creating a PE where the conditions of Article 5 are not met.2

3. Commissionnaire arrangements and similar strategies

14. While our prior comments had noted problems with all four of the options from the October Discussion Draft, we like many others found Option B the least problematical and we appreciate the effort that was made to take business input into account.

15. That being said, there are a number of aspects of the currently proposed version of Option B that we believe are potentially over-broad or could benefit from further clarification.

3.1 Application of “habitually” to “negotiates”

16. We understand that one of the objectives of the proposed changes is to ensure that an agent who “habitually negotiates the material elements” of certain contracts on behalf of a nonresident enterprise should be deemed to give rise to a PE for that enterprise. While that objective is stated clearly at paragraph 32 of the proposed Commentary, we believe the drafting of proposed Article 5(5) (and of paragraph 32.1 of the proposed Commentary) makes it less clear that the term “habitually” is intended to apply to “negotiates the material elements”, since those portions of the document refer to a person who “habitually concludes contracts, or negotiates the material elements of contracts, […]”.

2 Such a clarification would be comparable to the clarification WP1 proposed, in its October 2012 discussion draft on “The Meaning of Beneficial Owner”, to add to the Commentary on Article 10 to confirm that the term “beneficial owner” when used in the context of Articles 10-12 of the Model Tax Convention did not have the same meaning as that term when used in the context of the FATF anti-money laundering recommendations.
17. **Suggestion:** The unclear text could be improved by redrafting (e.g., by saying “habitually concludes or negotiates the material elements of contracts …”).

3.2 **“Material elements of the contract”**

18. In order to apply the new provision, it is important for there to be certainty about whether “the material elements of the contract” have been negotiated by the person acting on behalf of the foreign enterprise. Proposed Commentary paragraph 32.5 (which says the “material elements” of a contract “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”) is too vague.

19. **Suggestion:** We suggest replacing “would typically include” with “at a minimum include”.

3.3 **“Negotiation” of contract**

20. We are also concerned that the proposed Commentary (in particular, paragraph 32.6) is drafted in such a way as to create significant ambiguity as to whether a person acting on behalf of a nonresident enterprise has actually “negotiated” the material elements of a contract, as opposed to having merely carried out promotional or marketing activities. The first sentence of proposed paragraph 32.6 says the object and purpose of Article 5(5) “is to cover cases where the activities that a person exercises in a State are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise”.

21. We believe this statement is much too broad and fails to adequately distinguish marketing and promotional activities which fall far short of negotiating or concluding contracts, even though their intended purpose may be achieve the regular conclusion of contracts to be performed by the foreign enterprise.

22. **Suggestion:** We recommend deletion of that statement regarding the object and purpose of Article 5(5). A similar statement in paragraph 13 of the Revised Discussion Draft should also be deleted.

23. Paragraph 32.6 also says the proposed version of Article 5(5) applies to a person acting as a “sales force” of a foreign enterprise who “makes […] contractual offers” using “standard contracts”.

24. The example in that paragraph deems the employee of a local subsidiary (SCO) of the foreign enterprise (RCO) to have “negotiated” the material terms of a contract where he has merely presented or described or explained a standard contract to a customer who must contact the foreign enterprise directly (in the example, doing so online) to conclude the contract.

25. When a person acting on behalf of an enterprise has no authority to alter or determine the terms on which the enterprise is prepared to conclude contracts, it distorts the plain meaning of “negotiate” to say he can negotiate contracts, and saying that creates a serious risk of deeming a wide range of promotional activities performed on behalf of nonresident sellers (whether online sellers or not) to be PEs. For example, even activities as far removed from actual negotiation as advertising, trade shows, and...
communications to potential customers by promoters could give rise to deemed PEs under the proposed Commentary’s broad interpretation.

26. Paragraph 32.6 further muddies the standard by: (a) referring to a “sales force” without defining what is meant by that term; (b) including in the example the fact that the SCO employees’ remuneration is partly determined by revenues received by RCO from the customers they promote, without explaining the relevance of that fact; and (c) failing to acknowledge that the combination of presentation of standard terms and a customer’s expression of intent to be bound by those terms does not necessarily constitute the legal conclusion of a contract, since that may require both a customer’s offer to purchase and a seller’s acceptance of that offer.

3.4 Contracts covered

27. We understand that the proposed language regarding contracts “for the transfer of the ownership of, or for the granting of the right to use, property owned by [the foreign] enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise” is intended to cover commissionnaire arrangements, where the foreign enterprise is not directly legally bound vis-à-vis the customers with whom the commissionnaire concludes contracts.

28. We appreciate that an effort has been made (in paragraph 22 of the Revised Discussion Draft and in proposed paragraph 32.12 of the Commentary) to clarify that the language is not intended to cover persons acting on their own behalf rather than on behalf of the foreign enterprise, such as buy-sell distributors of goods (including low risk distributors).

29. The proposed language could be improved, however, to clarify this principle. For instance, the example at paragraph 32.12 appears to condition the treatment of the distributor of goods as acting on its own behalf (rather than on behalf of the foreign enterprise from which it will obtain the goods to be sold onward to the customer) on the fact that title passes through that person. This creates questions about how the principle would apply to an intermediary acting on its own behalf with respect to other forms of transactions, such as leasing, licensing, or services transactions, where title passage is not a relevant factor.

30. **Suggestion:** We suggest the distinction between persons acting on their own behalf and persons acting on behalf of the foreign enterprise could be based on whether the revenue from the transaction with the customer is properly booked, for tax and/or accounting purposes, to those persons and not to the foreign enterprise.

31. **Suggestion:** Likewise, it would be preferable to include confirmation of this important principle in the text of the Convention itself, rather than leaving it only to the Commentary. For example, language along the following lines should be added to Article 5(5): “A person shall not be regarded as acting on behalf of an enterprise for purposes of this paragraph in respect of contracts concluded or negotiated by that person for the transfer of the ownership of, or for the granting of the right to use, property owned by that person or that the person has the right to use, or for the provision of services by that person,
regardless of whether that person obtains the ownership of or the right to use that property, or obtains the supply of those services, from the enterprise.”

32. **Suggestion:** Similar language should be added to proposed Commentary paragraph 32.7, in order to prevent any misinterpretation of that broadly drawn paragraph (which says that Article 5(5) applies “to contracts that create obligations that will effectively be performed by such enterprise rather than by the person contractually obliged to do so”).

33. An example might be a local subsidiary of an international telecommunications enterprise that concludes contracts with local customers to provide them with telecommunications services and also concludes a contract with the parent enterprise to obtain the services necessary to deliver the part of those services requiring access to a foreign network (see for example the “roaming” agreement case described at paragraph 9.1 of the Commentary on Article 5 and paragraph 9.2 of the Commentary on Article 12).

34. **Suggestion:** We further suggest the deletion of proposed Commentary paragraph 32.10, which reads: “The crucial condition for the application of subparagraphs b) and c) is that the person who concludes the contracts or negotiates the material elements of the contracts is acting on behalf of an enterprise in such a way that the parts of the contracts that relate to the transfer of the ownership or use of property, or the provision of services, will be performed by the enterprise as opposed to the person that acts on the enterprise’s behalf.” That paragraph is subject to potentially over-broad reading in the kinds of cases just mentioned and is unnecessary to ensure application of new Article 5(5) to commissionaire arrangements, since those are squarely addressed by proposed paragraph 32.8.

35. **Suggestion:** For the sake of clarity, the Commentary should include language confirming that a person who acts in a Contracting State on behalf of a foreign enterprise does not create a PE for that enterprise under Article 5(5) where he neither habitually concludes nor habitually negotiates the material elements of contracts in the name of the enterprise or for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise.

36. **Suggestion:** Similarly for the sake of clarity in connection with the interpretation of not only the new Article 5(5) but also the version of Article 5(5) in the existing Model, the Commentary should negate any implication that a presentation of standard terms to a customer, followed by that customer’s manifestation of agreement to those standard terms, necessarily amounts to the conclusion of a contract, in the absence of the seller’s acceptance of the customer’s offer to purchase on those terms.

37. Whether there has been an “offer” and “acceptance” resulting in the conclusion of a legally binding contract is a matter of applicable contract law. Contract law typically distinguishes between an invitation to negotiate (e.g., the presentation of catalog prices) and an offer to sell, so a customer’s manifestation of an intent to agree to terms communicated by a seller may not result in the conclusion of a contract until the seller manifests its agreement to sell to the customer on those terms (i.e., by accepting the customer’s offer to purchase).
3.5 Independent agent definition

38. We also have some concerns about the proposed changes to the “independent agent” description at Article 5(6). We were pleased that the OECD dropped the proposal to treat unrelated agents as automatically dependent where they worked exclusively or almost exclusively for the enterprise or the group of which the enterprise is a part.

39. However, the new “connected person” standard for relatedness is troublesome. First, it is based on an “at least 50%” ownership standard rather than “greater than 50%”, so it could, for example, inappropriately sweep in joint ventures.

40. Moreover, it is not clear what is meant by “beneficial equity interest” in a company (separate from voting power or value).

41. The “control” standard does not seem to be much of an improvement on the former “associated enterprise” proposed language, especially where it operates as an alternative to a 50% ownership standard.

42. We question whether the changes to Article 5(6) justify certain of the proposed changes to the Commentary. For example, the statement in new paragraph 38.6 of the Commentary, with respect to an agent acting for principals unconnected to him, that independence is less likely in the case of an agent acting wholly or almost wholly on behalf of a group of enterprises connected to each other (as opposed to existing paragraph 38.6’s reference to one enterprise), without regard to whether the members of the group of enterprises are “acting in concert to control the acts of the agent in the course of his business on their behalf” (see existing paragraph 38.6), is a change in interpretation of what is essentially the same treaty provision as appears in current Article 5(6). Changing the Commentary interpretation like this, without any identifiable corresponding change to the Model text, calls into question both the interpretation of treaties based on the existing Model and the integrity of the Commentary as a reliable guide to the interpretation of Model text.

43. Similarly, we question the basis for deleting from the Commentary the language which currently appears at paragraph 38.6 and which states that, in the context of determining whether an agent has independent status, it is necessary to consider all the facts and circumstances to determine “whether the agent’s activities constitute an autonomous business conducted by him in which he bears risk and receives reward through the use of his entrepreneurial skills and knowledge”.

44. We also question the statement in proposed paragraph 38.5 that the business of acting as distributor for a number of companies is unrelated to the business of acting as an agent for another company. Enterprises involved in distribution activities often act as buy-sell distributors for some companies and as sales agents for others, and both activities can be considered part of the ordinary course of the distribution business for such an enterprise. All such activities should be considered in determining whether the enterprise is carrying out its agent activities as an independent agent.
3.6 Profit attribution to a new Article 5(5) PE

45. We find it troubling that there is no discussion of the profit attribution implications of a PE based on having a person who “negotiates the material elements” of a contract (but does not conclude the contract), or on having a *commissionnaire* arrangement. For example, what if activities leading to the conclusion of a contract take place in more than one jurisdiction – how will profits from sales be allocated? We note further that if the *commissionnaire* is earning an arm’s length remuneration, there is likely to be little if any additional profit attributed to the host State by reason of treating the *commissionnaire* as a PE for the foreign principal.

4. Specific activity exceptions under Article 5(4)

4.1 List of activities included in Article 5(4)

46. We were disappointed the decision was made to subject all the listed activities in Article 5(4) to the “preparatory or auxiliary” (P/A) condition. As indicated in our comments of January 9, 2015, we believe that this decision risks too much uncertainty about many routine business activities due to the fundamental ambiguity about what it means for an activity to be P/A. We also believe the decision is unjustified in light of the lack of any identified concern about the current coverage of several of the listed activities in the Article 5(4) *per se* exceptions, the extent to which the change puts great pressure on determining whether the activities are conducted at a fixed place of business of the foreign enterprise, and the highly questionable basis for attributing any appreciable profits to the activities.

47. **Suggestion:** We therefore recommend reconsideration of the decision to subject all the listed activities in Article 5(4) to the P/A condition, instead of a more surgical approach designed to target the activities that are of most concern and that are most likely to be capable of attracting material profits.

48. We were nevertheless pleased some effort was made (e.g., at proposed Commentary paragraphs 22.3 and 22.4) to confirm that these activities will not create a PE where the foreign enterprise is not carrying them on through a fixed place of business. For example, the Commentary helpfully indicates that where the activities are carried on at the premises of another enterprise that are not “at the disposal” of the taxpayer enterprise, no PE will arise.

49. **Suggestion:** It would be more helpful to have that confirmation in related party context, in addition to the unrelated party examples given in the proposed Commentary.

50. We were disappointed with how little additional clarity the new Commentary provided on what constitutes P/A activities. Our concern is that this lack of clarity is likely to lead to frequent and costly disputes between tax authorities and taxpayers, and between tax authorities of different governments, as to whether any of the current list of *per se* exempted activities are P/A.

51. For example, the new Commentary retains (at proposed paragraph 21.1) the language of the existing Commentary which says that the decisive criterion in distinguishing between activities which have a P/A character and those which do not is “whether or not the activity of the fixed place of business
in itself forms an essential and significant part of the activity of the enterprise as a whole”. However, no real guidance is provided on what is meant by “essential” or “significant” activities.

52. In our previous comments, we had noted the ambiguity of this language:

   For example, is an activity like storage “essential” because it needs to be done to carry on a business, or “non-essential” because it can easily be, and often is, outsourced to a third party provider? Is an activity like delivery “significant” because it represents the entirety of an enterprise’s activity in a particular jurisdiction or because it attains certain volume levels, or “not significant” because it represents a small portion of the enterprise’s overall cost structure or can easily be, and often is, outsourced to a third party provider?

53. Some tax administrations argue that any activities that occur within their jurisdiction are necessary and thus important, so the term “essential and significant” needs to be defined with particular attention to establishing an appropriate agreed threshold. The examples provided in the new Commentary shed little light on what it means for an activity to be an “essential and significant” part of the activity of the enterprise as a whole.

54. For example, the warehouse example at proposed paragraph 22 describes a situation where an online seller of goods has a “very large warehouse” in State S in which a “significant number of employees” work for the main purpose of storing and delivering goods owned by the enterprise that the enterprise “sells online” to “customers in State S” and concludes that the storage and delivery activities carried on through the warehouse, being “an essential part of the enterprise’s sales/distribution business” are not P/A. But the example leaves many questions unanswered (in addition to those set out in our prior comments), such as:

   - When (if ever) are storage and delivery not an essential part of the business of an enterprise engaged in sales or distribution of goods?
   - Does it matter that the warehouse was “very large”, and if so, what is meant by “very large”?
   - Does it matter that the warehouse employed a “significant number of employees”, and if so, what is meant by significant?
   - Does it matter that the enterprise’s sales were made online?
   - Does it matter that the enterprise’s sales were to customers in the same country as the warehouse?

55. Similarly, paragraph 22.2 retains an example from the existing Commentary which says that a pipeline used by an oil refining enterprise to transport its own oil to its refinery in another country is “merely incidental to the business of that enterprise” (and therefore presumably not “essential and significant”), without giving any hint of the factors that led to that conclusion.
56. **Suggestion:** We therefore recommend that the OECD reach a consensus on a clearer explanation of what is meant by “essential and significant”.

57. A similar concern relates to the retention, without any new explanation, of the language in proposed Commentary paragraph 21 that equates a place of business through which P/A activities are conducted as one which “may well contribute to the productivity of the enterprise, but the services it performs are so remote from the actual realisation of profits that it is difficult to allocate any profit to the fixed place of business in question”.

58. We had previously commented as follows on this language:

It’s not at all clear how useful [that] guidance is in identifying preparatory or auxiliary activities in light of the modern transfer pricing and Authorised OECD Approach (AOA) principles, which presume that all functions must be compensated at arm’s length. [footnote: See, e.g., paragraph 17 of the 2010 Report on the Attribution of Profits to PEs, which says: “Under the second step of the authorised OECD approach the Guidelines are applied by analogy to the PE’s dealings with other parts of the enterprise to ensure that the performance of all of its functions in relation to these dealings is rewarded on an arm’s length basis.”] The intention of the Commentary language may have been to suggest that the activities were remote from the enterprise’s actual realization of profits based on its transactions with third parties, such that it was difficult to allocate a portion of those profits to the fixed place of business. Assuming that to be true, the Commentary’s description of “preparatory or auxiliary” activities could be modified to make that point clearer. Otherwise, subjecting all of the Article 5(4) activities to an overarching condition of being preparatory or auxiliary risks creating many more PEs than exist today….

59. **Suggestion:** In light of those comments and the continuing ambiguity, if the cited language is retained in proposed Commentary paragraph 21, we recommend the addition of new language to that paragraph along the following lines: “In order for an activity to meet the standard of being preparatory or auxiliary, it is not necessary to conclude that it would be difficult to determine an arm’s length remuneration for that activity, but the activity would typically be remote from the enterprise’s realization of profits from third parties.”

60. **Suggestion:** We also suggest that the OECD provide further clarification on the P/A character of the other previously *per se* exempted activities in common factual situations, for instance:

- Is proposed Commentary paragraph 22.4 intended to suggest that an enterprise’s use of a toll manufacturer (and hence its maintenance of a stock of goods at the toll manufacturer’s premises for processing) is always OK if the enterprise doesn’t directly do any manufacturing itself?

- For purposes of proposed Commentary paragraph 22.5, is purchasing raw materials or components considered P/A if for subsequent use in a manufacturing process?
For purposes of proposed Commentary paragraph 22.6, would an investment fund’s use of a fixed place of business in a State to collect information on possible investment opportunities there still qualify as P/A if the information collection activities continue after the fund has begun to invest in the State?

61. As with the other changes proposed to Article 5, we are concerned that there is no analysis of the PE profit attribution implications of the PEs that will be created based on previously excluded activities.

4.2 Fragmentation of activities between related parties

62. We were disappointed the OECD went for the broader option (Option J), which could trigger the anti-fragmentation rule even where the foreign enterprise is carrying on an activity that would clearly be P/A in the context of its business, simply because a related enterprise is carrying on an activity that is subject to the taxing jurisdiction of the host State and the two activities constitute complementary functions that are part of a cohesive business operation carried on by the group as a whole. This does not strike us as “artificial avoidance” of PE status, and it strays very far afield from the previously applicable basic principle that the PE analysis should be done on an entity-by-entity basis.

63. **Suggestion:** Because the proposal fails to address in a sufficiently targeted way the cited concern about “artificial” avoidance of PE status, we suggest an amendment that would call off the application of the anti-fragmentation rule in situations where legitimate commercial, regulatory, or similar business considerations motivated the separation of activities into different group members, such that avoidance of PE status was not a principal purpose of the structure.

64. For the reasons outlined above in connection with the change to Article 5(6), we were not particularly comforted by the proposed change in language from “associated enterprises” to “connected enterprises”.

65. We remain very concerned about the continuing lack of clarity, and the potential over-breadth, of the concept of “complementary functions in a cohesive business operation”. For example, we were very troubled by Example B in the Commentary involving a foreign enterprise’s in-country warehouse from which its local subsidiary, acting as a buy-sell distributor, could obtain items it wished to sell to customers. We assume that the foreign enterprise’s in-country warehouse would be P/A and would not be considered a PE if the foreign enterprise sold its goods to an unrelated distributor in State S, rather than to a related distributor. This is just one of several troubling examples where the proposals under consideration seem designed to discourage the use of related parties.

66. Moreover, the example confirms that a local entity maintaining a fixed place of business in its local territory constitutes an existing PE for the purposes of the anti-fragmentation rule. The consequences of this are that in any territory in which a MNE has a local subsidiary, it will have to rely on any additional activity it conducts in that territory not constituting a “complementary function” of its subsidiary in order to avoid a PE, irrespective of how minor that additional activity is.
67. **Suggestion:** In order to provide a threshold to the level of activity required to create a PE we would therefore strongly recommend that it should be only the activities of a foreign enterprise in a territory that are considered in determining whether the grouping of fragmented activity constitutes a PE.

68. We are also concerned that the language seems broad enough to catch activities even where most of the activities of the “cohesive business operation” take place outside the source State. It strikes us as inappropriate to trigger taxing jurisdiction in a State on the basis of activities constituting a “cohesive business operation” when most of that business operation has no connection with that State.

69. We are also concerned that no guidance was given on:

- Whether there is any limit on how many degrees of separation there can be between two affiliates’ activities in order for them to be liable to be aggregated;
- How much profit is attributed to each PE created by the aggregation;
- What guarantee the MNE group (and treaty partners) will have that the host State will not tax more than 100% of total profit; and
- Whether there is a mechanism for resolving the potential disputes with multi-country implications that could arise.

5. **Splitting-up of contracts**

70. We were somewhat comforted that the PPT option, rather than “automatic” option, was the preferred choice for dealing with the instances of splitting contracts among affiliates. That being said, the inclusion of the “automatic” option in the Commentary reduces our comfort level.

71. We were also somewhat comforted that changes were made to the “automatic” option to include a 30-day minimum threshold and a requirement that the activities under separate contracts be “connected”.

72. However, we are particularly concerned about the potential applicability of this “splitting up of contracts” concept in relation to service-PE 183-day thresholds.

73. We are also concerned that the proposed new Commentary does not include points that were made in the October 2014 Discussion Draft (DD). For example, that DD had said:

- The provision’s opening words “for the sole purpose” emphasize that time periods spent by associated enterprises are merely aggregated for the purpose of deciding whether the 12-month period has been exceeded, not for the purpose of attributing the activities of one enterprise to the other; and
- The reference to “different periods of time” means that any day where the two enterprises are carrying on activities at the place that constitutes the building site or construction or installation project will not be counted twice.
74. **Suggestion:** We recommend reinstatement of those points from the October 2014 DD in the final Action 7 Report, and their incorporation in the Commentary.

75. Finally, we are particularly concerned about countries invoking this rule to try to sweep in contracts that cover design, engineering, and/or manufacturing activities conducted primarily outside the source State (e.g., in the case of turnkey contracts). We note this problem is likely to be exacerbated by the failure to deal with the profit attribution consequences of the newly created PE, and we emphasize the importance of providing clear guidance on the appropriate application of the AOA in order to prevent that kind of over-reaching by certain tax administrations.

6. **Profit attribution to PEs**

76. We were very disappointed to see that no effort had been made to analyze the profit attribution implications of the newly created PEs before deciding to change the threshold. In our view, this approach omits a crucial step in the policy analysis of deciding where the PE threshold should lie.

77. Nevertheless, we were relieved to see there will be an effort to address those issues between September 2015 and December 2016. This will be an important exercise for purpose of providing guidance that could help to avoid a great many disputes in the years to come, and it will require a holistic understanding of both the AOA and the elements of the newly created PEs.

78. **Suggestion:** For that reason, we suggest it would be useful to get a joint working group of WP1 and WP6 delegates engaged early on this, and to set out a framework for obtaining business input on an ongoing basis.

79. **Suggestion:** It would also be useful to get confirmation that the existing principles of the AOA will continue to apply unless and until supplemental guidance is adopted which modifies them in any way.

80. We note that the RDD says no PE profit attribution analysis could be conducted before the BEPS transfer pricing Action Items were concluded. This rationale did not strike us as convincing, since most of those Action Items seem focused on giving greater weight to people functions in applying an Article 9 arm’s length analysis. This should not have any significant effect on the AOA analysis, which is already based on people functions. Finally, we continue to be troubled by the prospect that countries will think there is a “pot of gold” to be obtained from introducing these PE threshold changes, without having actually undertaken an analysis of the profits to be attributed to the new PEs under the AOA. This is, in our view, likely to be one of the primary causes for increased (and increasingly difficult) controversies relating to PEs and one of the reasons it will be critically necessary to achieve significantly improved dispute resolution.
June 12, 2015

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Sent by email: taxtreaties@oecd.org

Re: Consultation Response to Revised Discussion Draft on Action 7 (Prevent the Artificial Avoidance of PE Status) of the BEPS Action Plan

Dear All,

The Taxes Committee of the International Bar Association (IBA) would like to take this opportunity to respond to the Revised Discussion Draft on Action 7 (Prevent the Artificial Avoidance of PE Status) of the BEPS Action Plan.

The International Bar Association (IBA), the global voice of the legal profession, includes over 45,000 of the world's top lawyers and 197 Bar Associations and Law Societies worldwide. The IBA is registered with OECD with number 1037 55828722666-53.

We are submitting our comments on behalf of the IBA Taxes Committee which has 1037 members from around the world. This committee formed a Working Group to respond to this Consultation. The Working Group includes Albert Collado, Spain; David G. Shapiro, USA; Peter Utterström, Sweden; Leandro M. Passarella, Argentina; Francisco Lavandera, Spain; and Tiago Cassiano Neves, Portugal.

The comments made in this report are the personal opinions of the Working Group participants (the “Working Group”) and should not be taken as representing the views of their firms, employers or any other person or body of persons, including the IBA as a whole, apart from the IBA Taxes Committee which they are a member.

Sincerely yours,

/s/ Simon Yates
Co-Chair of the Working Group

/s/ Ricardo León Santacruz
Co-Chair of the Working Group

London São Paulo Dubai
Preliminary Comments

The Revised Discussion Draft issued on 15 May 2015 is the result of the work undertaken by the Working Party 1 on Tax Conventions and Related Questions (a subsidiary body of the CTPA) consisting on the analysis and the discussion of the comments received on the Discussion Draft released on 31 October 2014 and the public consultation meeting held on 21 January 2015.

The main objective of the work reflected in this Revised Discussion Draft is to move from a series of alternative formulations to one specific proposal with respect to each of the areas of discussion around the prevention of the artificial avoidance of PE status.

In this context, and given the fact that the proposals in this Revised Discussion Draft were all included amongst the different options that appeared in the October 2014 document, the IBA Taxes Committee will not reproduce the comments and suggestions put forward in the context of such initial Discussion Draft.

The purpose of this document, following the invitation of the CTPA, is to state in a short manner our views and comments on the specific proposals (particularly, in all what constitutes new material with respect to the October 2014 document) reflected in the Revised Discussion Draft.

Comments on Section A (Artificial avoidance of PE status through commissionaire arrangements and similar strategies)

● Comments on proposed reformulation of paragraph 5 of Article 5

Working Party 1 of the CTPA has reached the conclusion that Option B is the preferable alternative amongst all those initially considered. Likewise, a substantial amendment (mainly, by inserting additional literature) to the Commentary on paragraph 5 of Article 5 is proposed aiming at providing additional guidance on the suggested changes.

The IBA Taxes Committee expressed two main concerns when commenting on Option B. On one side, the uncertainty created by the use of an expression such as “the material elements of contracts” and, on the other, the risk that PEs could be found even where the agent lacks any authority to bind the principal it represents.

On the first issue, the new paragraph 32.5 of the Commentary on Article 5(5) provides some guidance on this point, by indicating that “the material elements of contracts” would typically include “the determination of the parties (...) as well as the price, nature and quantity of the goods or services (...”). This clarification will
help to mitigate, to a certain extent, the interpretative doubts posed by such a generic and broad expression. However, there is a risk that based on this wording the tax administrations tended to attach more importance to the first-mentioned factor (i.e. “determination of the parties”) and reduce the other elements (i.e. “price, nature and quantity”) to something less important, where in our opinion these latter aspects are often the key elements of a negotiation. We would hence suggest using a language that clearly and conclusively places all those factors in an equal footing for the purposes of ascertaining which the “material elements” of a contract are.

The second issue remains unsolved and, in our view, the additions to the Commentary on Article 5(5) even create greater concern. The proposed new language of Article 5(5) entails a complete reformulation of the dependent agent concept in that it may lead to the existence of a PE where the agent’s acts “do not legally bind” (para. 32.8) the enterprise being represented, i.e. irrespective of their actual authority to enter into legally binding contracts.

Along this same line, the example in paragraph 32.6 of the Commentary suggests that an agent with no capacity to modify any element of a contract (i.e. standard contracts) which is concluded online by the client is regarded as having negotiated “the material elements of the contracts”.

Again, this outcome deviates from the original spirit of the dependent agent concept, which is intended to capture situations where the agent’s powers actually entail the creation of rights and obligations which are binding on the foreign enterprise. In our view, the modified Commentary could allow nearly any advertising or marketing activity by a dependent agent to create a permanent establishment. We are concerned that this could create significant uncertainty, with the result that any marketing personnel in any capacity would create significant permanent establishment risk, at least in cases where the terms of a contract or purchase order are largely non-negotiable.

● Comments on proposed reformulation of paragraph 6 of Article 5

The final proposal for a new paragraph 6 of Article 5 introduces some changes with respect to the initial version contained in the October 2014 Discussion Draft, which generally result in a less restrictive configuration of the independent agent concept.

The alternative finally chosen restricts the exclusion of the independent status to situations where the agent acts exclusively or almost exclusively for (one or more) enterprises “to which it is connected” (as opposed to the former version, where the restriction could apply even if agent and principal were unconnected).

Despite the above, paragraph 38.6 of the Commentary on Article 5(6) clarifies that this provision does not mean that paragraph 6 applies automatically (and, hence, the
independent status can be deemed to exist) whenever a person acts for enterprises to which he is not connected. We totally concur with this view.

Generally, while we appreciate the reasonableness of the less strict scope of the limitations laid down in paragraph 6 (as compared to those foreseen in the previous Draft), we still believe that the establishment of an automatic exclusion of the independency status of agents working solely for connected enterprises goes too far in the desired purpose of tackling abusive schemes.

A provision setting out a rebuttable presumption (that no independency status exists in those cases) but allowing for a proof to the contrary would seem a more desirable solution. For example, the fact that the agent is remunerated at arm’s length could be indicative of its independence. In this sense, a conjunctive condition that the agent would be considered as independent if it was paid an arm’s length compensation might be added.

Finally, article 38.7 of the Commentary on Article 5(6) sets forth a sort of numerical threshold (10 percent) to determine when a person could be deemed (not) to act “almost” exclusively for connected enterprises. This solution provides, in the IBA Taxes Committee’s view, greater certitude in interpreting the meaning and scope of this expression. This was, precisely, one of the suggestions made in our initial comments on the October 2014 Draft.

Comments on Section B (Artificial avoidance of PE status through specific activity exemptions)

- Comments on proposed changes to the list of activities included in paragraph 4 of Article 5

Option E has been considered the preferable alternative amongst all those initially proposed for further discussion. This was the option for which the IBA Taxes Committee expressed its preference as well.

The Revised Discussion Draft incorporates new content to the Commentary on Article 5(4) with the aim of providing additional guidance, mainly through examples of situations where the preparatory or auxiliary character of the installation could be under discussion.

The IBA Taxes Committee acknowledges the usefulness of these examples. There are, however, some remarks to be made when looking closely into the specific content of these examples.

Firstly, one of the aspects that transpires when analysing the additions to the Commentary on Article 5(4) is that a decisive importance is placed on the size of the premises (and related human means). For instance, the example laid down in paragraph 22 seems to exclusively rely on such element when assessing the PE issue
in relation to the warehouse of an online selling company. While the quantitative element of the installation is clearly relevant, we believe that not all emphasis should be put thereon, but also focus the analysis on the qualitative aspects of the case.

Secondly, Example 1 in paragraph 22.5 seems to suggest that a PE should be deemed to exist in all cases where a company selling certain products (agricultural products, in this case) operates a purchasing office in a State different from its home State. We appreciate that this could be the case in many scenarios potentially arising under similar schemes. However, we would suggest introducing the caveat that such a conclusion would be conditioned to a comprehensive analysis of all the facts and circumstances that could be relevant to ascertain the potential character of the installation as a “significant and essential” part of the enterprise’s business. Absent such remark, one would take the conclusion that, in the CTPA’s view, a PE would automatically be deemed to exist in cases where a seller operates a purchasing office in another State.

- **Comments on the proposed new paragraph 4.1 of Article 5 (Fragmentation of activities between related parties)**

Among the existing options (I and J) Working Group 1 of the CTPA has opted for option J, which expands the scope of the new anti-fragmentation rule to cases in which none of the places to which it refers constitutes a PE, but the combination of the activities at the same place goes beyond what is preparatory or auxiliary.

Since nothing has been added to the initial wording of option J, as it was drafted in the October 2014 document, we refer to our comments in that connection. Basically, the following concerns were expressed:

- The fact that this new provision could shift from the principle that “each place of business has to be viewed separately and in isolation for deciding whether a PE exists”.

- The risk that a “force of attraction” effect was produced because the tax authorities could be tempted to attribute functions of the foreign enterprise to the local PE.

- It was suggested that the existing words (present in paragraph 27.1 of the Commentary) “coherent whole commercially and geographically with respect to that business” would be preferable than the more expanded version of “cohesive business operation”.

**Comments on Section C (Splitting up of contracts)**

The solution proposed by Working Group 1 of the CTPA is more or less in line with the preference expressed by the IBA Taxes Committee in light of the options initially presented, i.e. not to include any express anti-abuse provision specifically dealing with
this matter and leave it the States to address the issue through their general anti-abuse rules.

In addition to the above, an example referring to the splitting up of contracts has been inserted in the Commentary on the PPT rule. Moreover, in the case of States that cannot deal with this issue through their domestic anti-abuse rules and do not have a PPT rule in their tax treaty, an additional provision setting out an automatic rule (the wording of which is essentially coincident -with some minor differences- with that of Option K) is suggested in order that those States can include them in their bilateral treaties.

We do not have any specific comment with regard to the provisions referred to in the preceding paragraph.

**Comments on Section D (Insurance)**

Since the final stance of Working Group 1 of the CTPA has been not to introduce any specific provision in Article 5 referring to insurance companies and this had been the initial position of the IBA Taxes Committee on this point, no comments are made in this section.

**Comments on Section E (Profit attribution to PEs and interaction with action points on transfer pricing)**

Working Group 1 of the CTPA has decided to undertake follow-up work on attribution of profits to PEs, especially in light of the outcome of other Actions of the BEPS project, such as Actions 7 and 8-10.

The IBA Taxes Committee appreciates the convenience and opportunity of carrying out this additional work, as had been suggested in various sections of the document submitted by us in January 2015, in response to the initial Discussion Draft.
The International Chamber of Commerce (ICC) as the world business organization speaking with authority on behalf of enterprises from all sectors in every part of the world, welcomes the opportunity to provide comments on the Revised Discussion Draft regarding Base Erosion and Profit Shifting (BEPS) Action 7 ‘Preventing the Artificial Avoidance of PE Status’.

ICC remains concerned that a project intended to tackle BEPS is resulting in a wider reconsideration of the allocation of taxing rights between source and residence countries. This will result in an increased risk of double taxation in non-abusive circumstances unless there is a very clear consensus as to the precise detail of how the new approach will be applied, including objective (rather than subjective) criteria and “bright lines” tests, supported by clarifying examples. The revised Proposals are still somewhat subjective in nature and further guidance will be necessary.

ICC welcomes the assurance that the attribution of profit to Permanent Establishments (PEs) will be examined during 2016 and offers its support to contribute to that work.

The Discussion Draft seeks to address artificial avoidance of PE status through the use of commissionaire arrangements and similar strategies. Commissionaire arrangements, and other arrangements involving dependent agents, are quite frequently employed in non-abusive cases. ICC continues to believe that the proposed measures will not only impact commissionaire arrangements, but also a wide range of arrangements used for making direct sales or providing sales support, i.e. limited risk distributor and other principal structures. Furthermore, appropriate weight should be given to the nature of the activities and the functions being performed, outside the territory in which the PE is argued to exist. In such instances, where significant substance and activities do take place outside the territory, ‘bright line’, objective tests or gateways could perhaps be used to exclude the existence of a PE. A concrete example of the need for a bright line test is the proposed sub paragraph (b) of paragraph 6 of Article 5. The first sentence of the sub paragraph provides an adequate definition of the new “connected” concept. However, the second sentence does not provide any clarity with regard to the “control” concept. The introduction of an undefined test based on “control” will create ambiguity in relation to associated enterprise, and is likely to result in double taxation and increased uncertainty. ICC suggests that there is a strong case for applying the existing rules where there is no intended abuse and where arrangements, often of long standing nature, represent an efficient way of conducting business. ICC feels that there is still time to develop a test to exclude non-abusive cases.

ICC is highly concerned about the boundaries of the terms ‘complementary functions’ and ‘cohesive business operations’. The proposed wording – as illustrated in the commentary section 30.3 Example B – disregards any separate entity reporting and introduces a wide force of attraction rule. The only limitation on combining activities is that they must constitute complementary functions where this condition seems to be met already if there is any kind of interaction between the connected companies in the same country. The proposed rule does not recognise that multinational enterprises (MNEs) operate globally in separate lines of businesses to respond efficiently to the commercial challenges of a globalised and specialised market.
These lines of businesses should be treated separately and be outside the scope of the anti-fragmentation rule. Further guidance should be provided to differentiate between ordinary business arrangements and abusive cases.

The use of the term ‘fixed place of business that is used...’ suggests that activities outside the scope of Art. 5.4 could become taxable: If, for example, a MNE owns an affiliate R Co. in country R that owns stock in a warehouse of an independent third-party company in S which are delivered from that warehouse to an affiliate S Co. in country S, it would seem, under the proposed rule of using a fixed place of business (here the warehouse of an independent company), the affiliate R Co. in country R would have a PE in country S. It should be clarified – at least in the commentary section – that the application should be limited to activities of R Co. which qualify as Art. 5.4 activities, i.e. the activity must be performed through a fixed place that is at the disposal of R Co.
The International Chamber of Commerce (ICC)
Commission on Taxation

ICC is the world business organization, whose mission is to promote open trade and investment and help business meet the challenges and opportunities of an increasingly integrated world economy. Founded in 1919, and with interests spanning every sector of private enterprise, ICC’s global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.
Dear Ms de Ruiter

Revised discussion draft: BEPs Action 7: Preventing the artificial avoidance of PE status

Thank you for inviting comments on the revised discussion draft, BEPS Action 7, Preventing the artificial avoidance of PE status, issued on 15th May 2015.

The International Underwriting Association of London (IUA) represents international and wholesale insurance and reinsurance companies operating in or through London. Its purpose is to promote and enhance the business environment for its members. We estimate that premium income for the London company market in 2013 was some £24bn.

We note that this revised discussion draft results from the work carried out following the release of the original draft on 31st October 2014 and we welcome the proposals to adopt Option B, to maintain sub-paragraph d) of paragraph 4 of Article 5 and to deal with insurance as any other business rather than as one that requires specific rules.

Our comments focus on the additional changes and on the revisions to the Commentary to the extent that they have an impact on insurance operations. The comments are provided in the spirit of trying to make sure that the PE article and the Commentary provide clarity on when a PE of an insurance operation is created and that the provisions are workable and properly targeted.

Changes to paragraphs 5 and 6 of Article 5 and related Commentary

The proposed paragraph 32.5 of the Commentary discusses the interpretation of the phrase “or negotiates the material elements of contracts” and notes that, “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”. In the insurance industry, the broker acting for the prospective buyer of the insurance policy and an agent of the insurance company may work together to put together a preliminary proposal to be submitted to the principal for its evaluation. The preliminary proposal could contain elements such as the potential price and what may be covered under the policy, elements of which may be included in the final contract. However, the proposal in those circumstances is a basis for the principal to perform its underwriting work and does not imply that the material elements of the contract have already been negotiated. The regulatory position is aligned in that an insurer would typically need to be licensed (or permitted through a passport arrangement) in order to carry out insurance activity in any jurisdiction and such preliminary proposal work would not typically require a licence. It would be helpful if the
Commentary could clarify that, where an agent is involved in proposing policy terms which are subject to underwriting at head office, that does not create a PE under paragraphs 5 of Article 5.

In our letter of 9th January 2015, we made the point that, in most cases, the definition of an insurance PE for tax purposes is closely aligned with the definition of a branch for regulatory purposes and a move away from that would create complexity, which would be difficult to manage for business purposes. It would, therefore, be helpful if the Commentary were to note that tax authorities should not generally seek to argue the existence of a PE of an insurance company which is not also a regulatory branch and that, where a strict reading of Article 5 might lead to the tax authorities arguing for a recognition of a tax-only PE, they should adopt a pragmatic approach and not argue the position where the profit attributable to such an (arguable) PE, based on the facts and circumstances of a full business value chain, would be nil or minimal.

Paragraph 38.6 states that: “Where, however, a person is acting exclusively for one enterprise, to which it is not connected, for a short period of time (e.g. at the beginning of that person’s business operations), it is possible that paragraph 6 could apply”. That commentary provides some clarity on the position, but as the situation typically applies to independent third parties in a set-up situation, we consider it more appropriate that that situation is not considered to give rise to a PE. For insurance business, such a situation could arise, for example, where a third party managing agent is setting up and has only one client. That agent’s business model would typically stay the same as it gains more clients. In addition, that situation would not normally constitute a branch for regulatory purposes.

Paragraph 4 of Article 5: “Preparatory or auxiliary” and related Commentary

It would be helpful to broaden the Commentary in paragraph 21.2 to include some examples relating to financial services. In the insurance context, the activity that requires a significant proportion of the assets or employees would be the active assessment of the terms of the contract, including setting the price for the cover to be provided. All other related activity, such as collecting data, providing data on past claims or performance of individual clients or of a market as a whole, should be capable of being considered preparatory or auxiliary (subject to the facts and circumstances and the specific business value chain).

As explained in Part IV of the OECD’s 2010 Report on the Attribution of Profits to PEs, the key entrepreneurial risk-taking function of insurance is the assumption of insurance risk. While attribution of profits to a PE can take place only once a PE has been created, we think that the analysis of typical functions of an insurance business in Section B of Part IV is helpful in considering whether activities are of a preparatory or auxiliary character.

It would be helpful to provide some further examples of what might be considered to have a preparatory or auxiliary character in the context of digital communications. Subject to an analysis of the overall value chain, we consider that the processing of documents, including scanning and basic verification of data and the provision of pre-defined communications to third parties via e-mail carried out in a state, should typically be regarded as having an auxiliary character.
2. Fragmentation of activities between related parties

It would be helpful to clarify what is meant by “complementary functions that are part of a cohesive business operation” (in the last paragraph of the proposed paragraph 4.1 of Article 5) in the context of a global business.

Example A in paragraph 30.3 of the proposed Commentary on Paragraph 4.1 illustrates the position where there are branches of RCO in State S and the work of employees in a separate office in State S is to carry out services which are ultimately included in reports to those branches. In this example, the activities of employees in the office in State S are part of the overall value chain relating to loan applications by clients in State S.

In a global insurance group, it is possible that more than one line of business may wish to carry out activities in a particular state. Let us say RCO is an insurance company resident in State R with a branch in State S which accepts insurance risk and constitutes a PE and, separately, some verification activity relating to a different line of business originating outside State S is carried out by employees of RCO or by employees of another group company in an office in State S. While those activities may be seen as complementary functions that are part of a cohesive business operation for the insurance group taken as a whole, they relate to separate lines of business. We do not think that the verification activities taking place in the office in State S (assuming they are of a preparatory or auxiliary character) should be considered to be part of the cohesive business operation. We would suggest that the “cohesive business operation” should be considered at a local level (for example, taking an individual value chain, such as all the activities relating to the insurance business of the PE in State R) rather than at the overall group level. Alternatively, the example at 30.3 should state more explicitly that the complementary functions need to lead to the conclusion of the same piece of business. It would be helpful to have that clarified to enable taxpayers to comply with what is intended and to avoid different tax authorities adopting different interpretations, which could lead to disputes and, potentially, double taxation.

As ever, we would welcome the opportunity to engage further with you in this area.

Yours sincerely

Nick Lowe
Director of Government Affairs
The Investment Association welcomes the opportunity to comment on the revised discussion draft on BEPS Action 7. We are grateful to the OECD for recognising the particular concerns of the investment management industry.

Commentary on Article 5(4)

Proposed paragraph 22.6 of the Commentary says:

“Where, for example, an investment fund sets up an office in a State solely to collect information on possible investment opportunities in that State, the collecting of information will be a preparatory activity and the office will therefore be deemed not to be a permanent establishment.”

The intent of this paragraph is very helpful. However, in order to reflect the actual business models that operate in fund management we believe that the words ‘or its manager’ should be inserted after the word ‘fund’. It is more usual for an investment manager to have an office for these purposes than the investment fund itself (although a self-managed fund may have such an office too).

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1 The Investment Association (formerly the Investment Management Association) represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of around $5.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles.
**Attribution of profits to PEs and interaction with transfer pricing**

The OECD has acknowledged that there will be a need for additional guidance on Article 7 in order to determine the profits of any PEs and to take into account the work on transfer pricing being undertaken within the BEPS project. We would like to emphasise the importance of this.

Activities of an incorporated group company in one country could give rise to a PE of the parent in another company, even in cases where the group company is attributed an appropriate arm’s length profit for all of the activities and risks in the other country. Therefore the PE gives rise to no increase in tax payable in the other country. The consequence of this would be for cross border groups of incorporate entities to have multiple PEs and filing obligations, without any additional tax being paid.

Para 32.12 of the proposed Commentary clarifies that this problem should not arise on the transfer of goods, where the legal title of the goods passes to the distributor. This is a welcome clarification, but the circumstances described will be more difficult to replicate for the provision of services. We question whether the transfer of legal title should itself be conclusive in determining whether a PE is created where the functions of group companies are clearly reflected and accurately priced in a group’s transfer pricing methodology.

Thank you again for the opportunity to comment on the revised discussion draft. We hope to continue to be able to contribute to the consultation and I am available at your convenience to discuss anything in this letter at jorge.morley-smith@theinvestmentassociation.org or on +44 (0)20 7831 0898.

Yours sincerely

Jorge Morley-Smith  
Director, Head of Tax

cc. Mike Williams   HM Treasury
Ms. Marlies de Ruiter  
Head of Tax Treaties, Transfer Pricing and Financial Transactions Division  
Centre for Tax Policy and Administration  
Organisation for Economic Cooperation and Development  

Accounting & Tax Committee  
Japan Foreign Trade Council, Inc.

Comments on Revised Discussion Draft on  
Action 7 (Preventing the Artificial Avoidance of PE status)  
of the BEPS Action Plan

The following are the comments of the Accounting & Tax Committee of the Japan Foreign Trade Council, Inc. (JFTC) in response to the invitation to public comments by the OECD regarding the “Revised Discussion Draft on Preventing the Artificial Avoidance of PE status”.

The JFTC is a trade-industry association with Japanese trading companies and trading organizations as its core members. One of the main activities of JFTC’s Accounting & Tax Committee is to submit specific policy proposals and requests concerning tax matters. Member companies of the JFTC Accounting & Tax Committee are listed at the end of this document.

General Comments

1. Since disputes between tax authorities and taxpayers frequently occur in various states concerning the interpretation and application of the PE concept, we support the ongoing efforts of the OECD to clarify the definition and scope of PE from the perspective of stability and certainty of taxation. We also appreciate the need to focus on actions aimed at artificial avoidance of PE status.

2. It should be appreciated that the revised discussion draft partly considers opinions from industries and additionally includes some cases in the commentaries. However, there does not seem to be a drastic change from the
initial suggestion of excessively lowering PE threshold. Concern about the increase in qualifications for PE status, which is clearly outside the purpose of the BEPS project, remains.

3. In the revised discussion draft, without a new indication regarding profit attribution to PE, the comments are still at the stage of offering necessary guidance by the end of 2016, which is the due date of negotiations on a multilateral agreement. Under the current situation that a consensus on a methodology of calculating income attributable to PE has not been achieved, foregoing the redefinition of PE may seriously undermine predictability for taxpayers and hold the risk of incurring double taxation. It may also substantially increase the administrative burden on tax authorities and taxpayers.

4. Therefore, first we request a reconfirmation of the purpose of the action plan toward its finalization. Next, we strongly request the formulation of countermeasures after gaining a certain level of international consensus on a methodology of calculating income attributable to PE, bearing in mind that the final proposal that will enable both tax authorities and tax payers to carry out tax practices appropriately and steadily. It is also necessary to avoid placing an excessive administrative burden on both tax authorities and tax payers.

Specific Issues

**OECD Model Convention Article 5-5 (Agent of Dependent Status)**

- On a plain reading of the explanation in the revised discussion draft, even a mere conveyance of contract terms to customers on behalf of a foreign enterprise may be treated as “negotiation”. However, whether or not negotiation was carried on needs to be determined carefully, taking into account all the relevant facts and circumstances. Especially, the second example provided in the revised draft may lead to misunderstandings, because whether the employees of SCO convinced the account holder to accept the standard terms is ambiguous in the assumption.

- Some MNEs centralize at their headquarters the sales functions such as negotiation or conclusion of contracts, in view of effective maintenance of
customer information, efficiency of work, or risk management and risk capability relating to various transactions. There is a case where negotiation with customer and conclusion of contracts are carried on by the headquarters but local subsidiaries support smooth communication with customers located in countries where there are differences of time and language. The local subsidiaries merely perform support activities between headquarters and customers, without carrying on any negotiation. Such cases should be clearly distinguished from the case considered in paragraph 32.6, where PE is constituted due to activities of sales force.

- Considering the above, we would like to request the following clarifications of this paragraph.

| Para.32.6 | The paragraph applies to a person who acts as the sales force of the enterprise and, in doing so, makes or accepts contractual offers even if standard contracts are used for that purpose, provided that based on all the relevant facts and circumstances the person substantially concludes contracts or negotiates the material elements of contracts.

******these employees’ remuneration is partially based on the revenues derived by RCO from the holders of these accounts. As a result of SCO’s activity to obtain contracts on behalf of RCO, when one of these account holders agrees to purchase a given quantity of goods or services promoted by an employee of SCO, the employee indicates the price ******. When concluding that contract online, the account holder is offered a choice of payment options. Whenever queries are raised by the account holders, SCO’s employees reply thereto and try to convince them to follow the standard terms of RCO’s contracts. In this example, SCO’s employees are negotiating the material elements of the contracts that are concluded with RCO. The fact that SCO’s employees cannot vary the terms of the contracts does not mean that there is no negotiation but rather means that the negotiation of the material elements of the contracts is limited to convincing the account holder to accept these standard terms.

However, it should be noted that such an act as SCO’s 209
employees explaining the standard terms of RCO’s contracts does not always indicate the employees negotiating the material elements of contracts, but rather just intermediating the communication between RCO and the account holders. In the above example, suppose RCO’s employees directly promoting its products in State S and SCO’s employees only providing RCO with supporting services such as translation of the contractual documents or maintenance of communication with the clients in accordance with RCO’s instructions. SCO’s employees are not allowed to make any decisions and/or proposals relating to the terms of the contracts and are only requested to convey RCO’s proposal to the clients and report such clients’ responses to RCO. In such a case, it would be reasonable to conclude that SCO does not negotiate any material elements of contracts.

OECD Model Convention Article 5-6(Agent of Independent Status)

- In this revised discussion draft, a new concept is introduced which defines standards for determining a dependent agent. However, the background of introduction of the new concept is not explained appropriately. Judgment based on only a dominant interest without a detailed examination of the actual transaction is irrational. Also, the influences on actual economies by introducing the new concept should be considered carefully.

- The proposed amendment includes the sentence “one has control of the other or both are under the control of the same persons or enterprises” in paragraph 6b of Article 5. We are concerned about abusive interpretation of this sentence as the definition of “control” is not clearly given. In this regard, we would request for a clarification in the Article 5 of the Model Convention as follows, in order to ensure objectivity in testing whether a person is a “connected person”, and having regard to the example shown in paragraph 38.10 where it is explained that the aim of this sentence of the Article is to cover situations where the structure of control is not very simple, including a situation where the beneficial interests in an enterprise are possessed indirectly.
Para.6b

...... In any case, a person shall be considered to be connected to an enterprises 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 directly or indirectly owns at least 50 percent of the beneficial interest in the other.

- Regarding the example for determining independent/dependent agent status based on whether “the sales that an 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”, the determination of the status should not be uniformly assigned based on the sales ratio or other criteria with no regard for the actual situation. For example, whether the agent is using its technologies, knowledge and other factors in taking on risk and receiving compensation should be taken into account for when determining the status.

**OECD Model Convention Article 5-4(Auxiliary and Preparatory Activities)**

- Excessive reassessment of facilities conducting the work in a)~d) of the paragraph, which has not been qualified formerly as PE, should be avoided. Moreover additional examples should be inserted for avoiding a perception gap about “auxiliary and preparatory activities” between tax authorities and tax payers.

- It is rational that the purchase of goods or merchandise by a local office is not of a preparatory or auxiliary character when the overall activity of an enterprise consists of rendering procurement services to other enterprises, as it forms an essential and significant part of the enterprise’s overall activity. However, it is not appropriate to determine that the purchase of goods or merchandise by a local office is always not of a preparatory or auxiliary character when the overall activity of the enterprise consists in selling these goods. Even in case where the overall activity of an enterprise consists in selling goods, procurement may be a mere routine activity e.g. goods are purchased from existing suppliers, whereas much more human resources may be devoted in selling activity to develop potential customers. In this case, it should be concluded that the significance of the procurement activity is relatively low. Therefore, whether the purchase of goods or merchandise forms an essential and significant part of
the enterprise’s overall activity needs to be determined on a case by case basis, after carefully examining all the relevant facts and circumstances including the importance of selling activity or other activities of that enterprise.

- Therefore, we would request for clarifications as follows, as to why the activity in example 1 is not a preparatory or auxiliary character.

| Para.22.5 | The first part of subparagraph d) relates to the case where premises are used solely for the purpose of purchasing goods or merchandise for the enterprise. Since this exception only applies if that activity has a preparatory or auxiliary character, it will typically not apply in the case of a fixed place of business used for the purchase of goods or merchandise where the overall activity of the enterprise consists in selling these goods procurement services for other enterprises. On the other hand, where the overall activity of the enterprise consists in selling these goods, whether the activity of the fixed place of business used for the purchase of goods or merchandise forms an essential and significant part of the overall activity of the enterprise has to be determined having regard to all the relevant facts and circumstances including the significance of selling activity and other activities of that enterprise. 

Example 1: RCO is a company resident of State R that is a service provider rendering procurement service to large buyers of a particular agricultural product produced in State S, which RCO sells from State R to distributors situated in different countries. RCO maintains a purchasing office in State S. The employees who work at that office are experienced and well-paid buyers who visit producers in State S, determine the type/quality of the products according to international standards and enter into different types of contracts (spot or forward) for the acquisition of the products by buyers RCO. In this example, although the only activity performed through the office is the purchasing of products for RCO, which is an activity covered by subparagraph d), paragraph 4 does not apply.
and the office therefore constitutes a permanent establishment because **RCO's overall activity is to procure agricultural product itself and, that purchasing function performed by purchasing office in State S forms an essential and significant part of RCO's overall activity.**

**Proposal 3: New Anti-Fragmentation Rule**

- Cracking down on the artificial avoidance of PE status by applying inappropriately treaty benefits is appreciated. On the contrary, the new rule should be applied only when there is no practical business reason. We request the addition of supplementary commentary to make clear that judgments should be made after due consideration of a company's actual activities and background rather than being based solely on its superficial form.

**Proposal 4: Changes dealing with the Splitting-up of Contracts**

- If the commentary paragraph 18.1 is included, contract periods will be added automatically for determining construction PE. We believe that mechanical addition without considering the actual situation is irrational. An explicit provision should be included in the commentary that stating judgments should be done based on whether there is business purpose or not, and if the reason for splitting-up of contracts isn’t tax avoidance, it should not be subjected to the paragraph 18.1.
Japan Foreign Trade Council, Inc.

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Comments on the Revised Discussion Draft on BEPS Action 7  
(Preventing the Artificial Avoidance of PE Status)

Keidanren hereby submits its comments on the Revised Discussion Draft “BEPS Action 7: Preventing the Artificial Avoidance of PE Status” published by the OECD on May 15, 2015.

1. Introduction

Keidanren supports the OECD’s work to implement Base Erosion and Profit Shifting (BEPS) Action 7, in principle. Our position is based on the perspective of preventing a source country’s tax base from being wrongfully eroded, addressing the digital economy, and ensuring a level playing field for companies, as we stated in our January comment letter.

Furthermore, we appreciate the fact that this Revised Discussion Draft has narrowed down the proposals compared to the October 2014 discussion draft, has reflected Keidanren’s comments to some extent, and has specifically stated in various sections that consideration had been given to taxpayers’ opinions in the narrowing-down process, enhancing transparency in the OECD’s discussion processes.

In terms of specific individual items, though, this Revised Discussion Draft still has many issues that need to be solved. It is true that preventing a source country’s tax base from being wrongfully eroded is important, but the importance does not justify either the scope of permanent establishments (PEs) being set more broadly than is warranted by that end, or PE status being determined based on more substantive criteria. These changes would create an extremely high risk of double taxation. From that perspective, it is of high importance to make the definition and threshold of PEs as objective and clear as possible. In view of this, we present below our comments on the proposed changes to the provisions of the OECD Model Tax Convention and to the Commentary thereon on a subject-by-subject basis.

2. Commissionnaire Arrangements

First of all, the reality is not that all commissionnaire arrangements and similar strategies are put in place to erode the taxable base, as we stated in our January comment letter. Also, even if a commissionnaire were to be regarded as a PE, profits attributable to the PE would presumably be extremely limited. Hence, the reasonable approach is not to expand the PE concept, but to try to resolve the matter in the context
of transfer pricing taxation, including by checking as a first step whether commission income is appropriate compared to the arm’s length price. Of the Options A to D proposed in the October 2014 discussion draft, Option B has been chosen in this Revised Discussion Draft—one that is the least harmful of the four but is not positively agreed upon either. We are strongly concerned about the increasing possibility that transactions unrelated to BEPS may be readily regarded as PEs in the future. From that perspective, we state our opinions below of the proposed changes to the Commentary on paragraph 5 of Article 5 of the OECD Model Tax Convention.

• Paragraph 32.3
Although the paragraph states “if the enterprise is not directly or indirectly affected by the action performed by that person,” it is not clear how the term “indirectly affected” should be construed. We request that the term be clearly defined.

• Paragraph 32.5
As the subject and limit of the phrase “negotiates the material elements of contracts” are unclear, tax administrations may interpret the phrase arbitrarily. The Commentary should clearly state, at least, that the word “negotiates” in the aforementioned phrase does not include an intermediary merely communicating the terms and conditions of the contract or the needs of the customer, head office, or other parties. Additionally, each country should be aware that neither of the following two types of agreements fall under the definition of “concludes contracts” or “negotiates the material elements of contracts”: agreement to enter into negotiations of a contract; and agreement reached as part of the routine process under the master (long-term) contract (e.g., agreement which does not need to be negotiated to change the price as long as it is within the expected price range that has been roughly set in the master contract concerning the long-term supply of the product whose price tends to fluctuate depending on the market prices of the raw materials).

• Paragraph 32.6
The illustrative example given in this paragraph may lead to the misinterpretation that informing the account holder of the standard terms of contracts on behalf of RCO in itself constitutes “negotiate.” Whether having engaged in a negotiation or not needs to be carefully determined taking into account the relevant facts. In the case of the aforementioned example, the determination should be predicated on whether SCO’s employee has convinced the account holder to accept the standard terms of contracts.

• Paragraph 33
The phrase “in a way binding on the enterprise” in the current text of the Commentary should be maintained, from the perspective of preventing undue determination of PE status and limiting the contracts subjected to the determination process.

3. Independent Agents

In principle, independent agent status should be determined based on the nature of the agent, in other words, whether the agent conducts business in which he or she bears risk, based on his or her skills, knowledge, experience, and other assets. We thus basically believe that no amendments should be made to paragraph 6 of Article 5.
We, however, should make comments on amendments to the provisions of paragraph 6, which this Revised Discussion Draft proposes. The new provisions of paragraph 6 read, “Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is connected, that person shall not be considered to be an independent agent . . . with respect to any such enterprise.” As the threshold for connected enterprises, it is proposed that a person should be considered to be connected to an enterprise if one possesses “at least 50 percent” of the beneficial interests, etc., in the other. We request that this threshold be changed to “more than 50 percent” because a 50-50 joint ownership with another entity cannot be regarded as having control over the enterprise in question.

As for the criterion for exclusivity, paragraph 38.7 of the Commentary provides that, when “the sales that an agent concludes for enterprises to which it is not connected represent less than 10 percent of all the sales that it concludes as an agent acting for other enterprises,” the agent should be viewed as acting exclusively or almost exclusively. However, the basis for this criterion is unclear.

4. Preparatory or Auxiliary Activities

We appreciate to some degree the adoption of Option E, rather than Options F and G under which the word “delivery” would be uniformly removed from subparagraphs a) and b) of paragraph 4 of Article 5. Still, care should be taken to ensure that these proposed amendments to the provisions on preparatory or auxiliary activities do not lead to substantial changes in the current treatment of fixed places of business that are used to conduct the activities listed in subparagraphs a) to d) of paragraph 4 of Article 5 and that have hitherto been deemed not to constitute PEs. To that end, we request that the definition of preparatory or auxiliary activities be clarified and augmented by more examples.

- **Paragraphs 21.1, 21.2**

We welcome the guidance on the significance of preparatory or auxiliary activities. Paragraphs 21.1 and 21.2 state that the decisive criterion as to whether activities have a preparatory or auxiliary character is whether the activities constitute "the essential and significant part of the activity of the enterprise as a whole". Under the Option B, it is vital to decide whether the activities are preparatory or auxiliary activities or not, and it is important more than ever before to make a case-by-case basis judgment about what constitutes "the essential and significant part of the activity of the enterprise as a whole" which varies significantly depending on industries. For example, we believe that a warehouse used by a manufacturer for delivering its products to customers does not basically influence the conditions of competition for companies, and thus does not constitute "the essential and significant part of the activity". Additionally, throughout paragraph 21.2, what we consider important is the sentence that reads, “It is unlikely that an activity that requires a significant proportion of the assets or employees of the enterprise could be considered as having an auxiliary character.” This specifically suggests that, when determining whether an activity has an auxiliary character, attention should be paid to the “proportion” the activity accounts for in the enterprise’s assets or employees, rather than simply to the fact that the size of the fixed place of business in question (e.g., a warehouse) is large. We request that the reason for this reference to “proportion” be explained more clearly in paragraph 21.2.
• **Paragraph 22**
The paragraph states, “Whether the activity . . . has a preparatory or auxiliary character will have to be determined in the light of factors that include the size of the facilities used for that purpose and the overall business activity of the enterprise.” However, from the perspective of ensuring consistency with paragraph 21.2, it may be more appropriate to refer to the “proportionate size” of the facilities relative to the asset and employee composition of the entire enterprise, rather than to the “size” of the facilities. When considering the overall business activity of an enterprise, the position of the fixed place of business in question within the enterprise’s entire supply chain needs to be taken into account as well. Moreover, we request that the Commentary add examples of cases that fall under the definition of preparatory or auxiliary activities in relation to subparagraph a) of paragraph 4 of Article 5, with “delivery” in the manufacturing sector in mind. Such examples will be useful in combination with the examples already given concerning cases that do not fall under the definition of preparatory or auxiliary activities in relation to subparagraphs b) and c) of the same paragraph.

• **Paragraph 22.3**
The paragraph provides that, “where . . . that enterprise is allowed unlimited access to a separate part of the warehouse for the purpose of inspecting and maintaining the goods or merchandise stored therein,” a permanent establishment is deemed to exist unless these activities constitute preparatory or auxiliary activities. We request that what “unlimited access” means be explained in more detail.

With regard to the phrase “for the purpose of storage, display or delivery” that has been deleted from the current text of this paragraph, we do not see any particular need to delete the phrase and thus request that it be maintained (and the same be done for paragraph 22 as well).

Moreover, consideration should be given to vendor-managed inventory (VMI) contracts that are unique to the manufacturing sector, as we pointed out in our January comment letter. Under a VMI contract, accommodating a request from the foreign-domiciled client, the enterprise places its own goods or merchandise in a warehouse located within the client’s factory so that the client can process such goods or merchandise there. We reemphasize that no VMI contracts are entered into with the intention of avoiding taxes, that none of such contracts are related to BEPS, and hence that they should not be regarded as PEs. Although the proposed amendments to the Commentary can be construed as meaning that VMI warehouses do not in principle constitute PEs, we request that steps be taken to ensure a consistent approach among countries.

• **Paragraph 22.5**
The paragraph states that “it will typically not apply in the case of a fixed place of business used for the purchase of goods or merchandise where the overall activity of the enterprise consists in selling these goods.” This sentence indicates that purchasing activities do not constitute preparatory or auxiliary activities. However, whether a purchasing function constitutes a PE should be determined on a case-by-case basis, from the standpoint of whether the function forms an essential and significant part of the activity of the enterprise, including whether it bears risk, because even for the companies which sell goods they procure, the important point of business activities may be the development and acquisition of potential customers rather than the procurement
activities in some cases.

5. Anti-fragmentation Rule

There remains a question as to the effectiveness of the new paragraph 4.1 that is proposed to be added to Article 5. This is because it is sufficient for abusive arrangements with no legitimate business reason to be dealt with on a case-by-case basis in the first place. Also, PEs to which this paragraph would apply are expected to have very little profits attributable thereto.

In the event that the matter proceeds as proposed in this Revised Discussion Draft, the term “cohesive business operation” should be more clearly defined or explained through illustrative examples in the Commentary, as the term leaves large room for interpretation. Particular consideration should be paid to enterprise groups operating globally in which, presumably, a group firm is often engaged in a business activity that is connected to that of another group firm but unrelated to BEPS. It is no easy task for such a group to, whenever an arrangement is made, grasp each and every connection between individual business activities and determine whether some of them constitute a cohesive business operation. Another concern is that an activity deemed to have a preparatory or auxiliary character under paragraph 4 of Article 5 may nevertheless be unduly regarded as being linked to a connected enterprise’s activity and be determined to be a PE. That would make determinations under paragraph 4 meaningless. We also fear that temporary activities conducted by an employee seconded to a firm in an emerging country or elsewhere may be regarded as a PE. To prevent these from materializing, the Commentary should contain a clear statement to the effect that paragraph 4.1 applies only to abusive arrangements made for the purpose of tax avoidance.

Additionally, the sentence “it applies equally where an enterprise of one State uses or maintains a fixed place of business in that same State” in the second bullet point of example B in paragraph 30.3 of the Commentary should be deleted, because this would substantially expand the current PE concept.

6. Splitting-Up of Contracts

Viewing different contracts as the splitting of one contract and thereby as an abuse of the tax treaty should be limited to exceptional cases. If each country were to regard contracts differing in their business purposes, responsibilities, parties, and other elements as a series of contracts and levy taxes, the scope of entities regarded as PEs would drastically expand, resulting in the increased risk of double taxation. The types of transactions that do not raise BEPS concerns should continue to be treated in the same way as before.

Many multinational enterprises organize their group companies by function in order to allocate roles within the group and enhance the efficiency of business activities. Take enterprises engaging in the plant construction business, for example. Their installation and construction operations, among others, are often spun off into separate subsidiary companies with the primary aim of assigning personnel optimally according to the
expertise and skills of individual employees and workers. This kind of allocation of roles is necessary and commercially rational. Suppose that the parent company concludes a contract, subcontracts it to the subsidiary companies which install machines and construct buildings, and conducts supervision activity at a construction site. If the activity of the parent company were to be regarded as a connected activity and automatically added to the activities conducted by the subsidiaries, those subsidiaries could constitute PEs, and the efficiency of business management would be spoiled.

In another case, suppose that separate companies (e.g. a parent company and its subsidiary) have respectively been awarded a contract as a result of their individual sales activities. In a case like this in which each of the companies has submitted a bid for a separate contract to begin with, they, as bidders, have no power to negotiate the terms and conditions of the contracts, and thus clearly have no intention of avoiding taxes. It is not appropriate to consider whether their activities fall within the definition of “connected activities” in this situation.

Paragraph 18.2 therefore needs to explicitly state that a determination of connected activities should be predicated on the intention of abusing the tax treaty from the beginning. Additionally, we have a concern that the phrase "the nature of the work involved under the different contracts" is vague and would be interpreted broadly without paying due attention to the different kind of activities conducted by each connected person. The factor "whether the nature of the work involved under the different contracts is the same or similar" should be replaced by "whether associated enterprises perform similar activities."

7. Attribution of Profits Issues

The number of countries adopting the authorized OECD approach has not increased to date. If, under such circumstances, the OECD proceeds with its work on the redefinition of the PE concept alone, the risk of double taxation will increase. We understand that follow-up work on attribution of profits issues will be carried on after September of this year for the purpose of providing the necessary guidance before the end of 2016, the deadline for the negotiation of the multilateral instrument. That work must culminate in the development of uniform guidelines that will apply to all the countries participating in the BEPS Project.

The final recommendations for BEPS Action 7 are scheduled to be issued this September. Needless to say, the current practices in determining PE status must not be changed in any way until the multilateral instrument is implemented or a bilateral tax treaty is concluded or revised by the relevant countries. It is our strong hope that effective dispute resolution mechanisms will be presented that will be instrumental in avoiding double taxation arising from the determination of PE status.

Sincerely,

Subcommittee on Taxation
KEIDANREN
KPMG International (“KPMG”) appreciates the opportunity to present our collective feedback to the Organisation for Economic Co-operation and Development (“OECD”) on the Revised Discussion Draft on “Preventing the Artificial Avoidance of PE Status” (the “Revised Discussion Draft”).

As a general matter, we commend Working Party 1 on the substantial progress made in the Revised Discussion Draft and appreciate the serious consideration the Working Party gave to the comments it received on the original Discussion Draft. We are providing the following comments for consideration to be included in the final report on Action 7 to be delivered in September 2015.

1. Proposed Paragraph 5 (Dependent Agents)

The selection of option B as the proposed amendment to paragraph 5 is generally welcomed, particularly with the clarification in the Proposed Commentary (¶32.12) that the provision is not intended to apply to low risk distributors. However, we believe that paragraph 5 and the related Commentary could be amended and expanded in certain respects to clarify the scope of the provision.

First, paragraph 5 should be amended to make it clear that the word “habitually” modifies both “concludes contracts” and “negotiates the material elements of contracts”. Currently paragraph 5 is drafted 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 and, in doing so, habitually concludes contracts, or negotiates the material elements of contracts ….(emphasis added).
Under current paragraph 5, it is not clear that the word “habitually” modifies both “conclude contracts” and “negotiates the material elements of contracts”, primarily due to the comma between the words “contracts” and “or”. But Proposed Commentary ¶32, as amended by the Revised Discussion Draft, states that “paragraph 5 proceeds on the basis that only persons habitually concluding contracts or habitually negotiating the material elements of contracts that are in the name of the enterprise or that are to be performed by the enterprise can lead to a permanent establishment for the enterprise” (emphasis added).

Thus, paragraph 5 should be amended as below to eliminate the comma between the words “contract” and “or” so as to make it clear that the activities of a person negotiating the material elements of contracts on behalf of an enterprise might result in a PE only if the negotiation occurs on a regular basis.

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 and, in doing so, habitually concludes contracts or negotiates the material elements of contracts….(emphasis added).

Second, Proposed Commentary ¶32.6 interprets the phrase “concludes contracts or negotiates the material elements of contracts” to include situations in which a person in the State engages in activities that “are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise”. The Commentary then notes that paragraph 5 applies to “a person who acts as the sales force of an enterprise and, in doing so, makes or accepts contractual offers even if standard contracts are used for that purpose.”

This principle is illustrated with two examples. The first example describes a person that solicits and receives (but does not formally finalize) orders that are sent directly to a warehouse for fulfillment and that are routinely approved by the enterprise.

The second example describes a situation in which the employees of a resident subsidiary corporation (“SCO”) “promote” the products and services of its parent (“RCO”), are responsible for large accounts in State S, explain the standard terms of RCO’s contracts (including the fixed price structure used by RCO, which the employees are not authorized to modify), and direct prospective customers to place orders online with RCO.
We believe that the use of the term “promote” in the second example might be misinterpreted to apply whenever a multinational enterprise maintains a resident customer service organization, as such organizations are always intended to improve the customers’ experience and impression of the enterprise’s products and services. We recommend that the example be deleted because (i) the promotion of products and services, as it is referred to in the example, could be misinterpreted to encompass a number of different activities other than sales solicitation, (ii) the fact that the employees’ compensation in the example is determined partially on RCO’s revenues is not sufficient to establish that the employees are in fact soliciting orders, and (iii) in the example, the employees of SCO seem to conduct very limited solicitation activities in the source state.

If the example is retained, then it should be amended to state explicitly that the SCO employees are actively soliciting orders, rather than merely implying that they are doing so based on the fact that they are remunerated based partially on RCO’s revenues. In that case, we also recommend that the examples illustrating when a PE may be asserted be balanced with an example illustrating when the activities of a local customer service organization would not give rise to a PE. For example, if RCO were to regularly modify the key elements of the terms or to reject some of the orders, the example should indicate that a dependent agent PE does not exist.

Furthermore, the additional examples should clarify that where it can be demonstrated that the executives and staff of RCO clearly made the principal contribution towards “convincing” the local customer to buy, with the SCO staff assisting merely in a liaison and facilitative capacity, then a dependent agent PE should not be deemed to exist. For example, the Commentary might add an example in which the technical staff of RCO have been working closely with the technical division of the potential customer to tailor a product or project to the customer’s specifications. Another example might involve a situation in which the top executives of a prospective customer make the customer’s significant purchase decisions. In such a case, if RCO executive staff conduct the significant meetings with these customer executives, and the SCO staff merely liaise with the prospective customer’s local staff, a dependent agent PE should not exist.

A third issue raised by the adoption of Option B is the intended scope of the provision as it applies to contracts for the delivery of services. Presumably, the provision is not intended to apply whenever a resident of a State enters into a service contract and subcontracts the performance of a portion of a contract to a nonresident enterprise. In such a case, the nonresident enterprise could, of course, create a PE through its operations within the State, but it should not be considered to have a PE merely because it has subcontracted to render some of the services that the resident entity is committed to provide. The Commentary
should be expanded to clarify the intended reach of subparagraph c), preferably with examples illustrating when the subparagraph would and would not apply.

2. Proposed Paragraph 6 (Independent Agents)

Proposed Paragraph 6 b) would add a new concept of “connected enterprises.” This concept would be relevant not only to the independent agent exception in paragraph 6, but also to the new anti-fragmentation rule in proposed paragraph 4.1 and, via proposed changes in the Commentary on the principal purpose test (“PPT”) proposed in the Report on Action 6, to the possible aggregation of activities for purposes of the application of paragraph 3 of Article 5. In general, under the first sentence of proposed paragraph 6 b), whether a person would be considered “connected” to an enterprise would be determined under a 50 per cent or more test. However, the second sentence of proposed paragraph 6 b) would broaden the concept by providing that in any event a person should be considered connected to an enterprise 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.”

We recommend that the second sentence in proposed paragraph 6 b) be deleted. The sentence injects uncertainty into the definition of “connected” that is unnecessary given the application of the concept of “connected enterprises.” Moreover, this broader definition of “connected enterprises” will be very difficult to apply in the context of the anti-fragmentation rules described below, as the information needed to make the required determination might not be available to the so-called connected enterprise. As such, if a broader definition of connected enterprises is needed to cover a relationship between enterprises that might not meet the 50 per cent control test, but nevertheless still should be described as “connected enterprises” under the relevant circumstances, then the second sentence could be modified to provide that “In any case, a person shall be connected to an enterprise, if one of the principal purposes of the nature of the legal relationship between that person and the enterprise is to avoid the characterization of that person as connected to that enterprise” (i.e. a PPT test).

3. Proposed Paragraph 4 (Specified Activity Exceptions)

The proposal to subject all of the specified activities described in paragraphs 4 a) through d) of the Model Treaty to the condition that they be preparatory or auxiliary would significantly undermine the benefits taxpayers and tax administrations have enjoyed from the current version of paragraph 4. Moreover, the proposal would cause the language in
paragraph 4 a) through d) to be superfluous, as a taxpayer would gain the protection of the paragraph with respect to the activities specifically described in those paragraphs if, but only if, those specifically described activities were determined to be preparatory or auxiliary.

We continue to believe that the current version of paragraph 4 should be retained. However, if the Working Party decides to adopt the current proposal, it should clarify in the Commentary that subparagraphs a) through d) are not merely surplus language, but rather describe activities that in many circumstances would be considered to be preparatory or auxiliary. Thus, for example, the proposed new language in Commentary ¶23 stating that “the examples listed in subparagraphs a) through d) being merely common examples of activities that are covered by the paragraph when they have a preparatory or auxiliary character” (emphasis added) should be deleted and replaced with language providing that the activities listed in subparagraphs a) though d) are activities that are often preparatory or auxiliary in nature. Similarly, the example contained in Proposed Commentary ¶22 (concerning an electronic retailer’s maintenance of a very large warehouse with a significant number of employees) should be balanced with an example illustrating the continued application of subparagraphs a) through d).

4. Proposed Paragraph 4.1 (Anti-Fragmentation Rule)

The Revised Discussion Draft proposes new paragraph 4.1, which would permit a State to aggregate the activities conducted by two connected enterprises, or by a single enterprise at two places, that constitute complementary functions of a cohesive business enterprise in determining whether the activities exceed the preparatory or auxiliary threshold.

We believe that this approach suffers from serious deficiencies. It ignores the separate entity principle, which promotes the responsible compliance of tax reporting obligations by taxpayers, the predictable administration of taxing authority by the Contracting States, and the proper application of the arm’s length principle by both taxpayers and tax administrations. In effect, this proposal would seem potentially to expose every affiliate of a resident operating enterprise in a State to taxation on its activities in the State, no matter how minor those activities might be, as long as they are part of a “cohesive business operation” with the resident enterprise’s operations. One consequence might be, for example, to cause taxpayers to file many “protective” tax returns in a State for nonresident group members, each showing no tax liability, merely to protect against penalties for failures to file returns or an unlimited statute of limitations. The resulting administrative
burden on taxpayers and tax authorities is not justified by the policy concern raised by the potential fragmentation of activities.

A more measured approach to this issue, in our view, would be to subject the application of paragraph 4 to the same application of the PPT proposed in response to the splitting of contracts under paragraph 3 (in which case paragraph 4.1 would be deleted and replaced with an example in the Commentary on the PPT rule).

If paragraph 4.1 is retained, we believe that it should be modified to clarify that the activities of nonresident enterprises should not be aggregated with those of a connected resident enterprise. In such a case, unless the connected resident enterprise is acting as a dependent agent described in paragraph 5, its activities should not cause nonresident connected parties to have a PE.

If paragraph 4.1 is retained and not modified as above, then we recommend that an example in the Commentary make clear that a nonresident enterprise will not have a PE based on the activities of a connected resident enterprise if the nonresident enterprise does not undertake any activities in that State whatsoever, but merely receives some form of benefit as a result of the activities of the connected resident enterprise (e.g., is a service recipient of the connected resident enterprise).

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About KPMG
KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 155 countries and have more than 162,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.
Dear Ms de Ruiter

BEPS Action 7: Preventing the Artificial Avoidance of PE Status

Matheson welcomes the opportunity to comment on the revised discussion draft issued under BEPS Action 7 (the "Revised Discussion Draft").

Matheson is an Irish law firm and our primary focus is on serving the Irish legal and tax needs of Irish and international companies and financial institutions doing business in Ireland. Our clients include over half of the Fortune 100 companies. We also advise seven of the top ten global technology companies and over half of the world’s 50 largest banks. We are headquartered in Dublin and also have offices in London, New York and Palo Alto. More than 600 people work across our four offices, including 75 partners and tax principals and over 350 legal and tax professionals.

Comments made in this letter are made solely on our own behalf. As requested, we have endeavoured to keep our comments as short as possible.

1 General comments

1.1 No change until work on allocation of profits is completed

We agree that the changes to the definition of what constitutes a permanent establishment ("PE") will require additional guidance on how profits should be attributed to the new types of PE, in particular for PEs that will be recognised as a result of the changes proposed to paragraph 4. It would be unwise to introduce changes to the PE concept without additional guidance on how taxpayers should allocate profit to those PEs. Such an approach will inevitably result in unnecessary and protracted disputes with tax authorities and likely double taxation. We suggest that the proposed changes to Article 5 are not included in the
Model Tax Convention or the Multilateral Instrument until after the work on attribution of profits is completed.

1.2 Increased multilateral tax controversy should be addressed under Action 7

The widening of the PE concept will likely result in more taxpayers with a number of PEs in different jurisdictions. Currently, profit allocation to PEs is determined on a bilateral basis. It is likely that this will prove inadequate in circumstances where a taxpayer has PEs in different jurisdictions and faces challenges from different revenue authorities in respect of profit allocations. A series of bilateral resolution mechanisms will likely be insufficient (and will certainly be inefficient) in a multilateral dispute. This is a matter that should be addressed as part of work under Action 7.

2 Changes to paragraphs 5 and 6 of Article 5

2.1 Additional commentary on “negotiates the material elements of contracts” required

As noted in our comments on the October 2014 discussion draft, the changes to the definition of what constitutes a PE will create much uncertainty for taxpayers doing business outside their own jurisdiction. Accordingly, the proposed inclusion in paragraph 5 of a person who “habitually concludes contracts, or negotiates the material elements of contracts” requires detailed commentary. We would also welcome the inclusion of more examples on this point in the draft commentary, including examples focussed on the financial services sector.

2.2 Third party agents act exclusively in a broad range of circumstances

We disagree with the sentiment in paragraph 38.6 of the draft commentary that independent status is less likely where a person acts as exclusive agent. Genuine third party agents often act exclusively in a jurisdiction on behalf of a non-resident principal for genuine commercial reasons. In certain sectors, the industry norm is to appoint only agents who agree to act exclusively. In other cases, although acting exclusively is not a term of the agent’s appointment, due to the level of activity undertaken by the agent on behalf of the third party principal, the agent cannot act for any other clients. Paragraph 38.6 of the draft commentary should be amended to reflect this.

3 Anti-fragmentation rules

It is not clear what amounts to “complementary functions that are part of a cohesive business operation”. Commentary (in addition to the examples) should be provided in this respect. The language is quite subjective and could be interpreted broadly by tax authorities considering the activities of multinational organisations with a number of different business lines operating under the same brand and in the same business sector. An example should be included that specifically confirms that where different (but connected) taxpayers in a multinational group operate separate business lines, the fact that they share a brand and are part of the same multinational group should not of itself result in functions being considered “complementary functions that are part of the same cohesive group”.

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Should you wish to discuss any of the comments raised, please let us know.

Yours faithfully

Sent by email, bears no signature

MATHESON
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New York, 11 June 2015

Comments on the Revised Discussion Draft on Action 7 of the BEPS Action Plan on Preventing the
Artificial Avoidance of the Permanent Establishment (the ‘PE’) Status

Dear Ms De Ruiter,
Dear Marlies,

Thank you very much for the opportunity to provide comments on the Revised Discussion Draft on
Action 7 of the BEPS Action Plan (the ‘Discussion Draft’) which was released by the OECD for public
(‘Mazars’) are impressed by all the progress that the OECD has made to date and we are very
pleased to provide our input on the Revised Discussion Draft.

Mazars welcomes the results of the work performed by the OECD with respect to issues related to
the artificial avoidance of PE status, including the proposals for changes to the definition of
permanent establishment found in the OECD Model Tax Convention.

Our specific comments on the Discussion Draft are provided below:

A. Artificial avoidance of PE status through commissionaire arrangements and similar
strategies

Mazars encourages a more detailed review of the implications of the proposed amendments,
especially as there are significant discrepancies in the commissionaire concept between
jurisdictions (for instance Europe versus China). The application of a broad definition could result in
a(n) (unintended) collateral impact on various other commissionaire structures and similar
arrangements, as there is a wide scope of these structures in the market. Furthermore, we note
that, albeit we agree that in many cases commissionaire structures and similar arrangements may
have been put in place primarily in order to erode the taxable base of the state where the sales
took place, the statement recorded under item 13 has not been supported by evidence.

In paragraph 19, it is noted that a multitude of PEs could be created as a result of the proposed
options. It may be considered to work on the concept of so-called ‘sub PEs’ in order to provide

Mazars Global Business Unit Tax
clarification on the question whether a permanent establishment could have its own permanent establishment.

In the academic literature, a theoretical outline has been made between a hierarchy approach (super-ordinated head PE and a sub PE) and a non-hierarchy approach (a PE in each state). For the offshore sector, the hierarchy approach could — within the European Union — create possible benefits, for instance if and when a foreign head office in one state has a physical PE (article 5 paragraph 1) in another state where all the equipment and personnel is located, whilst via this PE in a third state ‘drilling and casing activities’ are performed.

In Proposal 1 (item 23), under article 5, paragraph 6, subsection b, a definition of “connected” has been recorded. It may be worthwhile to create a link with article 9 of the OECD Model Convention. Moreover, also the wording ‘beneficial equity interest’ has been introduced. In our view, this leads to confusion as this may be interpreted to imply that a beneficial ownership test is introduced in article 5 of the OECD Model Tax Convention. Moreover, we have seen the term ‘beneficial owner’ and ‘equity interest’, but not the term ‘beneficial equity interest’. We would welcome further clarifications and guidance in this respect. In paragraph 32.1, some conditions for applying article 5 are proposed. It may be sensible to considering a more holistic overview and to combine the comments made to the Comments on the Discussion Draft on Action 10 of the BEPS Action Plan on the Transfer Pricing Aspects of Cross-border Commodity Transactions to this Revised Discussion Draft with these comments. For ease of reference, we refer to the Mazars comments made on 4 February 2015. Furthermore, the word ‘authority’ has been deleted in the context of concluding contracts on behalf of the enterprise. As the binding by contracts remains relevant, some clarification is appreciated to avoid a permanent establishment being recognised through unauthorized negotiations of contracts (e.g. when an employee engages in negotiations without consent of the enterprise).

Mazars supports the decision on “Option B” as the best approach in determining whether a PE exists. However, as written, we do have a concern that terms are too subjective and could lead countries to different determinations, particularly as to when a contract is negotiated. Particularly troubling are paragraphs 32.5 and 32.6 of the proposed change to Article 5.

Paragraph 32.5 reaches the conclusion that if the “key ingredients of the contractual relationship have been determined in the relevant State (it) is sufficient to treat these contracts in the same way as if they had been formally concluded in that State.”

Subsequently, paragraph 32.6 indicates that the acceptance of a standard contract, in relation to which no negotiation of terms has been conducted in the local State, would be sufficient to be concluded in that State. This seems to indicate that all solicitation would result in a PE unless there is substantial negotiation outside the state. The example goes on to provide that even where the local employees have no ability to vary the terms, they will be considered to have negotiated the contract simply because they encouraged the buyer to accept the terms. This would cause virtually all sales forces to be deemed to be a PE and this is in our view a radical departure from the accepted practice and definition of a PE. In this respect, we stress that the current commentary to Article 5 indicates that even when “a person has attended or even participated in negotiations in a
State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has exercised in that State an authority to conclude contracts in the name of the enterprise.”

If the purpose of these paragraphs is to impact on commissaire arrangement as is specified in paragraph 32.8, it would be preferable that this is spelled out in the earlier paragraphs. While the situation of a “low-risk” distributor is excepted from this rule in paragraph 32.12, we have a concern that this could be viewed by individual countries as similar to a commissaire, or that it could have profits attributable to it in excess of the return a low risk distributor might otherwise have.

B. Artificial avoidance of PE status through the specific activity exemptions

We welcome the fact that the Working Group has provided some examples – albeit more would be encouraged – and extended the commentary. We are pleased to understand that each of the exemptions recorded in article 5 paragraph 4 would be restricted to activities that are otherwise of a “preparatory or auxiliary” character. This would reduce the administrative and compliance burdens for companies and authorities.

Mazars is concerned that specific activity exemption examples, while very detailed, are still going to be interpreted very subjectively. For example the warehouse exemption for the use of facilities for the purpose of storage, display or delivery of goods is now restricted to apply only if the activity is of a preparatory or auxiliary character. The examples in paragraph 22 emphasize the size of the facility as being a disqualifying factor to therefore create a PE. While the example goes on to state that the warehouse also employs a significant number of employees involved in the delivery of goods, which in our view does create a PE, we would want the commentary to clarify that the size of the warehouse alone does not create a PE, while it is clear that the other services mentioned could in fact create a PE.

Compare the unequivocal statement in paragraph 22.3 relating to the maintenance of a stock of goods or merchandise. Including a similar statement in paragraph 22 relating to Subparagraph a) would clarify the exception and provide business with the certainty that they can rely on for conducting their activities.

C. Splitting-up of contracts

For contractors and subcontractors working on the continental shelf, engaged in activities connected with the exploration and exploitation of the continental shelf or construction, installation and offshore companies in general, it is quite common to establish joint ventures, also to combine the expertise of specialized companies and minimizing the risk in large projects. These joint ventures are commercially driven.

In order to reduce the uncertainty, Mazars encourages further work on guidance on the definitions ‘group’ and ‘control’. The current wording of the Principal Purpose Test would not help these companies when working with more than one joint venture party. Moreover, we are of the view that the current wording may leave too much room for discussions: tax-motivated differs from principal motive or one of the principal motives to tax evasion, tax avoidance or abuse (and the latter results in uncertainty as well).
Under paragraph 47, the proposed wording is welcomed and provides for more guidance.

D. Insurance

D.1 - General Comment

Mazars welcomes the fact that Option N was chosen and that there will be no specific rule for insurance enterprises in article 5. However, as the documents suggest that issues with insurance will be tackled through the changes to article 5 paragraph 5 and 5 paragraph 6 we have commented below where we think that there are issues for the insurance industry in those proposals.

However, we still are of the view that the provisions are widely drafted, difficult to apply in practice and invite variation in interpretations by tax authorities. As Section D states that insurance will be dealt with through the wider changes, we are of the view that it would be helpful if the commentary considered insurance specifically.

D.2 – Insurance Sector comment on artificial avoidance of PE status through commissionaire arrangements and similar strategies

We also welcome the choice of Option B here, it is without doubt the preferred option of the insurance industry generally. However, it does still provide a number of issues which we have outlined below. We have not though repeated the comments on Option B from our initial response to the first paper and have therefore concentrated on the changes to the commentary.

Clearly the addition of the “negotiates material elements” widens the potential scope of article 5 paragraph 5, and some comfort can be taken from paragraph 33 where it states that participating in negotiations in a State will not be sufficient in itself to conclude that the person has negotiated material elements of contracts. However the example given at 32.6 appears to widen the scope of this wording far further than an ordinary reading of the words would suggest. Other responses to the initial consultations suggested more precise wording, for example using terms rather than elements. We think this would still be helpful.

Although the example is not based on an insurer, as we know that the changes are intended to tackle a perceived issue with insurance we must draw a comparison with how insurance is sold across borders in certain scenarios. In particular if we consider an insurer based in one territory, where it holds all of the KERT functions associated with being able to write the business as well the capital and is regulated there, but has some form of marketing or support in another country in which sales are made. In this sort of scenario usually decision about pricing, and eligibility criteria, would be made in the insurers home country where the KERT is located and you would not expect a PE to be created in any different sales territory. However, paragraph 32.6 states that even though the employees cannot vary the terms of the contracts, it does not mean that there has been no negotiation, but that the negotiation of the material elements of the contracts is limited to convincing the customer to accept these standard terms. This seems to go far beyond the words of the proposed change to article 5 paragraph 5, as there is really no negotiation of the terms of a contract if the terms are fixed.
We would welcome further comment on this area for the insurance industry. Our original response
gave the view that there would be little or no profit to attribute to any new PEs created by the
revised rules for insurers and we think that still to be true. It seems that this view has been
recognised in the revised paper, but that being the case it would be helpful to have it confirmed in
the Commentary. This is particularly the case as there are jurisdictions which are known to be
looking to tax the arrangement outlined above and may look to take action using the amended
article 5 paragraph 5 to tax insurance profits which don’t belong outside of the originating
jurisdiction of the insurer which would lead to the creation of double tax and increase the number
of cross-border disputes.

The exception of article 5 paragraph 6 only applies where a person acts on behalf of an enterprise in
the course of carrying on a business as an independent agent. Paragraph 37 states that it may be
difficult to determine whether an individual is serving the enterprise as an employee or as an
independent agent and stipulates that the Commentary on article 15 OECD (Income from
employment) will be relevant for that purposes. We would recommend clear guidance on how
person should be interpreted. For example, if a Delegated Underwriting Authorities (DUA) is given
to major independent broker, it may well be that one individual of that broker is focused on
sourcing business on an insurer’s behalf and may have binding authority. A sensible interpretation
of a person operating exclusively on an insurer’s behalf should not trigger a dependent agent PE in
theses circumstances. We would welcome further guidance on this area for the insurance industry.

We are of the view that the second sentence of paragraph 38.6 “That last sentence does not mean,
however, that paragraph 6 will automatically where a person acts for one or more enterprises to
which that person is not connected” is in contradiction to the last sentence of article 5 paragraph
6a, therefore, we would welcome further guidance on this area, particularly for the situation
outlined in the paragraph above where the DUA would likely be unconnected to the insurer. Our
reading of the revised wording at article 5 paragraph 6 would not include unconnected persons, but
the commentary appears to look to bring that possibility back into consideration.

We also welcome the modification of the October 2014 proposals on the independent agent
exemption for unrelated principals, however, we are concerned about the clarity of the explanation
of an independent agent as described in the Commentary. Based on current Commentary the
relevant facts and circumstances need to be investigated for determining whether the person’s
activities constitute the carrying on of a business as an independent agent. In our view the test to
apply are far from clear and therefore, we would welcome further guidance on this area for the
insurance industry, particularly as the general changes are intended to tackle perceived abuses in
the insurance industry.

In our view, guidance is recommended to define clearly what “almost exclusively” means in the
context of article 5 paragraph 6-a. The example mentioned in Paragraph 38.7 is welcomed, but
more examples or clarity is necessary for the insurance industry. Otherwise there is a potential risk
that tax authorities may interpret “almost exclusively” differently, which may lead to disputes and
potential double taxation. Especially if – as described in our initial response to the first paper – an
insurer has multiple DUA in place with unrelated third parties.
Furthermore, the words “acts exclusively or almost exclusively on behalf of one or more enterprises to which it is connected” could be interpreted as meaning that related companies that perform routine (non-KERT) functions could create a PE. In our view, this is not in line with the policy problem that BEPS Action 7 is addressing: “...the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions.” This would likely create unintended consequences, and does not appear to be in line with OECD’s own report on attributing profits to permanent establishments in the insurance industry. Whilst it may be included to stop structures in other industries from getting around any new rules, it is clearly not realistic to suggest that an insurer could look to put in place a structure to artificially avoid a PE through activities considered to be non-KERT.

On behalf of the global network of Mazars Member Firms, we submit our response to the Revised Discussion Draft on Action 7 of the BEPS Action Plan on Preventing the Artificial Avoidance of the Permanent Establishment Status. For any clarification of this response, please contact the undersigned.

Yours sincerely,

[Signature]

Ton Tuinier
Global Tax Leader at Mazars Group
Chairman of the Board at Mazars Netherlands
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[Signature]

Dick van Sprundel
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Marlies de Ruiter  
Head of Tax Treaties,  
Transfer Pricing and Financial Transactions Division  
OECD  
Centre for Tax Policy and Administration

June 12th, 2015

Comments on the revised draft action 7: Permanent Establishment

Dear Marlies,

MEDEF is pleased to provide comments on the Revised Discussion Draft “Preventing the Artificial Avoidance of PE Status” issued on the 15th May (hereafter “the draft”).

We welcome the efforts made in terms of clarity by giving definitions (e.g. connected enterprises, material elements of the contract, preparatory or auxiliary activity) and providing more guidance through examples.

However, we believe that the PE concept is enlarged while BEPS situations and abuses are not sufficiently targeted in the revised draft. The foreseeable consequence will be an increase of the number of PEs: as we already mentioned, some emerging countries are currently more and more aggressive concerning the possible existence of PEs. They already have a high propensity for creating PE where it is not justified. This project may give them more legitimacy to do so.

It is worrisome to note that in the meantime, no mandatory dispute resolution is offered by the BEPS Action Plan to taxpayers.

We are also disappointed by the fact that the revised draft will create more complexity as business will be compelled to implement new and cost-consuming tools to avoid undue qualification of activities that are not PEs.
As far as fragmentation of activities and splitting-up of contracts are concerned, we strongly regret that nothing is provided to exclude situations where fragmentation results from sound business organisation. In this regard, example A as well as example B (on fragmentation) do not provide for an appropriate solution when related entities, that are not active on the same segment of the value chain, intervene at different steps and with great autonomy, on a project that runs for several years.

We also regret that subjectivity has been maintained in the revised draft. By leaving the decision to tax authorities whether “it is reasonable to conclude” or not if there is an abuse (splitting-up), legal uncertainty remains. Moreover, nothing is said on the risk of dispute between two tax administrations -one considering there is a PE and not the other. Consequences of their disagreement should not be borne by the taxpayer.

Safe harbour clause: We believe it very useful to provide examples for both fragmentation and splitting-up on situations that are not abusive. For example, if a lengthy -several months interruption exists between the interventions of two connected entities or if the contractualisation of the second intervention happens after the performance of the first is carried out or if fragmentation or splitting-up is the involuntary result of a third party’s decision, there should be a presumption of no abuse.

Finally, concerning profits attribution to PE we understand the approach of providing further guidance via other Actions of the Plan (especially 8/10). However, it is mostly important that clarification is given especially as attribution might give rise, in many situations, to retroactive adjustments. In this respect, we urge the OECD not to implement Action 7 before clear guidance is given on at least the method that will be used (to assess the PEs contribution to the contract, the margin attributable to the PE and to retroactively allocate the profit to the PE etc...).

We hope our contribution will give you a clearer insight into our expectations.

Yours Sincerely,

Vanessa de Saint-Blanquat
June 12, 2015

Organisation for Economic Cooperation and Development
Centre for Tax Policy and Administration
Attn. Marlies de Ruiter
Head, Tax Treaties, Transfer Pricing, and Financial Transactions Division
2, Rue André Pascal
75775 Paris, France

Re: Comments on Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status

Dear Ms. de Ruiter:

The National Foreign Trade Council (the “NFTC”) is pleased to provide written comments on the revised Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status, published May 15, 2015.

The NFTC, organized in 1914, is an association of some 250 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. Our members value the work of the OECD in establishing international tax and transfer pricing norms that provide certainty to enterprises conducting cross-border operations, and we appreciate the opportunity to comment on this important project. A list of the companies comprising the NFTC’s Board of Directors is attached as an Appendix.

This letter is divided into two parts. The first part provides general comments and observations regarding the main elements of the Discussion Draft. The second part addresses the options identified by the Discussion Draft.

General Comments

The NFTC supports the efforts of the OECD to maintain a Model Tax Convention that reflects international tax norms. Among those norms are reciprocal and mutually beneficial limitations on source country taxation designed to facilitate and promote international trade and investment. The permanent establishment standard is a critical element to this goal, by providing that a source country may not tax an enterprise of the other country on its business profits unless that enterprise meets a minimum threshold of business presence in the source country. To serve its purpose, the permanent establishment standard should require significant business presence by the foreign enterprise in the source country and the threshold of business activity that gives rise to a permanent establishment should be clear.
The consequences of a low or less than clear permanent establishment standard are manifold. Foreign enterprises would face uncertainty over whether their operations give rise to a taxable presence in the source country, with attendant reporting and other obligations. Employees of foreign enterprises would face the risk of source country taxation of their wages, with attendant reporting and other obligations, to the extent such wages were borne by the permanent establishment and without regard to time spent in the source country. Such changes inevitably would lead to a proliferation of actual or asserted permanent establishments, particularly in the initial years following the implementation. Tax authorities and businesses would be required to apply the rules for attributing business profits, which are complex and untested, to these marginal permanent establishments in novel contexts and without guidance. Tax disputes between countries would multiply, with no adequate mechanism to resolve them.

Indeed, one OECD country has already given notice that it will change its definition of permanent establishment to include a “significant digital presence” and the proposed document states that “[e]conomic activity that is performed through the Internet necessitates the implementation of existing rules in a way that is consistent with the different character of the economic activity and leads to the implementation of tax principles in respect of the digital economy as well.”

The NFTC urges the OECD to consider an equitable approach that better balances the historical objectives of the permanent establishment standard with the concerns identified by the revised Discussion Draft. We urge governments participating in the OECD BEPS project to withhold changes in their definition of permanent establishment until final recommendations are approved by the G-20. Our concerns with the specific proposals of the revised Discussion Draft are discussed below.

Specific Comments

Commissionnaire Arrangements and Similar Strategies

The OECD policy basis for the change to the OECD Model Treaty is that where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise should be considered to have sufficient taxable nexus in that country unless the intermediary is performing these activities in the course of an independent business. The new test set out in the revised Discussion Draft applies where an agent acting on behalf of an enterprise habitually “concludes contracts, or negotiates the material elements of contracts” that are in the name of that enterprise, or that broadly relate to property of that enterprise or which are for the provision of services by that enterprise.

The summary to the revised Discussion Draft notes the strong objections that were raised to the October 2014 Discussion Draft on the proposed narrowing of the independent agent exception, but the revised Draft nevertheless decided to proceed with the Option B proposal with some modifications. The proposal retains the current standard under which the exemption applies if the relevant agent carries on business as an independent agent and acts for the foreign principal in the ordinary course of business. The revised Draft adds that where an agent acts exclusively or almost exclusively for one or more enterprises to which it is connected, the agent shall not be
considered to be an independent agent for the purpose of the exemption. The new test also includes a connected parties concept based on vote and value of a company’s shares or de facto control. The independent agent test should generally and as a matter of principle be directed at whether the agent is in any particular case carrying on the business of the principal or whether the business of the agent has merged with that of the principal. Instead, we recommend that the focus should be on the nature of the agent’s activities, not the relationship between the agent and the principal (i.e. whether or not connected). The revised Discussion Draft seems to recognize this point, but for reasons that are not explained, the Draft retains the absolute bar on the ability of an agent to act in the capacity of an independent agent where it acts exclusively or almost exclusively on behalf of connected parties. We believe that this discrimination against connected parties is hard to justify.

The NFTC remains concerned with the level of clarity in the explanation of what it is to be an independent agent. As the revised Discussion Draft is currently written, there is a great deal of emphasis on looking at the relevant facts and circumstances in any particular case, yet the tests to apply in any such case are far from clear. The tests in the revised Draft seem more uncertain and subjective than in the October 2014 Draft. In relation to the revised connected party test, the benefits of that test seem diluted by the inclusion of the more subjective test of control which is based on “all relevant facts and circumstances.”

The revised Discussion Draft includes proposed new text to change the relevant sections of the OECD Model on the dependent and independent agent tests. It clarifies the new concepts of “negotiates the material elements of contracts.” We believe that more clarifications are still necessary. For example, what does it mean to “negotiate” a contract? What is the range of “material elements” of a contract? What are the range of activities that will constitute “accepting a contract?” Does the interaction of on-line or physical activities of agents determine where the line is drawn? What elements are material in this context? What if some material elements are negotiated by the person in the source country, and other material elements are negotiated by the foreign enterprise outside the source country? What if the foreign enterprise develops standards for material terms it will accept, and negotiations in the local country involve persuading a potential customer to agree to such terms? In addition, the statements in the revised Discussion Draft to the effect that a contract may be concluded without negotiation, and that a contract may be concluded in a country even when it is not signed there, create unnecessary uncertainty. Notwithstanding its perceived faults, the current dependent agent standard has the benefit of being clear, and it is not as susceptible to the same myriad interpretive issues.

Many countries require a non-resident company to have an in-country collection agent for VAT/GST purposes. These independent collection agents are not affiliated with the non-resident company, and are only used for VAT/GST purposes. Many of these agents could be seen by some governments to be controlled by the non-resident company, even if those activities are for tax collecting and remitting purposes. If those agents are considered dependent under Action 7, and would give the non-resident company a permanent establishment where there are no other employees or affiliations located, it is very likely that a company would be exposing itself to direct taxation in order to comply with its VAT/GST collection. The Discussion Draft for Action 7 is very ambiguous on this point and will likely be interpreted very broadly by tax authorities. For the most part, large platform marketplace service providers generally comply with existing remote seller registration obligations — often by assuming the primary burden for
tax collection and remittance as a “commissionaire.” If these large platform service providers were deemed to create PE’s for the tens of thousands of small sellers they represent, the use of these aggregation points would cease and governments would be forced to deal with a much higher number of remote sellers. In addition, since these platforms aggregate sales of thousands of developers, the overall VAT collection is higher since many of the developers would either be below registration thresholds or may even not be aware of their remote compliance burden.

We feel very strongly that an independent agent established for VAT/GST collection should not give rise to a permanent establishment for a company that has no other affiliations or employees within that jurisdiction. We encourage the OECD to include explicit language in its proposals to cut the common link between PE determinations and VAT registrations by stressing that the term “permanent establishment” as used in the OECD Model Income Tax Treaty is a distinct concept from the “VAT establishment” term used in the International VAT/GST guidelines, such that the existence of one should not in itself result in the other. In addition, while companies might have to register for VAT in order to comply with their national VAT obligations, such registration in itself should not trigger the creation of a permanent establishment for purposes of Article 5.

Finally, it is impossible to evaluate these options without additional guidance regarding the manner in which business profits would be attributable to a permanent establishment. We understand that the work on attribution of profits to a permanent establishment will be undertaken in the year ahead after the initial work on BEPS is completed. Nonetheless, the current work on PEs is hard to reconcile without this further work. For example, the commissionnaire is already subject to tax on its profits. Would the business profits of such permanent establishment be limited to the difference between the profits of a local country limited risk distributor and the commissionnaire? Would the business profits of such permanent establishment depend on the extent to which material negotiating and selling activities were performed by the dependent agent in the source country as opposed to the foreign enterprise outside of the source country? The guidance to date under Article 7 is not adequate to evaluate these issues.

Specific Activity Exemptions

In general, the NFTC supports the retention of the specific activity exemptions to the greatest extent possible. In typical commercial contexts, the activities traditionally listed in Article 5(4) are so far removed from the income generating activities of an enterprise that they should not in and of themselves, or in combination, give rise to a permanent establishment. Even if these activities were deemed to constitute a permanent establishment, it is unlikely that the business profits that could be fairly attributable to such a permanent establishment would be material. Consideration also needs to be given to the additional filing and reporting burdens and the inevitable disputes that will arise. Given the role of the permanent establishment standard, it would be very helpful to have a per se list of activities that do not give rise to permanent establishments.

The revised Discussion Draft proposes to restrict all of exemptions in Art 5 (4) to activities that are “preparatory or auxiliary” in nature, and proposes to clarify that phrase. There are now more details that explain the key concepts than were included in the October 2014 Discussion Draft,
and the revised Discussion Draft does not propose to eliminate any of the specific activity exemptions altogether. We are appreciative of that change. However, the revised Draft includes some fairly pointed comments on large warehouses used for storage and delivery in the context of on-line business failing the preparatory or auxiliary test. These comments seemed unusually specific and out of place in the revised Draft.

As the revised Discussion Draft acknowledges, the vast majority of commentators on the October 2014 Draft expressed strong objections to the anti-fragmentation alternatives. However, the revised Discussion Draft includes an anti-fragmentation rule, under which the preparatory or auxiliary exemption of Art. 5(4) would not be available if there is an existing PE of the enterprise concerned or an affiliate, or there is no such PE but the overall activity resulting from the combination of the activities of those connected enterprises is not of a preparatory or auxiliary character. The NFTC remains concerned that it will be difficult to comply with the anti-fragmentation rule. Business needs a more clear and detailed explanation of the scope of what falls within the notion of “complementary functions that are part of a cohesive business operation” than is provided in the examples. The revised Discussion Draft also sets forth an example in which the anti-fragmentation rule applies to combine activities of a foreign enterprise with those of an affiliate that is a resident of the source country. The extension of the anti-fragmentation rule to “permanent establishments” of residents is inappropriate and would create significant uncertainty about the ability of businesses to rely on the specific activity exemptions in many of the most typical business arrangements.

**Splitting up of Contracts**

The Discussion Draft expresses concern with the splitting-up of contracts among different foreign enterprises to abuse the twelve month threshold of Article 5 (3) or similar time thresholds in services-PE provisions. The Discussion Draft proposes two options to address these concerns: (A) an “automatic” rule that would aggregate the time periods that different enterprises carry on activities at a single building site or installation project, or (B) an application of a general treaty anti-abuse rule to the tax-motivated splitting up of contracts, as illustrated by an example in the OECD Model Commentary.

The NFTC believes that a narrower anti-abuse rule is more appropriate. To the extent that there is a commercial rationale for the involvement of two enterprises in separate aspects of different projects, there is no abuse of the 12 month or other thresholds. For example, if different phases of a project require different skills and expertise (e.g., design/engineering, site preparation and construction) and are put out to bid on a separate basis and independently awarded to two or more associated enterprises, each of which has the capacity to execute its phase of the project but not the others, then aggregation should not occur. Countries should be permitted to adopt this approach even if they do not adopt a more general principle purpose test applicable to the treaty as a whole.
Conclusion

The NFTC is pleased to see that the revised Discussion Draft clarifies, and drops some of the most egregious options contained in the October 2014 Discussion Draft. However, we think further clarification is still needed to eliminate the subjectivity of many of the remaining provisions. Business needs certainty in knowing where it has a permanent establishment, how that PE is determined, the scope of the specific PE exemptions, and that the disputes that are sure to arise, will be resolved expeditiously.

Sincerely,

Catherine G. Schultz
Vice President for Tax Policy
cschultz@nftc.org
Appendix to NFTC Comments on BEPS Action 7: Preventing the Artificial Avoidance of PE Status

NFTC Board Member Companies:
McKenna Long & Aldridge LLP
ABB Incorporated
AbbVie Pharmaceuticals
Applied Materials
Baxter International Inc.
British American Tobacco
Caterpillar Incorporated
Chevron Corporation
Chrysler Corporation
CIGNA International
Cisco Systems
Coca-Cola Company
ConocoPhillips, Inc.
Deloitte & Touche
DHL North America
eBay Inc.
E.I., du Pont de Nemours & Co.
Ernst & Young
ExxonMobil Corporation
Fluor Corporation
Ford Motor Company
General Electric Company
Google, Inc.
Halliburton Company
Hanesbrands Inc.
Hercules Group
Hewlett-Packard Company
Johnson & Johnson
JPMorgan Chase & Co.
KPMG LLP
Mars Incorporated
Mayer Brown LLP
McCormick & Company, Inc.
Microsoft Corporation
Occidental Petroleum
Oracle Corporation
Pernod Ricard USA
Pfizer International Inc.
PricewaterhouseCoopers LLP
Procter & Gamble
Prudential Insurance
Ridgewood Group International, Ltd.
Siemens Corporation
Sullivan & Worcester LLP
TE Connectivity
Toyota
Tyco International
United Parcel Service, Inc.
United Technologies
Visa, Inc.
Walmart Stores, Inc.
To:

Marlies de Ruiter  
Head  
Tax Treaties  
Transfer Pricing and Financial Transactions Division  
OECD/CTPA

Petrofac Group Representations

The Revised Discussion Draft on BEPS Action 7 Preventing the Artificial Avoidance of PE Status

In response to the paper issued on 15 May 2015 requesting comments from Business and Industry to the proposals on preventing the artificial avoidance of PE Status (PE), Petrofac Group (Petrofac) would like to make the following comments.

Petrofac Group Background

Petrofac is a FTSE 250 oilfield services company which operates in 29 countries across the globe. Its primary corporate and operational offices are in UAE, India, Malaysia and the UK; project sites are located in a number of countries where we:

- design and build new oil and gas facilities,
- manage and maintain existing facilities,
- enhance the performance of more mature or marginal facilities, and
- develop and train our customers’ staff to work more effectively and safely.

We operate onshore and offshore, and any of our service lines can be delivered on a standalone basis or they can be integrated together, under a range of commercial models. Our workforce numbers almost 20,000 employees around the world.

Petrofac Position Summary

Petrofac understands that the measures set out in the Revised Discussion Draft have been the subject of extensive commentary and consideration but we continue to be concerned that adoption of the measures as drafted could inadvertently impact business which is not structured for avoidance purposes and may result in material additional costs and uncertainty to business in defending PE allegations resulting from normal activities carried out in the course of ordinary business.

Changes to Paragraph 5 and 6 of Article 5

In our initial submission Petrofac noted that the expansion of Paragraph 5 to include a person who ‘is acting in a Contracting State on behalf of an enterprise and in doing so, habitually.......negotiates the material elements of contracts’ could significantly increase the number of PE’s that are created in circumstances where there would be no loss of revenue to the tax authorities as long as the transfer pricing was appropriate.
Petrofac further noted that in those circumstances the creation of the PE’s and the mutual agreement procedure that may be required to settle attribution of revenues would substantially increase the compliance and administrative costs for both MNE’s and Tax Authorities.

In our submission Petrofac gave the following example of a situation that could create such a PE but many other similar examples could be envisaged.

Facts

1. An MNE has a legal entity (Company A) in Country X
2. It also has a legal entity (Company B) in Country Y that provides training services
3. A third party company (Company C) resident in Country X but with employees in Country Y is seeking training services in Country Y
4. Company A negotiates the material terms of one of a series of training contracts on behalf of Company B, whereby Company B will provide training services in Country Y to Company C
5. At no point does Company B carry out any activities or provide any services in Country X
6. Company A charges an arm’s length service fee for the provision of the brokerage service to Company B
7. Company A may provide the same brokerage service to a range of connected party companies none of whom operate in Country X

Analysis

1. Company A habitually negotiates in Country X material elements of contracts for the provision of services by Company B
2. Company B who has no other activity or connection with Country X has a PE in Country X and has to register that PE
3. The brokerage fee and associated expenditure has to be allocated between Company A and the PE of Company B and separate tax returns submitted
4. There is no loss of revenue to the tax authorities in Country X as the transfer pricing of the fee is correct
5. To the extent Company A extends this brokerage service to other group companies each of them will have to register PE’s in Country X

We note that this issue of PE proliferation has been raised by a number of commentators and we would encourage the OECD to consider if there is some additional commentary on Article 5 that could be added that would allow the OECD to meet its policy objectives vis a vis commissionaire arrangements without requiring companies to have to register multiple PE’s for activities that are already properly remunerated in the jurisdiction in which they are performed and for which, in many cases, agreement has already been reached with the relevant taxing authority on the transfer pricing of those activities.
Dear Ms. de Ruiter,

BEPS Revised Discussion Draft Action 7: Preventing the Artificial Avoidance of PE Status

We welcome the opportunity to comment on the BEPS Revised Discussion Draft: Preventing the Artificial Avoidance of PE Status document, issued on 15 May 2015 (the “Revised Action 7 Discussion Draft”).

In our previous response to the Action 7 Discussion Draft published in October 2014, we provided background on the aircraft leasing industry and its cross border operating model. As noted in our previous response, aircraft lessors are heavily reliant on access to tax treaties in order to ensure compliance with the tax rules and legislation of the multiple jurisdictions in which they do business.

The Revised Action 7 Discussion Draft narrows the options to change the language of paragraphs 5 and 6 of Article 5 and selects Option B (in the original October 2014 discussion draft) as the preferred option. We welcome the narrowing of the options in the latest discussion draft but are concerned that the proposals introduce a number of new and (to date) undefined concepts and terms which (i) substantially lower the existing threshold for creating a PE (as compared to the current OECD model) and (ii) creates the risk of different interpretations of what gives rise to a PE by various tax authorities around the world. Absent more detailed guidance and definitions, these uncertainties could result in the unintended consequence of creating a taxable presence for aircraft lessors in all jurisdictions with which they transact business but do not have any substantive physical presence or agents. This uncertainty, the potential for unintended taxation in multiple states, and increased compliance burdens may have a significant economic impact for the industry overall as commercial transactions are potentially stalled until the proposals included in the Revised Action 7 Discussion Draft are evaluated and their potential impact on the aircraft leasing industry business model more clearly understood.

We understand that this was not the intended outcome of the original and Revised Action 7 Discussion Drafts. In this regard we refer to paragraph 32 in commentary of article 5 which states “It would not have been in the interest of international economic relations to provide that any person undertaking...”
activities on behalf of the enterprise would lead to a permanent establishment for the enterprise." We therefore request some modifications to the proposed commentary to paragraphs 5 and 6 of Article 5 outlined in the Revised Action 7 Discussion Draft in order to provide more guidance and develop a clearer set of principles over how the new language for determining whether a taxpayer has a PE should be interpreted. While we appreciate that the changes were more directly aimed at commissionaire and similar type structures, we believe that the proposed changes, as currently drafted, will impact the aircraft leasing industry and other big ticket leasing and selling businesses. In this regard we do request some changes in relation to the aircraft leasing industry but we have tried to be mindful of the thought that has gone in to date in developing the proposed revisions to Article 5 and the related commentary. We have therefore limited our requests to (i) tweaking the proposed language in the revised commentary and (ii) requesting the inclusion of an illustrative example that deals with non-routine transactions in order to provide more clarity to non-routine, non-standard transactions and reduce the risk of different interpretations by tax authorities around the world.

- Proposal 1: Changes to Paragraphs 5 and 6 of Article 5

We note the proposed change to paragraph 5 to include, within the definition what constitutes a "dependent agent", situations where;

"...a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, or negotiates the material elements of contracts...."

In addition, we note in particular the proposed changes to paragraphs 32-32.6 of the Commentary to Article 5 as a means to clarify how the terms "habitually concludes contracts" or habitually "negotiates the material elements of contracts" should be interpreted.

We believe however that the proposed changes to the Commentary to paragraph 5 of Article 5 and the example[s] included therein merely deal with standard contracts or routine transactions. We believe that the proposed changes to the Commentary do not adequately deal with non-routine transactions, which possibly due to the high-value, small volume or regulated nature of the assets involved, may include a wide spectrum of commercial negotiations and touch points with customers, across a number of business teams, and require multiple levels of approvals and authorisations before any fundamental terms can be determined or approved in principle with the client and ultimately a final contract concluded with the client.

We propose therefore that, at a minimum, another example be introduced within paragraph 32.6 to address the more non-routine, non-standard situations/transactions. We also propose some changes to paragraphs 32.5, 32.6 and 33 to the revised Commentary to Article 5 to enhance the clarity and consistency of the Commentary as it applies to non-routine, non-standard transactions. See Appendix 1 for our requested changes to the proposed Commentary to Article 5. (All requested changes are included in red text and highlighted in yellow. Deletions are in strikethrough).

- Background Aircraft Leasing Industry; Sample contract negotiation and approval process

In the aircraft leasing industry, the process to negotiate and conclude aircraft lease/ or aircraft sales contracts is a non-routine process and is generally lead by a person from the lessor's marketing team (a "marketeer"). The role of the marketer and the process to negotiate and conclude aircraft lease/ or
aircraft sales contracts is generally uniform across the industry. Typically the marketeers are based in the country where the aircraft leasing company is located but spend the majority of their time travelling to meet potential customers.

The marketeers are involved in all stages of the leasing process. They typically participate in the origination and solicitation of potential lessees, facilitate negotiations and prepare the initial lease documentation, maintain a relationship with the customer during the time the aircraft is leased and assist in the coordination of end of lease term efforts to ensure proper re-delivery of the aircraft. In all these aspects the marketeer works closely with and under the authority of a wider team comprising key personnel from each function (e.g. finance, technical, risk, tax, legal) to coordinate and act as liaison for the overall deal process. Even when no specific deal is pending and no lease is scheduled to end in the near future, a marketeer maintains continuous contact with the customer to ensure that the commercial relationship remains strong and to continue to gather information on the customer's needs. The marketeer is continuously making contact with the airline, learning about its strategy, the way it operates, its needs, and its objectives.

In a typical transaction scenario, aircraft lessors typically limit the work of marketeers to merely discussing broad contractual terms in principle. For aircraft lessors, due to the high value of the assets under consideration, a marketeer in the prospective lessee's jurisdiction will not have the authority to conclude contracts on behalf of the aircraft lessor. The marketeer primarily discusses specification requirements of the customer and relays potential options that the lessor can offer. However, as the cost of an aircraft will often be a material item on an aircraft lessor's balance sheet, the lease/disposition of that asset is dictated via multiple authorisations from senior personnel located at the aircraft lessor's home base. Ultimate approval and conclusion of any contract is dictated by cost benefit and risk analyses of the placement of an aircraft in a particular country (amongst other considerations) and that process requires authorisation from a team of senior management including from those at the C-suite level. As a result, the authority to conclude or determine any specific contract, or even a key ingredient of any specific contract, with a lessee cannot be performed by the marketeer or even other senior personnel in the sales/marketing team.

Thus, the marketeers do not have any authority to determine the key ingredients of the contractual relationship or essentially negotiate, explicitly or implicitly, the material elements of contracts due to the risk and commercial considerations that are required in placing a high-value asset in a particular jurisdiction for a medium to long term duration.

In light of the aircraft leasing industry practice outlined above, and which may be similar in other industries involving high-value, big ticket or regulated assets we believe that further clarification is required in the proposed Commentary to Article 5 to deal with this or similar situations. In this regard we request the following changes to the proposed Commentary to Article 5.

- **Rationale for requested changes to the proposed Commentary to Article 5**

1. **Paragraph 32.5. Request to delete words “possibly with further approval or review” or alternatively request to amend to “possibly with minimal further approval or review”**

   We are concerned that these words are superfluous to the intended scope of paragraph 32.5 and therefore cause additional ambiguity and uncertainty which could lead to inconsistent interpretation by tax authorities around the world and lead to the unintended consequences of
creating taxable presence for enterprises in jurisdictions where it has merely a transitory presence in that state.

Thus the first sentence to paragraph 32.5 would instead read “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 outside that State.”

Alternatively the first sentence to paragraph 32.5 could instead read “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 minimal further approval or review, outside that State.”

We believe that either of these changes would retain the essence of what paragraph 32.5 intends to capture i.e. situations where contracts are essentially negotiated and agreed in a State but which are formally concluded outside the State, but would add clarity to certain genuine business transactions.

The requested change would clarify genuine situations where transaction terms are broadly discussed in principle in a State but which are entirely subject to further substantial discussion, approval and review outside the State – which would often be the case in non-routine, non-standard or high-value transactions, for example in the case of the aircraft leasing industry. The change would also be consistent with paragraph 32.4 which aims to define the term “concludes contracts” and includes situations where a contract is essentially concluded in a State even if the contract is actually signed outside the State.

We also believe that it would be consistent with the revised paragraph 33 which provides that “The mere fact that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person concluded contracts or negotiated the material elements of contracts.”

2. **Paragraph 32.6. Request to delete the words “are intended to”**

It is arguable that the “intended” result of any activity of a sales or marketing person is the conclusion of contracts, whether directly or indirectly. Furthermore where these activities are conducted with any regularity or repetitiveness it is arguable that these activities are intended to result in the regular conclusion of contracts. This also appears to be inconsistent with paragraph 32 which states “It would not have been in the interest of international economic relations to provide that any person undertaking activities on behalf of the enterprise would lead to a permanent establishment for the enterprise.” Therefore, we are concerned that the inclusion of these words is unnecessary and creates ambiguity as to the intended scope of paragraph 32.6 and potentially creates an opportunity for tax authorities around the world to overreach in their interpretation as to what constitutes a PE and seek to tax any activities of a sales or marketing nature as a PE – whether or not the activity regularly results in the conclusion of a contract.

We believe that the deletion of the words “are intended to” would not significantly change the scope or essence of the first sentence to paragraph 32.6. Their deletion would however provide some further clarity to paragraph 32.6 and its explanation as to how the phrase “concludes...
contracts or negotiates the material elements of contracts” should be properly interpreted. We also believe it would be consistent with paragraphs 32.5 and 33.

3. Paragraph 32.6. Request to include an additional example to deal with non-routine transactions

“ECO, a company resident of State E, deals exclusively in the leasing of valuable assets and transacts business with customers situated all over the world. ECO’s marketing employees are based in State E and travel to various jurisdictions for short periods of time on a transitory basis to promote the services of the company. The work of the marketing personnel travelling to local countries, including State F, is strictly limited to engaging with local customers to merely discuss broad commercial and contractual terms in principle. The marketing personnel do not have any authority to determine the material elements of any contract that might be entered into with the customer. Due to a myriad of reasons including the high-value of the assets under consideration and the associated risk and approval procedures developed in-house, the determination, negotiation and ultimate conclusion of any contractual terms is dictated via multiple authorisations from the senior management team based in ECO’s base in State E. There is no routine approval of transactions. Specifically when a customer in State F indicates interest in ECO's product on the back of marketing information provided by ECO’s marketing team, the ECO marketing employee will coordinate with the local customer in State F and the senior management team in State E to facilitate the negotiation and ultimate conclusion of the contract between the two parties in State E. ECO’s marketing employee’s role in State F is limited to gathering customer preferences in relation to product specification, volume and duration while simultaneously relaying information on ECO’s behalf around available stock and product specification, available alternative options, potential contract duration and pricing. Ultimately the marketing personnel do not have any authority to determine the material elements of the contractual relationship with the customer. In this example, ECO's marketing employees do not negotiate the material elements of contracts since essentially the negotiations of the contract terms are subject to approval and authorisation by the ECO senior management team in State E. The ECO marketing employee is not authorised to negotiate, agree or provide any offer to the prospective customer. The fact that ECO’s marketing personnel attended or even participated in negotiations in State F between an enterprise and a client is not sufficient, by itself, to conclude that the relevant sales or marketing person concluded contracts or negotiated the material elements of contracts in State F.”

Please feel free to contact Enda Faughnan, at 00 353 1 7926359 or enda.faughnan@ie.pwc.com if you would like to discuss this submission further or if you would like us to provide you with any clarifications or elaborations.

Yours sincerely

Enda Faughnan
PricewaterhouseCoopers Ireland
Appendix I

Requested Changes to the proposed Commentary to Article 5

"32.5 Option 1, 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" 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.

OR

Option 2, 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 minimal 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" 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.

32.6 The phrase "concludes contracts or 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 the activities that a person exercises in a State are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise. The paragraph applies to a person who acts as the sales force of the enterprise and, in doing so, makes or accepts contractual offers even if standard contracts are used for that purpose. The paragraph would therefore apply where, for example, a person solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods belonging to the enterprise are delivered and where the enterprise routinely approves these transactions. The following is another example that illustrates the application of paragraph 5. RCO, a company resident of State R, distributes various products and services worldwide through its websites. SCO, a company resident of State S, is a wholly-owned subsidiary of RCO. SCO's employees promote RCO's products and services and are responsible for large accounts in State S; these employees' remuneration is partially based on the revenues derived by RCO from the holders of these accounts. When one of these account holders agrees to purchase a given quantity of goods or services promoted by an employee of SCO, the employee indicates the price that will be payable, indicates that a contract must be concluded online with RCO before the
goods or services can be provided by RCO and explains the standard terms of RCO's contracts, including the fixed price structure used by RCO, which the employee is not authorised to modify. When concluding that contract online, the account holder is offered a choice of payment options. In this example, SCO's employees are negotiating the material elements of the contracts that are concluded with RCO. The fact that SCO's employees cannot vary the terms of the contracts does not mean that there is no negotiation but rather means that the negotiation of the material elements of the contracts is limited to convincing the account holder to accept these standard terms.

The following is another example that illustrates the application of paragraph 5 to non-routine transactions. ECO, a company resident of State E, deals exclusively in the leasing of valuable assets and transacts business with customers situated all over the world. ECO's marketing employees are based in State E and travel to various jurisdictions for short periods of time on a transitory basis to promote the services of the company. The work of the marketing personnel travelling to local countries, including State F, is strictly limited to engaging with local customers to merely discuss broad commercial and contractual terms in principle. The marketing personnel do not have any authority to determine the material elements of any contract that might be entered into with the customer. Due to a myriad of reasons including the high-value of the assets under consideration and the associated risk and approval procedures developed in-house, the determination, negotiation and ultimate conclusion of any contractual terms is dictated via multiple authorisations from the senior management team based in ECO's base in State E. There is no routine approval of transactions. Specifically when a customer in State F indicates interest in ECO's product on the back of marketing information provided by ECO's marketing team, the ECO marketing employee will coordinate with the local customer in State F and the senior management team in State E to facilitate the negotiation and ultimate conclusion of the contract between the two parties in State E. ECO's marketing employee's role in State F is limited to gathering customer preferences in relation to product specification, volume and duration while simultaneously relaying information on ECO's behalf around available stock and product specification, available alternative options, potential contract duration and pricing. Ultimately the marketing personnel do not have any authority to determine the material elements of the contractual relationship with the customer. In this example, ECO's marketing employees do not negotiate the material elements of contracts since essentially the negotiations of the contract terms are subject to approval and authorisation by the ECO senior management team in State E. The ECO marketing employee is not authorised to negotiate, agree or provide any offer to the prospective customer. The fact that ECO's marketing personnel attended or even participated in negotiations in State F between an enterprise and a client is not sufficient, by itself, to conclude that the relevant sales or marketing person concluded contracts or negotiated the material elements of contracts in State F.
Dear Marlies,

**PE Representations**

Detailed comments from the PwC network of firms on the new Discussion Draft on BEPS Action 7, dated 15 May, follow below. We note by way of preliminary comments, however, that the approach on Action 7 should take account of the progress on the work on improving the effectiveness of dispute resolution under Action 14. If the Action 14 work does not deliver the intended solutions identified in the Action Plan, this suggests that a cautious approach should be adopted in any expansion of the scope of the threshold PE rules (especially where this is achieved using new concepts and thresholds) given the widespread concerns relating to incremental double taxation from the Action 7 proposals.

**Dependent Agent PE test**

We have no further comments on the proposals for the amendment of Article 5 (5) itself, but do wish to comment on the proposals for the amendment to the Commentary on that provision, which deems a PE to exists if a dependent agent concludes contracts or negotiates material terms of the contract. We are concerned that the discussion in a number of the proposed new paragraphs (in particular, paragraphs 32.4, 32.5 and 32.6) goes well beyond the plain meaning of the proposed language and will leave room for agents to be regarded as falling within the rule when their activity would fall well short of a substantive role in the process for the conclusion or negotiation of contracts. This is at odds with the terms of the revised Article 5 (5) itself. It would also achieve very little given that the relevant profit attribution to any PE in such a case is unlikely to differ from the corresponding transfer pricing reward that would typically otherwise be relevant in the absence of a PE (see further below). We would urge that these paragraphs be re-assessed. It would also seem necessary to clarify in the Commentary that, in all cases, the agent must always play a real and substantial role in the process of negotiation or conclusion of contracts if the threshold test in Article 5 (5) is to be met. Further, it would help to add some further guidance on the scope of the phrase “the material elements of contracts”, particularly as the proposal in new paragraph
32.5 makes it clear that the meaning of that phrase may vary depending on the nature of the contract concerned.

**Independent Agent test**

We welcome the revision to this test to the effect that an agent acting exclusively for one unrelated principal is not automatically excluded from qualification as an independent agent. However, we consider that the logic should apply regardless of whether the agent is unrelated. In our view, the independent agent test should generally and as a matter of principle be directed to address whether the agent is in any particular case carrying on the business of the principal. On that basis, the focus should be on the nature of the agent’s activities, not the relationship between agent and principle (i.e. whether or not connected). In the absence of further explanation, this discrimination against connected parties seems hard to justify in principle. It would place a business in the awkward position of having to choose an unrelated party over its own affiliated entity to avoid adverse tax consequences where both agents are fulfilling the same function.

A second concern in relation to this proposal concerns the lack of clarity in the explanation of what it is to be an independent agent. The guidance in the existing Commentary is not particularly clear but the revisions proposed have the effect of making it less clear than it now is. The proposed removal of the economic independence test materially re-orientates the existing guidance, putting much greater emphasis on the “legal” independence test (which is basically concerned with the operational independence of the agent) and this in turn shifts the focus from any “entity” perspective in relation to the agent to a focus directed at the individuals (or “humans”) carrying on the agency functions. Proposed amendments to the Commentary add a clarification of what is not independent and emphasise that all the facts and circumstances need to be taken into account but the attributes of independence themselves are not particularly clear. Given that these proposed changes will clearly have a material impact in a number of cases, further clarification of the requirements of the independent agent test (and their rationale) seems essential.

**Exempt activities**

We have no further comments on this point.

**Anti-fragmentation**

The critical phrases “complementary functions” and “cohesive business operation” are not defined or clarified beyond the two examples that are proposed for the new paragraph 30.3. Given the potential significance of these terms, some further clarification would seem to be necessary of the intended scope of the test and we would suggest further examples would be helpful.

**Splitting up of contracts**

We have no further comments on this point.
Insurance

We welcome the decision to drop the proposal for a specific PE rule for the insurance sector.

Profit attribution issues

We have material concerns on this point. Our primary concern in relation to the OECD’s proposal for follow-up work on the attribution of profits issues is that it will in practice make it very difficult to address PE threshold and PE attribution issues in tandem, which in our view is clearly required. We, and very many other commentators, have to date expressed very strong concerns that the ongoing work on article 5 which involves lowering the existing PE threshold will lead to the creation of multiple PEs where there is no additional profit at stake, compared with the profit that would arise from what may be referred to as the corresponding transfer pricing arrangements that would typically otherwise apply in the absence of a PE. By disengaging the work on the profit attribution as is now proposed, those concerns will be much more difficult to address. Accordingly, if the work on the profit attribution issues cannot be accelerated, we would recommend that final decisions on Article 5 be taken only when the results of the work on the profit attribution are available.

Yours sincerely

Richard Collier
11th June 2015

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Submitted by email: taxtreaties@oecd.org

Dear Marlies,  

BEPS Action 7: Revised Discussion Draft on Preventing the Artificial Avoidance of PE Status

We are writing in response to the OECD’s request for comments in relation to the revised discussion draft on Action 7: Preventing the Artificial Avoidance of PE Status.

RELX Group (formerly Reed Elsevier) is a world leading provider of professional information solutions. We operate across several professional market segments through four business divisions comprising of Scientific, Technical & Medical, Risk & Business Information, Legal and Exhibitions. RELX Group has a formal presence in more than 30 countries and employs approximately 28,500 people worldwide. Importantly, we have customers who have entered into contracts for the provision of digital services in most countries in the world. We are also the world’s fourth largest provider of paid-for digital content.

We set out below our representations on the discussion draft. Our representations are focused on the key issues for our business in relation to the discussion draft as follows:

1. We consider that the proposed changes to Article 5(5) of the OECD Model Tax Convention will give rise to an increased risk of double taxation in non-abusive circumstances, unless there is more detailed guidance as to how the new approach will be applied, including objective criteria, supported by more clarifying examples. RELX Group has sales support staff who travel to our customers in over 150 countries, potentially giving rise to a significant number of small permanent establishments, if the rules are not sufficiently clear. As well as potentially creating an unwarranted level of uncertainty and of administrative cost, particularly in relation to those countries where we have a relatively low level of revenue, this is highly likely to give
rise to a risk of double taxation. This in turn is likely to lead to protracted disputes with tax authorities in multiple countries. We consider that this risk will add increased pressure to the discussions on attribution of income to PEs, which we understand will not progress until after views have been finalised on Action 7.

2. The digital products and services which RELX Group companies provide to customers include some which are highly complex such that it would not be easy for customers to contract without a great deal of information and explanation. In the digital economy, it will often be the case that complex services will require some degree of local interaction and we believe that there is a high risk of the problem of proliferating permanent establishments becoming a serious obstacle to cross-border trade and investment in digital services unless the global standard reflects a pragmatic approach. It will be extremely difficult for tax administrations in countries in which there is a small permanent establishment to adequately review the huge amount of complex detail which underpins the determination and allocation of taxable profit. Where digital services are provided, for example, to more than 150 countries, the allocation of technology, operating and other costs between multiple divisions and then to hundreds of individual permanent establishments will be exceedingly difficult to even communicate in a concise manner and the task of reviewing and agreeing the taxable profit in each case, and then resolving any differences of opinion, is not to be contemplated lightly.

3. An appropriate de minimis threshold would be extremely helpful in addressing these issues. The only practical measure would be turnover by jurisdiction. We envisage great difficulties in basing a threshold on profit, number of contracts or other measures. We propose a de minimis threshold of US$500,000 because the attributable profit would be nugatory.

4. There will be circumstances in which steps are taken which ultimately lead to the conclusion of a contract where the steps are of a preparatory nature. For example, the early stages of business development in a new jurisdiction might involve investigative discussions and the provision of general information. In such circumstances the preparatory activities should not be treated as giving rise to a permanent establishment.

5. In relation to the proposed changes to article 5(4)(f) and the revised anti-fragmentation rule, it would be helpful to provide detailed guidance and examples in relation to the concept that the rule applies only to complementary functions that are part of a cohesive business operation. As noted above, RELX Group operates through four business divisions. These divisions, for very sound and clearly demonstrable commercial reasons, have separate senior management teams, derive their revenues from different products and solutions, largely have different customers, pursue
different routes to market etc. In this respect, they operate parallel rather than complementary functions in any country and we view each division, rather than RELX Group as a whole, as being cohesive business operations. However, we are concerned that where one division has a taxable presence in a country, a tax authority may try to attribute to it profits of an entity which forms part of a separate division, on the basis that the business operation in question is the RELX Group as a whole and that, therefore, the preparatory or auxiliary exclusion could not apply to the fixed place of business of the other division. A detailed list of factors which could be reviewed in order to make a determination as to whether activities of one enterprise should be considered to be complementary functions which are part of the same business operation would be very helpful in this regard. Further examples in the Commentary would also be of benefit.

6. We offer the following suggestions as to factors which may support a determination as to whether activities are complementary functions which are part of the same business operation. This will not be the case if:

a. Strategic management is conducted by different teams of executives (or, if the same executives, acting in demonstrably different roles); Reports to the most senior executives in the corporation are separated by division;

b. The performance metrics are maintained separately for each activity for management purposes;

c. The performance metrics are different in accordance with the different characteristics of each activity; comparator metrics are drawn from different industries or sectors;

d. Capital is allocated separately to each division, and according to different criteria;

e. The performance of each business is reported separately to the capital markets, regulators or other stakeholders;

f. Investors apply different considerations to the different activities including different growth expectations, different margins etc.;

g. The customers are in different industries or market segments;

h. The products or services are different in nature;
i. The delivery mechanism is different, reflecting the different characteristics of the business (e.g. the technology platform is different or the supply chain or value chain is different);

j. Executives in each business would have distinct professional background, training and experience;

These factors will not always be relevant in every case but a balanced view would be required taking into account the majority of those which are applicable.

7. A further area in which we consider more guidance would be helpful relates to the extension of the “preparatory or auxiliary” requirement to each of the exceptions in Article 5(4). We are particularly concerned with Article 5(4)(d) in relation to the collection of information by an enterprise. RELX Group has subsidiaries in various countries which have a function of collecting information which then forms a part of the overall content of an online database, which customers access through a subscription arrangement with a central RELX Group subsidiary. The information gathering activity is typically rewarded on a cost plus basis. Whilst the information gathering activity is of an enduring nature, rather than being carried on during a short period, it is clear that it is not an integral part of the activities of the contracting entity. The value attributable to the original collection of information is very small in relation to the rest of the value chain. There is little value in collecting the information per se until the information has been processed, analytics applied and the other steps in the value chain have taken place.

We would like to thank you for providing us with the opportunity to comment on the discussion draft and would be happy to discuss the points raised above with you in more detail.

Yours faithfully

Paul Morton    Melanie Trotter
Head of Group Tax   Head of International Tax

First of all, Repsol thanks the OCDE the opportunity to provide comments on its Revised Discussion Draft on Action 7 aimed at preventing the artificial avoidance of PE Status. In particular, Action 7 addresses the following issues:

1. Artificial avoidance of PE status through commissionaire arrangements and similar strategies
2. Artificial avoidance of PE status through the specific activity exemptions
3. Splitting-up of contracts
4. Insurance
5. Issues related to attribution of profits to PEs and interaction with Action Points on Transfer Pricing

REPSOL, a Spanish multinational company of the Oil and Gas sector, would like to provide comments on some of the proposed changes to paragraphs 4 to 6 of Article 5 of the OECD Model. Our comments are particularly related to “specific activity exemptions”, “commissionaire arrangements” and “profit attribution”.

Submitted by email: taxtreaties@oecd.org
General remarks:

BEPS Action 7 may have an impact on the manner Oil & Gas companies have been performing its Upstream and Downstream operations in foreign countries until now.

While we appreciate that the Revised Discussion Draft (RDD) took into account prior comments to some extent, we are concerned that the proposals are over-broad and still leave a great deal of uncertainty, and we are particularly uneasy that profit attribution consequences were not considered in setting the new PE thresholds.

Indeed, the proposals seem to be based on the wrong presumption that companies structure their sales forces through commissionaire arrangements with the sole purpose of artificially reducing source states’ taxable profits.

Specific issues identified could be better covered by Action 6 (Treaty Abuse) rather than through broadening the span of Article 5 without a profound analysis on the associated compliance burden, the large room for controversies and double taxation issues created, or the actual tax collection impacts deriving thereof (e.g. preparatory and auxiliary activities may be recurrent loss making activities).

1. **Comment: Artificial avoidance of PE status through the specific activity exemptions (and fragmentation)**

First of all, we consider that the OECD is missing out on this golden opportunity to provide clearer tax criteria about various topics of relevance of the Oil & Gas Upstream sector:

- The PE status is not a controversial topic for this extractive industry since the vast majority of the Exploration and Production projects are already treated as independent business operations being managed by separate consortia, associations or JV (each ruled by a Joint Operating Agreement), and paying taxes as a separate PE in the state of source. Particularly, it would have been desirable to include comments to strengthen the existence of various PEs in a given country represented by each Exploration & Production project in keeping with the “coherent whole commercially and geographically” concept (as opposed to the “force of attraction principle”).
- The confirmation that the State of residence shall respect the tax status provided in the country of source.
- The widespread use of consortia, associations or Joint Ventures (JV) for international industrial projects under which dependent agent relations are
frequently created (the so-called operator under the signed Joint Operating Agreement), should be clearly clarified through specific Commentary.

Instead, these proposals are an attempt to unnaturally add bulk to the PE concept by fostering rules that may substantially change such current state of affairs for the industry and are a total shake-off of basic and long-preserved OECD principles of PE taxation such as the “separate and independent enterprise rule”, the “force of attraction rule limitation” as well as the “coherent whole commercially and geographically” concept, all of them from the Commentaries to Article 5.1 (par. 27.1).

For instance, rules allowing “automatic” amalgamations of various places of business that allegedly form a cohesive operation (even if they are not in the same country) or vague references to “artificial” fragmentation of contracts provide room for interpretations that may lead to important double taxation controversies and, hence, to a serious breach of Article 7.3 (symmetric attribution of profits for double taxation relief purposes). Besides, it overlooks one of the industry’s foundational characteristics: Upstream projects are legally shaped through administrative concession agreements or national laws so taxpayers lack any capacity to artificially fragment their activity.

Secondly, we highly appreciate the effort made to clarify some aspects of the initial proposals. However, our main concern is the lack of clarity as to whether any of the close-ended lists of exempted activities are deemed to be preparatory or auxiliary. In addition, no further guidance is provided on what is meant by “essential or significant activities”, which is likely to increase dramatically the number disputes between tax authorities and taxpayers, and between tax authorities of different governments.

Although it is true some of the activities listed in Art. 5(4) have a preparatory or auxiliary nature, it is not less accurate to say not all of them are such; hence, we can conclude that the proposed wording goes far beyond the intended purpose and will change international standards on the allocation of cross-border income.

Descending to our particular case (downstream sector), under Option E proposed, it could be the case that stocks of goods create a permanent establishment where none would exist under the current rules, and no ‘artificial avoidance’ of a PE is involved:

- Businesses in the oil & gas industries will often hold ‘strategic storage’ of crude oil, i.e. storage capacity to enable oil to be held in periods of low price with the expectation that, when prices rise, it will be removed from storage and sold.
- In the downstream oil sector, fuel storage may be a key commercial driver and obtaining storage tanks in confined areas where space is at a premium is often difficult (e.g. airports or ports).

We therefore conclude that this proposal could be better addressed if instead of deleting the delivery activity, a definition of the scope of this concept is provided by the commentaries to the OCDE Model.

2. **Comment: Artificial avoidance of PE status through commissionaire arrangements and similar strategies**

Action 7 calls for changes to the definition of PE, causing a *commissionaire* or other forms of agents to be treated as a PE of the principal.

We appreciate the intention to restrict the concept of “associated enterprises” and also to provide additional guidance as to the interpretation of paragraphs 5 and 6. However, we still believe that the proposed wording will affect not only commissionaire arrangements but also other principal sales structures, whose purpose is not to create artificial structures.

The proposed alternative (Option B), while addressing the concerns regarding commissionaires, contains new concepts and terms which are not sufficiently defined, are vague and capable of being interpreted differently by tax authorities and businesses, causing uncertainty.

The proposals, as of today, are likely to result in a significant increase in PEs with allocation disputes and an increased risk of double taxation in non-abusive circumstances. Therefore, we encourage the OECD to develop a test that would exclude businesses from being hit by an increasing number of PEs when already an arm’s length profit is declared for its local activities and where arrangements represent only an efficient way of conducting business.

In respect of the submitted wording of Article 5.5, we propose the following commentaries:
- Eliminating, replacing or providing clarification on ambiguous and unclear terms such as “habitually concludes” or “material elements of a contract”.
- Clarifying the scope of the contracts and structures covered by the new proposal and/or creating a safe-harbor test where there is no intended abuse.
For the sake of clarity, the commentary should include language describing the circumstances in which a person who acts in a Contracting State on behalf of a foreign enterprise would not create a PE for that enterprise under Article 5(5) where he neither habitually concludes nor habitually negotiates the material elements of contracts in the name of the enterprise or for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or for the provision of services by that enterprise.

Similarly, the commentary should reject any implication that a presentation of standard terms to a customer (sheer promotion and marketing activities), followed by that customer’s acceptance necessarily amounts to the conclusion of a contract.

Regarding the submitted wording of Article 5(6), we suggest reconsidering the commentary guidance on the meaning of “exclusively or almost exclusively independent”.

With the removal of the economic dependence test from the commentary, the guidance has become even more unclear as to what is required for an agent to be deemed as independent. In this, we would appreciate further guidance to achieve a greater level of clarity on the specific requirements of the test.

Besides, the adding of the wording “exclusively or almost exclusively” can take companies to look for existing operators in other countries instead of giving opportunities to new ones.

Another aspect to consider is that, due to strategy business reasons it could be convenient or desirable to have an independent agent acting exclusively or almost exclusively, for example if you are a vertically integrated company, such as Repsol.

3. **Profit attribution to PEs and interaction with action points on transfer pricing**

We are disappointed to realize the OECD has decided not to provide any guidance on attribution of profits issues related to Action 7 until the work on Actions 8-10 has been fully completed (i.e. at the end of 2016). However, governments will be highly tempted to immediately apply the principles of the agreed commentary in practice.

We are concerned that the subjectivity arising as a result of the application of the attribution rules will lead to formulary apportionment approaches as the only means to settle these disputes, and that the taxpayers will be in practice defenseless before the tax administration.
Said that, and considering the activities mentioned are recognized to generate very little revenues (or not revenues at all), many controversies and potential double taxation situations will arise, so it is of utmost importance the OECD provides further guidance on this aspect as soon as possible.
Marlies de Ruiter,
Head, Tax Treaties
Transfer Pricing and Financial Transactions Division
OECD/CTPA

Word document by email: taxtreaties@oecd.org

12 June 2015

Dear Ms Ruiter,

SABMiller plc response to the Revised Discussion Draft on BEPS Action 7: Preventing the Artificial avoidance of permanent establishment ('PE') Status

Further to our previous 9 January 2015 response, and the revised guidance of 15 May 2015, we would like to reiterate our point regarding the concept of involvement in commercial master contracts as the revised guidance may still create unintended PEs which we don't believe is the intention of the draft.

The revised discussion draft demonstrates that the OECD has considered all responses to arrive at considered options and, we believe, the draft benefits from including good, well positioned examples which add clarity to the issue at stake.

As requested we have kept our comments brief but we are happy to discuss either of them further should you require further information.

A: Artificial avoidance of PE status through commissionaire arrangements and similar strategies

Previously we have said that option B, the defined activity of ‘negotiate the material elements of contracts’, has the potential to create PEs in the area of global master contracts.

For example, today’s commercial environment includes increasingly global customers and global suppliers. With this trend groups need to respond and are required to form ‘centres of excellence’ in areas such as global contract negotiations, where deep subject matter experts are employed and the outputs are global master contracts with the ability for local businesses to operate under their own statement of work. The central activity clearly requires its own arm’s length pricing, however, the revised draft may also create a PE in the country of the master contract if ‘material elements’ are negotiated by the centre of excellence.

Given our reading of the discussion drafts and the public consultation we do not believe Action 7 intends to create a PE in this type of commercial situation. We suggest that this uncertainty could
be removed by including an example of a global contract negotiation not giving rise to a PE, provided there is arm’s length pricing for the activity; this would remove the potential for misunderstanding or misinterpretation between tax payers and tax authorities. Our suggestion is intended to provide clarity in the same way the example provided at paragraph 32.12 in respect of distributors.

E. Profit attribution to PEs and interaction with Action Points on Transfer Pricing

Para 57 explains that profit attribution guidance will complete in 2016, with Action 7 being finalised in 2015. We have read the reasons for these different timetables but it is difficult to see how Action 7 can be completed without considering how it works with profit attribution guidance. A desired outcome of the BEPS project must be congruent guidance that works well operationally in the future, and this can only be achieved when complementary guidance is prepared in parallel.

We would be happy to discuss our comments with you further if you require further information.

Yours sincerely,

Graham Holford

Director: Group Tax, SABMiller plc
June 12, 2015

**VIA E-MAIL**
taxtreaties@oecd.org

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
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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 longstanding 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 commissionaires, 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. 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. 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.” 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. 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.”
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 its business (see paragraph 32 above). …

Likewise, paragraph 38.5 should be revised as follows:

38.57 An independent agent Persons cannot be said to act in the ordinary course of their own business as such when it performs activities that are unrelated to the 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.

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. 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.” 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. 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”).


7 See OECD Model Tax Convention, Art. 5, Commentary ¶¶ 26.1, 42.3, 42.10.
country” or “owns (or leases) and operates the server on which the [nonresident’s] web site is stored and used.” 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.

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, a resident of State ST 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. When a customer buys such a large item from SCO, SCO 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 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

- SCO and RCO are connected enterprises;
- SCO’s store constitutes a permanent establishment of SCO 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 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
15. Broadcom Corporation
16. Brocade Communications Systems, Inc.
18. Chegg, 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
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.
June 11, 2015

Ms. Marlies de Ruiter
Head, Tax Treaties, Transfer Pricing and Financial Transactions Division
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Comments on the Revised Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status

Dear Ms. de Ruiter:

The Software Coalition thanks the OECD for the opportunity to provide comments on the Revised Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status, which the OECD issued on May 15, 2015 (the “Revised Discussion Draft”). The Software Coalition previously submitted comments on the Discussion Draft on BEPS Action 7, as issued on October 31, 2014.

The Software Coalition is the leading software industry group dealing with U.S. domestic and international tax policy matters. The Software Coalition was formed in 1990 and now comprises 23 companies which operate in the software and e-commerce sectors. Software Coalition members account for approximately $440 billion per year in total gross revenue. Member companies employ over 1.1 million individuals around the globe.¹

I. Introduction

Bilateral tax treaties are intended to facilitate international trade by providing a set of common rules to govern the tax treatment of transactions which involve persons subject

¹ The Software Coalition’s current membership comprises the following companies: Adobe Systems Inc.; Amazon.com, Inc.; Attachmate Corporation; Autodesk, Inc.; BMC Software, Inc.; CA, Inc.; Cisco Systems, Inc.; Citrix Systems, Inc.; Electronic Arts, Inc.; EMC Corporation; Facebook, Inc.; IBM Corporation; Mentor Graphics Corporation; Microsoft Corporation; Nuance Communications, Inc.; Oracle Corporation; PTC Inc.; Pivotal Software, Inc.; Salesforce.com Inc.; SAP America, Inc.; Symantec Corporation; Synopsys, Inc.; and VMWare, Inc.
to the laws of two or more jurisdictions with different domestic tax systems. Tax treaties must establish rules which can be effectively implemented through the domestic administrative and judicial processes of both States. To achieve this objective, treaty rules must be clear, unambiguous, and administrable. Precise drafting is the key to achieving such rules.

The current version of Article 5(5) requires a dependent agent to have and habitually exercise contract conclusion authority before a deemed dependent agent PE (“DAPE”) arises. The Revised Discussion Draft proposes a new standard that expands the scope of activity which creates a DAPE, namely the negotiation of the material elements of contracts. Expanding the scope of activities which create a DAPE establishes a different balance between source and residence state taxation rights. This will be the first policy change to the definition of tax nexus of a nonresident enterprise based on the actions of dependent agents since the Model Tax Convention was first published in 1963. Accordingly, the guidance which implements this new standard requires treaty text, Commentary, and policy statements that clearly and precisely delineate the standard’s scope. The purpose of our comments is to improve the clarity and precision of the treaty text, Commentary, and policy statements contained in the Revised Discussion Draft.

II. The Revised Discussion Draft Can Be Improved to Articulate the Negotiation Standard Clearly, Precisely, and Consistently

A. Recommended Changes to Proposed Article 5(5)

Paragraph 32 of the proposed Article 5 Commentary is clear that the term, “habitually,” modifies the actions of both concluding contracts and negotiating the material elements of contracts, as it states that “paragraph 5 proceeds on the basis that only persons habitually concluding contracts or habitually negotiating the material elements of contracts” can give rise to a DAPE. The punctuation of the proposed treaty language in Article 5(5), however, creates some ambiguity on that point, as the proposed text refers to a person who “habitually concludes contracts, or negotiates the material elements of contracts, that are . . .” Separating the phrases, “habitually concludes contracts,” and, “or negotiates the material elements of contracts,” by a comma could suggest that the adverb, “habitually,” modifies only the phrase, “concludes contracts,” and not the phrase, “or negotiates the material elements of contracts.” As this construction would be incorrect, we respectfully recommend that Working Party 1 revise the introductory clause of proposed Article 5(5) and the second bullet in the restatement of proposed Article 5(5) in paragraph 32.1 of the proposed Article 5 Commentary to read as follows:

Article 5(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 and, in doing so, habitually concludes contracts, or habitually negotiates the material elements of contracts, that are . . .
Paragraph 32.1

- in doing so, that person habitually concludes contracts, or habitually negotiates the material elements of contracts; . . .

These changes also would be consistent with paragraphs 33 and 33.1 of the proposed Article 5 Commentary, which do not separate the references to concluding contracts or negotiating contracts with a comma, and thus make clear that the word, “habitually,” modifies both, “concludes contracts,” and, “or negotiates the material elements of contracts.”

**B. Recommended Changes to the Proposed Article 5 Commentary**

1. **The Precision of the Commentary Can Be Improved by Deleting Extraneous Elements**

The new element of Article 5(5) is intended to create a DAPE in cases when the contractual relationship between contracting parties is determined in a State, but the formal conclusion of the contract occurs outside the State. Paragraph 32.5 of the proposed Article 5 Commentary, as drafted, states that the phrase, “or negotiates the material elements of contracts,” targets arrangements in which “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.”

We believe that the words, “essentially,” and, “possibly with further approval or review,” in the portion of paragraph 32.5 quoted above are unnecessary and make the articulation of the objective of the negotiation portion of the proposed DAPE standard unclear and imprecise. A DAPE arises in a State in respect of a dependent agent that in fact negotiates the material elements of contracts in that State whether or not further activity, such as formal conclusion of the contracts or some level of approval or review of the contract terms, occurs outside that State. This conclusion follows because proposed Article 5(5) considers the negotiation of the material elements of contracts to be sufficient in itself to create a DAPE. At the same time, if a dependent agent does not negotiate the material elements of contracts in a State, the fact that formal conclusion of the contracts or some level of approval or review may occur outside that State is irrelevant, as the dependent agent does not satisfy the threshold condition for a DAPE.

We respectfully recommend that Working Party 1 revise the first sentence of paragraph 32.5 of the proposed Article 5 Commentary as follows to ensure that this paragraph clearly and precisely articulates the objective of the negotiation portion of the proposed DAPE standard:
Paragraph 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. . . .

2. The Material Elements of a Contract Are Those Elements that Are Ordinarily Negotiated Between the Contracting Parties

Paragraph 32.5 of the proposed Article 5 Commentary suggests that the “material elements of contracts” typically include the parties to the contract and the price, nature, and quantity of the goods or services that the contract covers. Contracting parties do not bargain over a contract term unless that term is material. Thus, as a general rule, those contract terms which, as a commercial matter, are ordinarily the subject of negotiation between contracting parties constitute the material elements of a contract. Under this rule, the parties to a contract and the nature of the goods or services that a contract covers do not constitute material elements of a contract as parties do not bargain over these elements. Rather, these contract elements are determined before contract negotiation begins. Price and quantity frequently are, however, material contract elements because contracting parties in many cases would negotiate these terms. In addition, depending on the facts and circumstances of the transaction, terms that contracting parties could negotiate include warranties with respect to the goods or services that the contract covers, indemnities from the contracting parties, terms of use of the goods or services, rights granted / reserved in the goods or services, the term of the contract, and the law governing the contract.

In light of the above, we respectfully recommend that Working Party 1 revise the last sentence of paragraph 32.5 to read as follows:

Paragraph 32.5

. . . For the purposes of that rule, “the “material elements” of contracts” are those contract terms which, as a commercial matter, are ordinarily the subject of negotiation between the 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.
3. **Paragraph 32.6 Does Not Reflect the Negotiation of the Material Elements of Contracts**

Paragraph 32.6 of the proposed Article 5 Commentary incorrectly applies the proposed DAPE standard to the facts described in that paragraph, as it equates demand generation - e.g., marketing and solicitation - with negotiation. In particular, that paragraph includes an example that treats local personnel who drive customers to a nonresident enterprise’s website as “negotiating the material elements of contracts” with the customers, even though in fact no negotiation takes place. This example should be revised, as it simply is not plausible to interpret a treaty term that defines the conditions for tax nexus of a nonresident as the conduct of “negotiations” to mean business activities that in fact do not include negotiation.

The line which defines the local tax nexus of a nonresident must be clear. The PE definition is perhaps the most significant dividing line in international tax law. At least as compared to the other alternatives which were proposed for discussion in the October 2014 Discussion Draft, the recommendation now contained in the Revised Discussion Draft is relatively precise. The policy basis for the new threshold is that tax nexus should arise upon the conduct of negotiation of the material elements of contracts, not upon the conduct of any market-facing activity that directly or indirectly results in the conclusion of contracts with a nonresident enterprise.

“Negotiation” has a precise legal meaning, namely: “A consensual bargaining process in which the parties attempt to reach agreement on a disputed or potentially disputed matter.” It does not include solicitation, marketing, and other forms of one-sided demand generation, as these activities simply do not constitute bargaining between two parties. For the same reason, negotiation does not include customer support activities, such as client relationship management, invoice dispute resolution, and explanation of the sales order process.

We believe that paragraph 32.6 is the appropriate place to make this point clear. Accordingly, we have proposed revisions to paragraph 32.6 that refocus this paragraph solely on illustrating the application of the phrase, “negotiates the material elements of contracts.” These revisions thus excise the sentence, “The paragraph would therefore apply, . . . where the enterprise routinely approves these transactions,” from the paragraph, as this sentence goes to the meaning of contract conclusion. This sentence, which is based on a sentence in paragraph 32.1 of the current Article 5 Commentary, could potentially move to paragraph 32.4 of the proposed Article 5 Commentary, as that paragraph focuses on the meaning of contract conclusion.

We respectfully recommend that Working Party 1 replace paragraph 32.6 of the proposed Article 5 Commentary with the following paragraphs and renumber paragraphs 32.7 and following accordingly:

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Paragraph 32.6

The phrase “negotiates the material elements of contracts” must be interpreted in 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.

Paragraph 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.

Paragraph 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.
4. **A Person that Acts on Its Own Behalf Cannot Give Rise to a DAPE**

Paragraph 32.12 of the proposed Article 5 Commentary establishes that a person that concludes contracts on its own behalf, and obtains property or services from a nonresident enterprise to perform its obligations under the contracts, does not give rise to a DAPE. We fully endorse this proposition but believe that the Commentary should clarify that this principle applies to any person that enters into contracts on its own behalf and obtains goods, services, rights in property, or other items, from a nonresident enterprise to perform its obligations under those contracts. Thus, for example, an affiliate that resells a software license, sublicenses IP, or subleases equipment on its own behalf cannot give rise to a DAPE of a nonresident enterprise from which it obtains the right to distribute software, the IP license with a right to sublicense, or the equipment to sublease.

For purposes of Article 5(5), one legally relevant fact that can distinguish between a person that acts on behalf of another and a person that acts on its own behalf is whether the person records the revenue from the relevant transaction as gross income on its books. Thus, for example, a person that resells software on its own behalf would ordinarily book as gross income the revenues from transactions with its customers. A person that distributes software on behalf of a nonresident ordinarily would not do so.

To clarify that paragraph 32.12 applies to any arrangement into which a person enters on its own behalf, and to provide a useful example of when a person enters into contracts on its own behalf, we respectfully recommend that Working Party 1 revise proposed Article 5(5) and paragraph 32.12 of the proposed Article 5 Commentary as follows:

**Article 5(5)**

... that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph. *This paragraph shall not apply to a person acting on its own behalf.*

**Paragraph 32.12**

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. In these cases, . . . (regardless of how long the distributor would hold title in the product sold). Another example is that of SCO, a company resident of State S, which resells online software services (commonly referred to as “Software-as-a-Service”) to customers in State S. RCO, a company resident of State R, appoints SCO as the reseller of RCO’s online software services. RCO provides the online software services directly to SCO’s customers. SCO records on its books as gross income the revenue derived from the online software service contracts with customers. As SCO concludes online software service contracts with customers on its own behalf, paragraph 5 does not apply.

C. Statements of Policy in the Revised Discussion Draft Should More Accurately Reflect the Policy Foundation of the Negotiation Standard in Proposed Article 5(5)

In the BEPS Action Plan, the OECD characterized Action 7 as a response to the fact that the current DAPE standard did not capture arrangements in which “contracts for the sale of goods belonging to a foreign enterprise [are] negotiated and concluded in a country by the sales force of a local subsidiary of that foreign enterprise.” The Action Plan thus precisely defined the activities that would constitute the DAPE rule as both (i) contract conclusion and (ii) contract negotiation.

As noted above, “negotiation,” has a precise legal meaning. It is different from demand generation, marketing, sales solicitation, or other customer-facing activity that does not involve the negotiation of contract terms.

Certain statements of policy in the Revised Discussion Draft, however, are not entirely consistent with the Action Plan’s precise focus on the commercial function of “negotiation.” Some statements may imply that activities other than contract conclusion or contract negotiation could give rise to a DAPE. To ensure that the Revised Discussion Draft is consistent with the foundational statement of principle in the Action Plan, we respectfully recommend that Working Party 1 revise these statements as follows, if this text will be contained in further OECD guidance communicating the final treaty and Commentary text:

Revised Discussion Draft, Executive Summary, p. 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 commissionaire 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

3 See OECD, Action Plan on Base Erosion and Profit Shifting, p. 19 (July 2013); see also Revised Discussion Draft ¶ 2.
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.

Revised Discussion Draft ¶ 13

. . . . As a matter of policy, where the activities that an intermediary exercises in a country constitute the habitual 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.

As revised, these excerpts from the Revised Discussion Draft would more clearly reflect the policy decision to change the definition of tax nexus to include dependent agents which engage in the habitual negotiation of material elements of contracts on behalf of another person.


The proposals in the Revised Discussion Draft constitute changes to Article 5 and the Article 5 Commentary. The policy statements in the Revised Discussion Draft provide the justifications for these changes. Neither the proposals nor the policy statements can therefore be considered permissible constructions of existing treaties based on the Model Tax Convention, as bilateral tax treaties would first have to be amended to reflect proposed Article 5 for these proposals and statements to be relevant.

Paragraph 8 of the Revised Discussion Draft supports this conclusion, as this paragraph states that “nothing in the proposals included in this discussion draft should be interpreted as reflecting the views of the OECD or of any country concerning the interpretation of the existing provisions of the OECD Model Tax Convention and of treaties in which these provisions are included.” This statement is nevertheless incomplete, as it does not state that the proposals and the policy statements in the Revised Discussion Draft (i) do not represent permissible constructions of existing treaty law and (ii) are relevant only to treaties that incorporate the proposals in the Revised Discussion Draft. Accordingly, we respectfully recommend that Working Party 1 include in final guidance communicating the treaty and Commentary changes the following statement, which is based on paragraph 8 of the Revised Discussion Draft:

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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.

IV. Working Parties 1 and 6 Should Jointly Conduct the Follow-up Work on Profit Attribution to Which the Revised Discussion Draft Refers

We commend the OECD for deciding to pursue follow-up work on profit attribution in connection with Action 7. We believe that Working Parties 1 and 6 are best positioned to conduct this follow-up work on a joint or at least collaborative basis, on the grounds that profit attribution represents the intersection of the PE and transfer pricing rules. As the work which developed the Authorized OECD Approach was undertaken by the OECD, any follow-up work on profit attribution should be performed by the relevant OECD working parties.

We are grateful for the opportunity to provide these comments, and look forward to further participation in the BEPS process.

Sincerely,

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cc: Members of the Software Coalition

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4 See Revised Discussion Draft ¶ 57.
Dear Ms. De Ruiter,

The Swiss Bankers Association (SBA) is the leading professional organisation of the Swiss financial centre. Its main purpose is to maintain and promote the best possible framework conditions for the Swiss financial centre both at home and abroad. The SBA was founded in 1912 in Basel as a trade association and today has 317 institutional members and approximately 18'200 individual members.

The SBA would like to thank the OECD for the opportunity to comment on the revised discussion draft on Action 7: preventing the artificial avoidance of PE status.

We would like to build on the comments we made on 9 January 2015 and highlight the few following points that need in our opinion further consideration.

1. Coherence within the BEPS Project

We think that there should be an overall coherence within the BEPS project, which is missing at this stage according to us. To illustrate this, we would like to mention the three following examples:

- Deadline for the follow-up work on attribution of profits issues related to Action 7 should be aligned with the deadline set for Action 7: the deadline for the follow-up work has been set for the end of 2016, whereas the BEPS project should be completed by the end of 2015. We consider that the issue of attribution of profits related to Action 7 is crucial for Action 7 and should be handled within Action 7, with no time lag. Not treating attribution of profits related to Action 7 together with Action 7 itself does not make much sense according to us.
- Relation with Action 1 (Addressing the tax challenges of the Digital Economy) should be clarified: the revised draft on Action 7 does not contain any reference to
Action 1, whereas in “Action 1: 2014 Deliverable” the issues related to permanent establishments appeared to be crucial. For the sake of clarity, a reference to Action 1 in Action 7 would have been useful.

- There are neither common concepts nor clear delimitations with respect to connected vs. related persons: Action 7 foresees (see revised discussion draft p. 13) that “a person shall be connected to an enterprise if one possesses at least 50 per cent of the beneficial interests in the other”, whereas in the context of Action 2 “Neutralising the Effects of Hybrid Mismatch Arrangements” related persons are defined as follows: “Two persons are related if they are in the same control group or the first person has a 25% or greater investment in the second person or there is a third person that holds a 25% or greater investment in both.” (see “Action 2: 2014 Deliverable”, Definitions, p. 69). There is therefore no alignment of the concept(s) nor of the thresholds across the various actions. We think that a 50% investment, which corresponds to the threshold allowing full consolidation according to IFRS, would be the most appropriate.

2. Artificial avoidance of PE status through commissionaire arrangements and similar strategies

Paragraphs 32.5 and 32.6, page 15 of the revised discussion draft should be further clarified. It is very difficult to assess what the phrases "or negotiates the material elements of a contract" and "concludes contracts or negotiates the material elements of contracts" mean for the service industry and namely for the financial sector. In particular for the banking industry where employees are visiting clients outside the country of residence of the bank further guidance should clarify what kind of activities are regarded as material elements of a contract. In this case, an employee of a bank has typically no authority to conclude any contract with clients or to make any binding offer since such contracts/offers are subject to extensive checks and controls in the head office of the bank. However, an employee might present an investment proposal to a client but does not negotiate or add/remove anything to/from the proposal. Therefore such an activity cannot be regarded as a "material element of the contract". We would like to stress that such situations do not only occur in the banking sector but are an issue for all international groups in the whole service industry. As a consequence, the definitions contained in paragraphs 32.5 and 32.6 should be clarified in order to be able to assess whether an activity leads to the creation of a permanent establishment or not. For the sake of completeness we would also like to point out that a permanent establishment can only be established in case of a physical presence in a country (e.g. travelling employee in the example above). A permanent establishment can never result from an activity performed via remote means (i.e. by phone, e-mail or Internet).

3. Artificial avoidance of PE status through the specific activity exemptions

We strongly disagree with the content of the last sentence of paragraph 21.2, page 24 of the revised discussion draft, according to which the sole amount of assets or employees can lead to the conclusion that no preparatory or auxiliary activity is given. For example outsourcing activities can lead to situations where a large number of persons are employed in a country but only auxiliary activities are performed. Such activities typically do not add much to the value chain (e.g. production of reports for internal purposes). In addition, it should be made very clear, that in case an international group is
present in a country with a subsidiary and the subsidiary is providing services to the headquarter (e.g. providing the management of the headquarter with reports) no permanent establishment is assumed. Such situations should be handled by applying transfer pricing rules and not by assuming that there is a permanent establishment (in addition to the subsidiary) in a country.

4. Fragmentation of activities between related parties

Concerning paragraph 30.3, page 32 of the revised discussion draft, it should be made very clear that several types of preparatory and/or auxiliary activities in a country do not lead to the creation of a permanent establishment simply on the basis of the “fragmentation of activities between related parties” concept. The concept of fragmentation should only be applied in cases where activities are artificially split to avoid the creation of a permanent establishment that would have been clearly given without the fragmentation. This is not the case for example if a bank maintains a representation office in a country (i.e. performing only auxiliary activities such as socializing in the said country) and if an employee of the same bank (but employed in the country of the headquarter) is travelling to this country to meet clients and perform other types of auxiliary activities such as providing the clients with generic financial research reports. In our view, the concept of fragmentation should be refined.

The SBA thanks the OECD for taking due account of these comments.

Yours sincerely,
Swiss Bankers Association

Regula Häfelin  Jean Brunisholz
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Head, Tax Treaties, Transfer Pricing and Financial Transactions Division  
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Via Email:  taxtreaties@oecd.org

RE: Revised Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status

Dear Ms. de Ruiter:

On 19 July 2013, the OECD published an *Action Plan on Base Erosion and Profit Shifting* (hereinafter the Plan) setting forth 15 actions the OECD will undertake to address a series of issues that contribute to the perception that individual countries’ tax bases are being eroded or profits shifted improperly. Pursuant to Action 7 of the Plan, “Prevent the artificial avoidance of PE status,” the OECD issued a public discussion draft on 31 October 2014 (hereinafter the October Draft). After receiving comments and holding a public consultation on the October Draft in January 2015, on 15 May 2015 the OECD released a revised discussion draft entitled *BEPS Action 7: Preventing the Artificial Avoidance of PE Status* (hereinafter the Revised Discussion Draft or Revised Draft). The OECD requested comments on the Revised Draft no later than 12 June 2015. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the OECD’s request for comments.

**TEI Background**

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organisation has 56 chapters in Europe, North and South America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws,
at all levels of government. Our nearly 7,000 individual members represent over 3,000 of the largest companies in the world.¹

**TEI Comments**

TEI commends the OECD for the substantial improvements of the proposed modifications to the definition of a permanent establishment (PE) in Article 5 of the OECD’s model tax convention, as reflected in the Revised Discussion Draft. In particular, limiting the application of paragraph 6 of Article 5, regarding independent agents, to cases where the agent is “connected” to an enterprise ensures that there is a proper basis to impute the actions of the agent to the enterprise for purposes of creating a PE of the enterprise. Leaving in place the specific activity exceptions of paragraph 4, regarding activities that are generally of a preparatory or auxiliary nature, instead of eliminating one or more of them, is also welcome.

Even with these improvements, many of the changes proposed in the Revised Draft will regrettably lead to an increase in uncertainty and controversy over the tax consequences of entering new markets. The uncertainty will discourage cross-border business operations, whether they are conducted by a multi-national enterprise (MNE) entering a new market or a local company expanding internationally for the first time. As we discussed in our comments on the October Draft,² the tax consequences of inadvertently creating a PE are drastic and therefore any uncertainty regarding whether a PE exists is amplified and will result in a concomitant reduction in international business activity.

**Revised Option B – Paragraph 5**

Paragraph 5 of Article 5 of the OECD model convention addresses the circumstances when the use of a dependent agent by an enterprise within a state will give rise to a PE of that enterprise in that state. The Revised Discussion Draft sets forth “Option B” as the preferred option to address concerns arising from the use of commissioneer arrangements by MNEs to conduct business in a jurisdiction without creating a PE. While paragraph 5 of Option B is unchanged from the October Draft, TEI commends the OECD for recognising in the Revised Draft that “the changes to Art. 5(5) were not intended to address BEPS concerns related to the transfer of risks between related parties through low-risk distributor arrangements . . . .”³ Thus, the Revised Draft proposes to include a paragraph in a revised official commentary to Article 5

¹ TEI is a corporation organised in the United States under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).
³ Revised Discussion Draft, p.12
providing that the changes from the previous definition of a PE in the OECD model convention are not intended to reach a “so-called ‘low-risk distributor’ as long as the transfer of the title to property sold by that distributor passed from the enterprise to the distributor and from the distributor to the customer (regardless of how long the distributor would hold title in the product sold).”\textsuperscript{4} This is a welcome clarification.

Nevertheless, portions of the proposed revisions to the official commentary in the Revised Discussion Draft raise significant concerns. First, the expansion of “habitually concludes contracts” to “habitually concludes contracts or negotiates the material elements of contracts” is so broadly worded that it will be applicable to some of the most basic business practices of MNEs, will capture much more than the targeted commissionaire arrangements, and will apply to many transactions that do not raise BEPS-related concerns. For example, many businesses require goods and services to be delivered in multiple locations around the world. To ensure that the goods and services are always provided under the same terms and conditions, to meet the same standard, and to save time in negotiation and administration of contracts, a global master service agreement is often negotiated by a lead service provider (\textit{e.g.}, the parent company). The master service agreement terms are then incorporated by reference into local agreements with local subsidiaries. The local agreement is reviewed, approved and signed by the local subsidiary; however, to keep each local subsidiary from re-negotiating the contract, modifications are generally limited to changes that are necessary because of specific local business needs or to satisfy local legal, tax and other regulatory requirements. The local agreement will generally arrange for the provision of the local goods and services and for taxes to be paid on the local activities by the local subsidiary.

Given the relationship between the entity negotiating the master service agreement and the local affiliates, the independent agent carve-out as proposed in new paragraph 6 of Article 5 will not apply. Thus, it seems under the Revised Draft the parent company likely will have a PE in each location that a local agreement is executed based on the master services agreement. Given that the local subsidiary is already paying tax for its local activities, the lead service provider (\textit{i.e.}, the parent) that negotiated the global master agreement should not also have a PE in the local jurisdiction merely by virtue of the agreement. Moreover, no additional taxes would likely be assessable if there is no material change to the profit attribution rules. However, the creation of a PE of the parent company would add complexity and administrative burden if having a PE means that the lead service provider would be required to register and file tax returns. In addition, the number of disputes and potential double taxation will likely increase due to different interpretations of what constitutes “negotiating material elements of contracts” or in the application of modified profit attribution rules that are still to be determined.

\textsuperscript{4} \textit{Id.} at 16.
The proposed commentary of the Discussion Draft also stretches the interpretation of the phrase “concludes contracts” beyond any reasonable definition. Specifically, paragraph 32.4 indicates that a contract may be considered to be concluded in a state (i) even without any active negotiation of the terms of that contract, or (ii) if a person accepts, on behalf of an enterprise, the offer made by a third party to enter into a standard contract with that enterprise even if the contract is signed outside of that state. MNEs often create standard legal templates to save time and resources relating to negotiation and administration of contracts that are unrelated to any perceived attempt to engage in base erosion or profit shifting. The above new interpretation of concluding contracts as proposed is overly broad and would create unintended PEs where no BEPS activities are evident.

TEI recommends that the “habitually negotiates the material elements of contracts” only be applied where there is an actual abuse of a treaty’s provisions and where the applicable tax is not otherwise being paid by the local subsidiary. Although commissionaire structures have been targeted by the OECD, they remain acceptable from a legal and commercial standpoint and tax authorities should not automatically consider a business’ choice of such a structure to be abusive. The Member States’ primary concern seems to be that profits from the sale of goods and services are not being taxed to the same extent as they would be if the sales were made by a distributor. TEI understands that the OECD fears that profits from the transaction would otherwise be untaxed or taxed at very low rates, but that remains a factual interpretation and should not per se be ruled as abusive by employing the broad language proposed in the Revised Draft. A more concise rule would serve taxpayers better. If the OECD refuses to make concise recommendations, it should use broad definitions sparingly. Thus, the new interpretation on concluding contracts under paragraph 32.4 should be abandoned and the years of case law and interpretation on concluding contracts should be left in place.

Proposed changes to the specific activity exemption

The Revised Discussion Draft proposes changing paragraph 4 of Article 5 by requiring that each of the specific activity exemptions to PE status be of a preparatory or auxiliary character. The Revised Draft also includes substantial revisions to the commentary on this paragraph of Article 5, including examples set forth in paragraph 22.5 of the Revised Draft that raise concerns. In particular, in Example 1 the only activity being performed in State S is the purchasing function, which is performed through an office and staffed by “experienced and well-paid buyers.” From the example, it is not clear what the offending BEPS activity is and what deeming RCO (the out of state purchaser) to have a PE in State S would achieve other than increasing RCO’s registration and administrative filing requirements. Assuming there are no sales to customers in State S and there is no material change to the profit attribution rules, if the purchasing office is deemed to be a State S branch (PE) of RCO, it will merely have continuing

\[\text{Id. at 26.}\]
branch losses. However, the above deemed PE may have a tax impact if the profit attribution rules substantially change (e.g., to global apportionment of income). Is that the OECD’s intention?

Would the deemed PE arise if instead of being part of RCO, there is a separate legal entity whose only function is purchasing or research and development activities or any of the specific activity exemptions, or would the separate legal entity be respected? If respected, presumably the separate legal entity would enter into related party transactions with its various affiliates; therefore, it is more appropriate to apply the transfer pricing rules to ensure that each entity pays the proper amount of tax.

**Anti-Fragmentation Rule**

The Revised Discussion Draft proposes a new paragraph 4.1 to Article 5 addressing the fragmentation of cohesive business activities into constituent elements, all of which are of a preparatory or auxiliary nature even though the activities taken as a whole would constitute a PE. The Revised Draft adopts “Option J” from the October Draft (with minor changes) and would allow aggregation of activities that together rise to the level of a PE to attribute a PE to the enterprise carrying on the activities. This new paragraph would apply if, for example, an enterprise had an established business line within a country that constituted a PE and then a second business line of the enterprise began operations within the same country. The operations of the second business line would thus be considered part of the PE of the first business line, even if the second business line was wholly separate from the first and was conducted via a separate legal entity (as long as that legal entity was “connected” to the first). The only limitation on combining activities is that they must “constitute complementary functions that are part of a cohesive business operation.”

This is a form of a force of attraction rule that does not comport with modern business practices in MNEs. As noted in our prior comments, many MNEs are divided functionally on a worldwide basis so that, e.g., the purchasing function is separated from the manufacturing operation, which is separated from the sales function. Each of these functions would have its own management, reporting lines, and financial statements. Commercial advantage is the primary driver behind utilising the specialisation, expertise, economies of scale, and flexibility that accompanies this manner of conducting worldwide operations. These separate organisations may then enter particular markets to carry out their specialised functions in the most tax efficient manner, which may include avoiding PE status. TEI therefore recommends that no such paragraph be included in a revised Article 5.

In addition, the approach in the Revised Draft to combine separate functions of an enterprise to create a PE seems to be inconsistent with the approach taken in the 22 May 2015 revised discussion draft under BEPS Action 6: Prevent Treaty Abuse. The Action 6 draft
proposes adding a limitation on benefits (LOB) provision to the OECD model that can be satisfied where an enterprise carries on an “active business” within a jurisdiction (see Paragraphs 70-72 of the Action 6 draft). The proposed revisions to the LOB provision in that draft, however, only permit aggregation of business activities conducted by different related persons if such “persons are in the same or a similar line of business.” Obviously, this language differs from the “complementary functions that are part of a cohesive business operations” in the Revised Draft. TEI recommends that the OECD conform these approaches or further explain the reasons for the differing language.

Splitting-up of contracts

The Revised Discussion Draft also includes recommendations that would address enterprises splitting-up related contracts to avoid the 12 month PE threshold in paragraph 3 of Article 5. The Revised Draft includes an example illustrating the issue being addressed, along with an alternative provision that might be included in paragraph 3 listing factors that may be relevant in determining whether “connected” activities were split-up to avoid the paragraph 3 time threshold. These factors include “whether the conclusion of additional contracts with a person is a logical consequence of a previous contract with that person or related persons.”

The example is of little use in explaining the issues raised by MNEs splitting up contracts because it presents a simple case of a 22 month construction contract being broken up into two 11 month contracts, each with a separate entity of the contracting enterprise. Moreover, the contracts are negotiated and executed simultaneously (it appears) and provide for joint and several liability. The Revised Draft concludes these separate contracts can be aggregated under a revised OECD model treaty. Beyond this simple example and the optional factors listed, however, taxpayers are left with little guidance on when separate contracts will be aggregated for purposes of the 12 month period in paragraph 3 of Article 5. TEI submits that the factor addressing whether the additional contract was a “logical consequence” of a prior contract is overbroad and misleading. For example, a purchaser may put out for bid a contract to build, e.g., a system prototype and award that contract to Company A, which then builds the prototype over a nine month period. Sometime later, perhaps months or longer, the purchaser then awards the contract for full production of the product based on another solicitation of bids to unrelated Company B. Obviously in that case Company A should not have a PE because it does not satisfy the 12 month threshold. However, if Company A was awarded the subsequent full production contract, under the proposed rule it runs the risk that the production contract will be aggregated with the contract for the prototype and retroactively cause Company A to have PE back to the beginning of the prototype contract. This would appear to be the case even if there was no guarantee that Company A would be awarded the production contract and even if a substantial period of time had passed between the prototype and full production contract.
periods – because the awarding of the production contract could be interpreted as a “logical consequence” of awarding the prototype contract. TEI recommends that the OECD include an example in the final guidance under Action 7 along these lines and also specify that if the awarding of a subsequent contract was a later event contingent on actions outside of the contractor’s control, then that should be a factor in deciding whether to aggregate contracts for purposes of the 12 month rule.

Conclusion

TEI appreciates the opportunity to comment on the OECD Revised Discussion Draft regarding the artificial avoidance of permanent establishment status. These comments were prepared under the aegis of TEI’s European Direct Tax Committee, whose Chair is Nick Hasenoehrl. If you have any questions about the submission, please contact Mr. Hasenoehrl at +41 786 88 3772, nickhasen@sbcglobal.net, or Benjamin R. Shreck of the Institute’s legal staff, at +1 202 638 5601, bshreck@tei.org.

Sincerely yours,
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Revised Discussion Draft on Action 7 and Permanent Establishment Status  

TD appreciates the opportunity to submit comments on the OECD’s Revised Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status issued on May 15, 2015.  

Before commenting on specific issues raised by this Revised Discussion Draft, we are reiterating our grave concern that the combined BEPS proposals would have a stifling impact on global business and, as a result, have the potential of reducing corporate tax revenues for governments globally. The OECD should not lose sight of the fact that the role of business in the global economy is to produce goods and services and to create jobs – the primary role of business is not to raise revenue for governments. The OECD is on record as saying that governments should rely less and less on corporate tax as a tool to raise revenue, because corporate tax is a highly inefficient tax – corporate tax raises relatively little revenue for governments at an excessively high compliance cost and significantly reduces commercial activity. This is especially a concern because not all businesses are subject to corporate tax, which increasingly is creating an un-level playing field. We encourage the OECD to dedicate more resources to assessing the macro-economic impact of the proposed BEPS measures prior to finalizing these measures.  

Regarding the specific issues raised by the Revised Discussion Draft, our comments build on the comments that TD submitted on January 9, 2015 on the OECD’s October 31, 2014 discussion draft on Action 7.  

While we believe that the Revised Discussion Draft is an improvement upon the original discussion draft, we continue to be very concerned about the overall approach that is being pursued with respect to the permanent establishment (PE) standard under Action 7:
• Lowering the PE standard and creating new PEs for global businesses in countries where they have limited activities would dramatically increase compliance and administration burdens on businesses and tax authorities alike. These increased burdens represent real costs. A real cost-benefit analysis should be done before these proposals are advanced any further.

• Making the PE standard vague or "fuzzier" would create substantial uncertainty for global businesses. Increased uncertainty would have a chilling effect on cross-border trade and investment. And uncertainty is a cost for which there is no corresponding benefit in the system – uncertainty is a deadweight cost to the global economy.

• Making the PE standard "fuzzier" also would increase the likelihood of inconsistent and conflicting interpretations. This would create more controversy, at a time when mutual agreement procedures and dispute resolution mechanisms in countries around the world already are strained to the breaking point and beyond. This also would create substantial risk of double taxation, which would be a significant barrier to cross-border trade and investment.

In addition, we are concerned that the OECD is proposing these kinds of changes to the PE standard without at the same time addressing the approach for attribution of profits to the PEs that would be created. As we noted in our prior comment letter, it is impossible to evaluate the proposed changes to the PE standard without also knowing how profits are to be attributed. We appreciate the acknowledgement in the Revised Discussion Draft that additional guidance would be needed on how to apply attribution of profits rules to such new PEs. We also welcome the decision that follow-up work on attribution of profits issues related to the PE changes under Action 7 will be done with a view to providing guidance in this area before the 2016 year-end deadline for negotiation of the multilateral instrument that is intended to be used as a mechanism to incorporate the Action 7 recommendations into bilateral tax treaties. However, we urge the OECD to commit to following a discussion draft, comment and consultation model as it looks at such attribution of profits issues. We believe that input from global businesses will be critically important in any effort to develop appropriate and practical rules in this area. At the same time, we urge the OECD to make clear that any proposed changes to the Action 7 report to be issued in the autumn will not be considered to be final until the work that is yet to come on profit attribution has been completed.

We would like to reiterate two of the technical issues that we addressed in our previous comments on the discussion draft: (1) the proposed changes to Article 5(5) and 5(6) of the OECD Model Tax Convention relating to when the activities of an agent would be considered to constitute a PE for the principal and (2) the proposed changes to the specific activity exemptions in Article 5(4).
First, with respect to the proposal to create new PEs based on activities of an agent, we believe that the proposal continues to be overly vague. More guidance is needed on when a person would be considered to "negotiate the material elements of contracts." The proposed Commentary language in the Revised Discussion Draft is a good start, but further explanation is needed. Illustrative examples would be valuable as well.

We also continue to be concerned about the proposal to exclude from the independent agent exception any person that "acts exclusively or almost exclusively on behalf of one or more enterprises to which it is connected." This is a critically important issue in the banking business where activities often are conducted in different entities for regulatory, capital, or commercial reasons. In this context, one entity may function solely as a service provider to other entities in the banking group. We believe that separate entity status should be respected in such situations and we urge the OECD to make this clear as the work on Action 7 moves forward.

Second, with respect to the proposal to make the specific activity exemptions subject to an additional requirement that the functions be preparatory or auxiliary, we believe that it is essential that the phrase "preparatory or auxiliary" be clearly defined. Here again, we appreciate the proposed Commentary language in the Revised Discussion Draft, which is a good start. However, further explanation and illustrative examples are needed.

Also related to the specific activity exemptions, we have similar concerns about the implications of the proposed expansion of the anti-fragmentation rules. Consistent with the point made above about the entity arrangements in a global banking business, often multiple entities in a banking group will be involved in a particular activity because of regulatory, capital, or commercial considerations. This should not be considered to involve inappropriate BEPS-driven fragmentation and no new aggregation requirement should be imposed.

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We appreciate the opportunity to provide these comments on key issues in the Revised Discussion Draft under Action 7. We would be happy to respond to questions or to provide any further information that would be useful as the OECD continues its work in this important area.

Sincerely,

Peter van Dijk
Senior Vice President, Tax
TD Bank
June 9, 2015

VIA E-MAIL – taxtreaties@oecd.org

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Re: Treaty Policy Working Group Comments on Revised Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status

Dear Ms. de Ruiter:

We are writing to share the comments of the Treaty Policy Working Group on Revised Discussion Draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status, released on 15 May 2015 for comment by 12 June 2015.

The Treaty Policy Working Group (TPWG) is an informal association of large global companies based throughout the world that represent a broad spectrum of industry sectors. The TPWG has been working since 2005 with the OECD, and more recently with the UN, to analyze and provide constructive comments on tax policy and administration concerns regarding permanent establishment (PE), profit attribution, transfer pricing, and related issues that are critical to our ability to avoid double taxation and conduct international trade and investment. The TPWG has provided comments on and participated in consultations regarding all of the OECD discussion drafts on transfer pricing issues over the past decade and also provides input on the relevant UN work in this area.

The TPWG is pleased to comment on the Revised Discussion Draft, which addresses issues of great importance to our member companies.

1 The membership of the Treaty Policy Working Group is currently comprised of the following companies: Amazon.com, Inc.; BP plc; Cisco Systems, Inc.; Procter & Gamble Co.; Salesforce.com Inc.; TD Bank Group; Thomson Reuters Corporation; Tupperware Brands Corporation; and Vodafone Group plc.
Our comments below first offer some general concerns and then set forth our key substantive concerns regarding the Revised Discussion Draft. We have honored the request for brevity but would appreciate an opportunity to provide further clarification if necessary.

I. General Concerns

    A. Implications for International Trade and Investment

PE disputes are unusually difficult to resolve, due to their binary nature. This is a serious concern for international businesses, as PE status determines their tax filing, reporting, and payment obligations around the world as well as their ultimate tax liability on business profits. Some tax administrations are even attempting to assert VAT liability based on deemed income tax PEs, or vice versa, although there is no basis in treaties for linking the two. The exposure is heightened by the fact that, in many jurisdictions, the statute of limitations on assessment and collection never starts to run if no return has been filed, as is typically the case where a PE is deemed by the tax administration to exist. If conflicting interpretations arise because the PE threshold is unclear or unagreed, the resulting disputes will almost certainly go unresolved, with no treaty relief from double taxation, even in competent authority proceedings, absent effective arbitration. The risk of unrelieved double taxation is further heightened by the general lack of appetite for effective dispute resolution and the absence to date of additional profit attribution guidance.

Faced with this economically unsustainable risk, global businesses will be forced to reduce their footprint around the world to limit their exposure to unexpected PE assertions. A lack of clarity and consensus on the PE threshold could, therefore, quickly turn tax treaties into barriers to the very international trade and investment they are negotiated to facilitate. This would cause particular harm to low-income countries and other smaller markets that are especially dependent on such trade and investment. It would also undermine the long-standing tax treaty and trade policy of the OECD and the UN and their member jurisdictions and the core missions of these and other multilateral organizations. Those that seek to encourage international trade and investment and the resulting economic growth and improvements to living standards should tread with particular care on PE issues.

    B. Lack of Clarity

The Revised Discussion Draft makes several welcome clarifications to the prior Discussion Draft, including the confirmation that the proposed changes to Article 5 (5) are not intended to reach buy-sell arrangements, including low-risk distributors. We also welcome the announcement that additional profit attribution guidance will be developed, as promised by the BEPS Action Plan.
However, the proposed changes remain too unclear to facilitate voluntary compliance, ensure consistent tax administration, and avoid the proliferation of controversies. Both potential investors and treaty partners need and deserve guidance that enables them to know in advance whether a PE will be found and to understand the implications of having a PE.

Leaving the PE threshold unclear is especially troubling because it creates a one-way street. In practice, tax administrations tend to assert deemed PEs only where they seek to attribute profit, while resisting the declaration of PEs in loss situations. This is unprincipled and should not be facilitated through the adoption of unclear text.

These concerns regarding uncertainty are exacerbated by the fact that many tax administrations now appear to be viewing PEs as tools for raising new revenue, rather than as thresholds that limit taxing jurisdiction to encourage international trade and investment. Some tax administrations are even seeking to attribute gross in-country sales revenue to new deemed PEs, contrary to basic anti-force of attraction and arm’s length principles. Indeed, contrary to current treaty provisions, many appear to believe that all multinational enterprise groups with customers in a jurisdiction should be deemed to have a PE to which substantial additional profits may be attributed, even if they lack the requisite physical presence or contract-concluding dependent agent activity, or do not conduct functions, use assets, or bear risks that could provide a basis for profit attribution. And some have gone so far as to assert that not creating a PE in a market jurisdiction is tantamount to tax avoidance. Adopting ambiguous changes to the PE threshold in this context would be inconsistent with the BEPS Action Plan’s commitment to make only limited PE changes and not seek to change the balance between source and residence taxation. It would also seem imprudent, especially for jurisdictions that are (or hope to become) exporters as well as importers of goods and services.

We appreciate that the lack of clarity may be unintended on some points. The Revised Discussion Draft relies heavily on examples which, while helpful, often posit facts of questionable relevance and indeterminate meaning, such as “significant” number of employees and “very large” warehouse. To avoid ambiguity and controversy, all proposed changes should be reflected clearly in the operative Model Convention and Commentary texts and extraneous facts should be omitted from the examples.

C. Effective Date Issues

BEPS Action 7 states clearly that its recommendations will change existing treaty provisions, and even the Revised Discussion Draft states that it reflects “a policy re-evaluation of the existing permanent establishment definition”. However, some tax administrations are already taking the position in examinations and MAP proceedings that the proposed Action 7 changes constitute mere clarifications of the current Article 5 and Commentary texts and thus may be given retrospective effect under their existing treaties. Some jurisdictions are even asserting the application of the proposed changes prior to their finalization and for years predating the BEPS
Project. The principles of the Authorized OECD Approach are not being applied consistently in such cases, even by many OECD member countries, to attribute profits to the new deemed PEs. This situation creates serious concerns that the changes ultimately adopted will not be respected by all tax administrations as substantive changes that may be applied only with prospective effect, following the amendment of applicable treaty agreements.

To avoid this result, which would be contrary to the intent of BEPS Action 7, the final Action 7 report should confirm explicitly and unambiguously that:

- All of the changes made to Article 5 and its Commentary pursuant to the work on Action 7 will constitute substantive changes to the current treaty texts; and

- None of the changes made will be given effect for taxable periods beginning before the date on which changes to the text of Article 5 have been made to the applicable treaty and have entered into force and become effective.

For similar reasons, given the potential lack of consensus regarding the attribution of profits to the new deemed PEs and the fact that supplemental guidance on this issue is not due to be completed until December 2016, we request that the BEPS guidance instruct participating countries not to take action in the meantime to implement the Article 5 changes in their treaties with effect for periods prior to the implementation of the forthcoming profit attribution guidance.

D. Lack of Specific Profit Attribution Guidance

The prior Discussion Draft indicated that work to date had “not identified substantial changes that would need to be made to the existing rules and guidance concerning the attribution of profits to a permanent establishment.” We agree with this conclusion and believe that the general principles of the AOA, as finalized in 2010, should be applied equally to existing PEs and to any new PEs created as a result of the work on Action 7. However, given the intense interest in many jurisdictions in lowering the current PE threshold and the current practices of many tax administrations, businesses are seriously concerned that unpredictable and unprincipled attributions of profits will follow the implementation of changes made to the PE threshold. There is thus an urgent need for specific guidance on the manner in which profits may be attributed to PEs that may be deemed to arise as result of the changes made to the PE threshold. This profit attribution guidance should confirm the manner in which current AOA principles will apply to typical deemed PE scenarios created by the new PE guidance.

Delegates participating in WP1 and WP6 should start working together as soon as possible to develop such guidance. To minimize confusion and controversy in the interim, when the PE guidance under Action 7 is finalized, that guidance should explicitly confirm that the principles of the current AOA guidance will continue to apply to provide a common minimum baseline.
II. Specific Concerns Regarding the Proposed Changes

In addition to the general concerns above, we are concerned about many of the specific changes proposed by the Revised Discussion Draft. In the interest of brevity, we summarize below only the most important mutual concerns of our member companies:

- The new Article 5 (5) text and Commentary describe contract “negotiation” in an overbroad and indeterminate manner that threatens to go far beyond the commissioner arrangements targeted by Action 7. This creates a risk that many mere promotional and marketing activities might be viewed by some as creating deemed dependent agent PEs. The effect would come dangerously close to providing that a PE may be deemed to exist wherever sales are made into a market. We assume that is not the intent of the proposed changes, given the limited scope of Action 7, but the proposed text needs to be clarified, ideally by more clearly defining what constitutes “negotiation,” to preclude such arguments.

- As noted above, we welcome the confirmation in the Revised Discussion Draft and its proposed Commentary that buy-sell arrangements, including low-risk distributors, are not intended to be affected by the changes proposed to Article 5 (5) to reach commissioner. We are concerned, however, that this intent could be disregarded in practice, because the statement appears only in the Commentary and is not referenced in the treaty text itself. We are also concerned that some of the discussion regarding such arrangements references only product distribution, although the same principle should apply equally to services, leasing, and licensing transactions. To avoid any interpretive issues that might disrupt such common commercial transactions, these important points should be explicitly confirmed by adding text in Article 5 (5) itself to confirm that persons performing such transactions will be considered to be acting on their own behalf and not “on behalf of” another enterprise.

- The longstanding “preparatory or auxiliary” exception for fixed place of business PEs has always been important both to the treaty mission of encouraging international trade and investment, and to avoiding the creation of unproductive burdens for businesses and tax administrations. It is particularly important to developing countries and to SMEs from all countries that may wish to pursue markets abroad without triggering onerous tax compliance requirements that they are not yet equipped to handle, which could otherwise operate as trade barriers. The meaning of “preparatory or auxiliary” will assume much greater importance if the specified exceptions in Article 5 (4) for showrooms, warehouses, information-gathering activities, and other forms of limited presence are subjected to an overall “preparatory or auxiliary” requirement.

The Commentary has long indicated the view that no general definition of “preparatory or auxiliary” is possible. Unfortunately, instead of remedying this lack of definition, the proposed changes would effectively use two other, equally ill-defined terms as the
operative threshold – looking to whether an activity is an “essential and significant” part of the activity of the enterprise as a whole. The proposed new Commentary attempts to illustrate this concept in examples that reach conclusions that are difficult to reconcile on a principled basis (e.g., that the use of a warehouse can be considered “essential and significant” for a business that sells and distributes its products, while the use of a pipeline is not essential and significant). The central concept of a “cohesive business” in proposed paragraph 21 also remains undefined, although it assumes increased importance with the proposed expansion of anti-fragmentation provisions. The “preparatory or auxiliary” exception and related terms need to be given a true definition rather than a few targeted examples that fail to illuminate its parameters in a principled manner.

• Finally, we are concerned that the proposed “anti-fragmentation” rule would apply to render the “preparatory or auxiliary” exceptions of Article 5 (4) completely inapplicable in any case where the MNE group has a legal entity in the jurisdiction. The rationale for this significant change is unexplained and deserves further reflection, as it would substantially erode the scope of Article 5 (4) in many common scenarios.

* * *

The Treaty Policy Working Group hopes that these comments will be helpful as deliberations continue on these important issues. We would welcome the opportunity to discuss our concerns further as comments on the Revised Discussion Draft are considered.

Sincerely yours,

For the Treaty Policy Working Group

Carol A. Dunahoo

Gary D. Sprague
June 12, 2015

VIA EMAIL
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Re: USCIB Comment Letter on the OECD Revised Discussion Draft on BEPS Action 7: Prevent the Artificial Avoidance of PE Status

Dear Ms. de Ruiter,

USCIB is pleased to have this opportunity to provide comments on OECD’s revised discussion draft (hereinafter “RDD”) on BEPS Action 7.

General Comments

USCIB is disappointed with the RDD; although the RDD makes some concessions to business concerns, we continue to believe that the proposals set forth in the RDD, if adopted, will increase uncertainty and in the absence of adequate dispute resolution, will likely lead to increased double taxation which will create a significant barrier to cross-border trade and investment. These concerns were set forth at length in our letter of January 6, 2015. Our views are unchanged; the concerns set forth in that letter have not been adequately addressed by the RDD.

USCIB believes that the lack of clarity in the RDD is due, at least in part, to some countries preferring ambiguity. That is, they do not want business to be able to plan up to a clear line and avoid PE status. Intentionally adopting ambiguous rules is inappropriate for a number of

1 USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

2 Je n’ai fait celle-ci plus longue que parce que je n’ai pas eu le loisir de la faire plus courte. Blaise Pascal.
reasons. First, companies need to know whether they have a filing obligation, particularly if, as in some countries, criminal penalties exist for failure to file. Second, the PE line is supposed to define the agreed upon taxing jurisdiction between the two countries; if the line is unclear how can a country know when it is ceding taxing jurisdiction to the other country? This is especially problematic in the context of the Multilateral Instrument under Action 15 (MLI) because countries will not have an opportunity to identify and resolve discrepancies in the course of bilateral negotiations. If the line is unclear, and therefore essentially unagreed, dispute resolution will be impossible. Third, if the line is acceptable to a country, then the fact that a company decides to stay below that line should not raise any policy issues for that country. Fourth, if the line is unclear, companies may decide to engage less with the local economy because of this uncertainty. Companies are already beginning to restructure to account for possible BEPS outcomes and these decisions may reduce the global footprint of some companies and perhaps have an impact on global trade and investment.

Principal Policy Concerns

Concerns newly raised by the revised discussion draft

The RDD is not a consensus document. The Action 7 deliverable will likely be implemented through adoption of the MLI. To the extent this is not a consensus document the minority view ought to be reflected in the Action 7 deliverable, so that the MLI can provide options that would permit those countries that disagree with the majority view to implement those views in the MLI. Failure to reflect those views would essentially cut those countries out of the MLI and require those countries to renegotiate each bilateral treaty. As the OECD has pointed out, renegotiating each treaty will mean that the changes to address BEPS issues will not be addressed for many years. Countries should not be forced to choose between their legitimate policy decisions and being able to participate in the MLI. Business has a stake in this decision, because the minority view may result in more certain outcomes. Even if these more certain outcomes are only adopted in a minority of cases, that would improve the business climate in those jurisdictions where this choice was made and such a result should be possible under the MLI.

Paragraph 8 of the revised discussion draft provides “nothing in the proposals included in this discussion draft should be interpreted as reflecting the views of the OECD or of any country concerning the interpretation of the existing provisions of the OECD Model Tax Convention and

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3 Treaty negotiators ought to want these boundaries to be clear and political bodies that approve treaties and exercise the taxing jurisdiction remaining to that country should insist on clarity otherwise they cannot know the appropriate scope of their taxing jurisdiction.

4 This is an important function of bilateral negotiations and in their absence more clarity is necessary in any model provisions that may become part of the MLI.
of treaties in which these provisions are included.” USCIB understands that this sentence is intended to mean that the new proposals cannot be read to support similar policy results under the existing Model and existing treaties. We are concerned, however, that this caution is not strong enough. Some countries may try to assert that the language of the existing Model supports the creation of PEs in cases addressed by the proposals. These positions should be explicitly rejected. Retroactive changes to tax law should be disfavored for reasons of fundamental fairness. Most of the changes proposed by the revised discussion draft require changes to the language of Article 5 to implement. These changes should be prospective only and should also be accompanied by a significant transition period to allow taxpayers to restructure in response to the changes.

The last paragraph on page 7 and paragraph 57 of the revised discussion draft both indicate that the Article 5 changes will go forward and there will be follow-up work on attribution of profits under Article 7. This work will begin after September 2015 and be concluded by the end of 2016 which is the deadline for concluding the work on the MLI.

USCIB welcomes the acknowledgment that work on profit attribution under Article 7 is important and will be taken up. We believe, however, that changes with respect to the definition of PEs and profit attribution to those PEs should move in tandem because the amount of the profit attributed to a PE should inform the decision on the creation of a PE. USCIB has repeatedly made the point that if very little profit is attributable to an activity and the administrative costs associated with establishing the financial systems that permit PE reporting are significant, business will restructure to avoid those administrative costs. Thus the amount of profit likely to be attributed to a PE should be taken into account in determining the scope of the PE rules, particularly in those cases where FDI is reciprocal. It seems unlikely that this has happened at this point, since the profit attribution rules have not been reconsidered in light of these changes.

Second, it is critical that there be appropriate stakeholder input on the issue of profit attribution. Therefore, this issue should not be included in the work of developing the MLI. As we understand the development of the MLI, it is intended to be a government-to-government process with no avenue for private participation. Profit attribution is the most important issue

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5 USCIB understands that some countries believe that Article 5 paragraph 4 can currently be read to achieve the result proposed by the revised discussion draft. This view is inconsistent with the plain language of the article (“the term “permanent establishment” shall be deemed not to include”) and the longstanding interpretation of those provisions, as confirmed by the stated agreement of Working Party 1 reflected in the October 2012 discussion draft on The Interpretation and Application of Article 5 (Permanent Establishment). Countries should not be permitted to “bootstrap” a flawed argument with retroactive application of new treaty language and commentary.
in any PE discussion and therefore it is critical that businesses and other stakeholders have input into the development of any proposals on profit attribution.

**Concerns held over from the first discussion draft**

The proposed rules would significantly lower the threshold at which an enterprise of the state of residence would be considered to have a PE in the other (“source”) state. The exact scope and intent of the rules is unclear, but USCIB expects that adoption of the proposed rules would result in the proliferation of PE assertions.

As a substantive matter, the adoption of the rules proposed in the RDD would create PEs from little, if any, activity by the nonresident enterprise within the so-called “source” jurisdiction. If the foreign enterprise performs no functions and assumes no risks itself in the local jurisdiction, then the only activities to look to are those performed by other parties, whether a local affiliate, independent agent or dependent agent. Creating a PE from these activities and attributing profit to it would result in double taxation. This double taxation would be especially pernicious because it would be a case of the same country taxing the same income twice.

The rules proposed in the RDD would create significant uncertainty. Recently, particularly in Western Europe, authorities have been asserting criminal liability (including at the individual non-resident director level) for failure to file tax returns when the tax authorities asserted a PE existed. Individuals should not be at risk of criminal penalties when the rules are subjective and/or uncertain.

The PE proposals also fail to recognize the bilateral nature of tax treaties. PE rules that restrict the ability of a so-called “source” country to impose tax are particularly appropriate in the context of trade relationships in which the flow of foreign direct investment runs both ways. Each country will be both benefitted and burdened by rules restricting the creation of PEs. The proposals are, therefore, particularly inappropriate in the context of economies where FDI is reciprocal. We believe the proposed rules would create significant burdens with no significant net tax impact between the treaty partners in such cases.

Lowering the PE threshold will inevitably give rise to additional disputes both as to the existence of a PE and the profits attributable to it. Taxpayers, therefore, must have access to effective dispute resolution procedures. USCIB continues to believe that mandatory binding arbitration is necessary to improve currently ineffective dispute resolution. If dispute resolution continues to be ineffective, maintaining a higher PE threshold is essential because ineffective dispute resolution will lead to increased unresolved double taxation. In determining the costs of these proposals, the OECD should consider the impact of disputes and dispute

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6 This is why it is important to consider profit attribution at the same time as development of the PE rules.
resolution. These costs may be significant and business will seek to avoid them. These high costs will all have a negative impact on cross-border trade.

**Artificial avoidance of PE status through commissionaire arrangements and similar strategies**

**Dependent agent rule**

The RDD proposes to adopt Option B, which USCIB considered preferable to the other options contained in the first discussion draft, but only if essential terms are clearly defined. In USCIB’s view, the RDD may be proposing the language of Option B, but the Commentary is interpreting it in such a way that effectively the standard contained in Option A is proposed to be adopted. USCIB strongly opposed Option A because it was exceedingly ambiguous and overbroad.

Paragraph 32.6 of the proposed Commentary provides: “the phrase “concludes contracts or 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 the activities that a person exercises in a State are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise.” This is not far from the language in Option A, which would have applied if a person “habitually engages with specific persons in a way that results in the conclusion of contracts”. Thus, Option B is seemingly interpreted to reach the activities that would have been a PE under Option A.

Proposed paragraph 32.4 of the commentary on Article 5 (Box page 14 of RDD) provides: “The phrase “concludes contracts” focuses on situations where a contract is legally concluded by a person. A contract may be concluded without any active negotiation of the terms of that contract; this would be the case, for example, where a contract is concluded by reason of a person accepting, on behalf of the enterprise, the offer made by a third party to enter into a standard contract with that enterprise. Also, a contract may be concluded in a State even if that contract is signed outside that State; where, for example, the conclusion of the contract results from the acceptance, by a person acting on behalf of an enterprise, of an offer to enter into a contract made by a third party, it does not matter that the contract is signed outside of that State.” It is not at all clear what exactly an enterprise has to do to conclude a contract. If a contract is not signed, is it clear that it has been accepted? How would that be proved? If the contract is not valid unless it is in writing, is a signature required? In that case would signature outside of a State control?

Proposed paragraph 32.5 of the commentary on Article 5 (Box page 15 of RDD) provides: "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 purposes of that rule, "the material elements" of contracts 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."

Proposed paragraph 32.6 of the commentary on Article 5 (Box page 15 of RDD) in part, provides: "The paragraph applies to a person who acts as the sales force of the enterprise and, in doing so, makes or accepts contractual offers even if standard contracts are used for that purpose." There is a long example illustrating this principle involving an online business that concludes with the following: "The fact that SCO's employees cannot vary the terms of the contracts does not mean that there is no negotiation but rather means that the negotiation of the material elements of the contracts is limited to convincing the account holder to accept these terms."

The scope of these proposals is very unclear and potentially very expansive. The person must be acting on behalf of the enterprise in a State but it is not clear what that person must be doing. Personnel in a market jurisdiction may perform a wide variety of activities towards a potential customer base in the jurisdiction, including any or all of the following: market development; demand generation; education; marketing; sales solicitation; negotiation; returns; training; service; repair; and support. One could argue that all of these activities are intended to help the principal sell products and therefore are captured by these paragraphs of the proposed Commentary. Under a standard that looks to negotiation and conclusion of contracts, not all marketing activities should create a PE, but under the RDD the standard remains exceedingly unclear.

In particular, the relevance of the facts in the online business example are unclear. Is it essential that SCO’s employees’ remuneration is partially based on the revenues derived by RCO? If the employees of SCO only have contact with RCO’s large customers, is there any impact on the vast majority of RCO’s sales, if those customers have no contact with SCO? Paragraph 34 of the proposed Commentary seems to have some type of force attraction rule, but its scope is not clear. If this rule is implemented through the MLI, would the fact that a particular bilateral treaty follows the UN Model change the extent of any force of attraction rule?

Finally, the RDD fails to recognize that large sales may have sales/negotiating teams in multiple countries leading to one sale. In such a case, how is the income to be divided to ensure that double or multiple taxation is to be avoided?
USCIB welcomes the recognition that a distributor, including a low-risk distributor, is not a dependent agent.\(^7\) We believe that, for further certainty, language excluding distributors from the dependent agent rule should be included in Article 5 itself and not just the commentary. The rule should be expanded to include distributions of licenses and services. This is especially important when the distinction between goods, intangible property and services is as unclear as it may be in the digital economy. Finally, as discussed below, we are concerned that this rule is substantially undercut by the anti-fragmentation rule.

In our prior comments USCIB requested that the Focus Group clarify the clause concerning the negotiation of material elements of the contract by reference to actual business models. We provided the following suggestions:

- **Material elements.** Guidance will be necessary as to what elements of contracts are to be regarded as "material". Depending on the type of transaction, a business may consider a wide variety of contractual provisions to be material, in other cases those same elements may not be considered material. This will make the test very subjective and tax administrations may assert that an element is a material element, when the business believes it is not. In some cases, different persons in an organization will be responsible for negotiating different material terms (for example the sales organization may have responsibility for pricing while the legal group would have responsibility for indemnities), so guidance will be necessary as to which set of negotiations is the determinative one for PE purposes.

- **Marketing or sales solicitation.** It should be clarified that all marketing, sales solicitation, demand generation, and other customer-facing activities that do not involve the actual negotiation of terms of sale are not described by this text.

- **Rate cards.** It is common for enterprises to authorize local representatives to communicate prices to potential customers through rate cards, which may include pre-agreed discount ranges. The local personnel normally will have no authority to deviate from the ranges prescribed on the rate card. This should not be regarded as "negotiation", due to the absence of authority of the local personnel to deviate from agreed terms. Business policies which require escalations for approval of deviations by management personnel located outside of the market jurisdiction should be sufficient to establish that no PE would arise in the market state if behavior is consistent with the policy. As this suggestion has thus far not been adopted, it will be necessary to determine the profit attributable to the PE which should be determined based on the variation permitted under the rate card and not the entire profit from the sale.

- **Standard contracts.** Many enterprises sell their goods and services through standard contracts, including online contracts. Since the terms of those contracts are not

\(^7\) RDD box page 16, proposed Commentary, paragraph 32.12.
negotiated, it should be confirmed that Option B cannot apply to any sales made pursuant to standard contracts. Again, the RDD has not adopted this proposal. If local staff make potential customers aware of standard terms, but are not otherwise involved in the negotiation or conclusion of contracts, what additional profit above the amount already allocated to the local affiliate for marketing support can be allocated to the deemed PE resulting from the activities of the local affiliate? USCIB is concerned that the countries intend to allocate 100% of the profit from any sale to the deemed PE. Such a result likely will not properly reflect the functions, assets and risks of the related entities.

The above suggestions have largely been rejected. It is difficult to see how a standard relating to negotiation of material elements of a contract can be satisfied when there is no conclusion or negotiation, at least as those terms are commonly understood. It seems as if the OECD by its interpretation of what it means to conclude or negotiate the conclusion of material elements of the contract has essentially adopted Option A and, therefore, any activity that ultimately results in the conclusion of contracts can be considered a PE.

USCIB wishes to reiterate that the OECD should expressly state that the purpose of the amendment being proposed is to change the existing international standards on the allocation of taxing rights on cross-border income. This is important in order to ensure that tax administrations cannot argue that these proposed changes are merely clarifications of existing treaty provisions. The proposed rules are in response to a string of cases lost by tax authorities. Not only would these rules reverse those losses, but they would also sweep many additional activities into the scope of the proposed PE rules. It would be a grossly unfair to attempt to use the proposed rules to expand taxing jurisdiction on past activities in such circumstances.

**Independent agent rule**

USCIB agrees with BIAC comments on this topic. In our view it is possible for connected enterprises to act independently of each other. This is certainly the case when the standard is at least 50% and therefore the connected party could be counter-balanced by an unrelated joint venture partner who would have an interest in ensuring the relationship was entirely arm’s length. Further, a more stringent rule should not apply to related parties than unrelated parties. We also agree with the BIAC suggestion that if countries are concerned with abuse, a rebuttable presumption or other form of anti-abuse rule would be appropriate. An absolute prohibition on independent agent status is not an appropriate response to whatever concerns countries may have.

**Artificial avoidance of PE status through the specific activity exemptions**

USCIB objected to the option E, which the RDD proposes to adopt, because this proposal would create uncertainty with respect to every item on the list, would lead to a proliferation of PEs
and a proliferation of disputes concerning whether a PE exists. Certainty of outcome is an important principle for business and subjecting all the items on the list to a subjective test will increase uncertainty. Because the RDD supports this option it is necessary to articulate a standard for consistently determining whether an activity is preparatory or auxiliary and to include many examples. The proposed commentary\(^8\) is inadequate.

Proposed paragraph 21.1 retains language from the existing Commentary. This language has always been ambiguous. Because taxpayers and tax administrators now must apply that language to determine whether the items listed in Article 5 paragraph 4) are preparatory or auxiliary this ambiguity is now more important and must be resolved.

The proposed Commentary attempts to do this with some circular rules and a few examples. While the examples that are provided are generally somewhat helpful, they are likely to be inadequate to address the many issues that will likely arise as these rules are implemented.

With respect to the warehousing example,\(^9\) the facts in the example posit that R owns the warehouse in State S. Is this fact important? We do not believe that in most cases R will own the warehouse. It is much more likely that a foreign entity, either related or unrelated, will own and operate the warehouse. If this is the case, will R have a PE in State S? The example should also make clear that the PE only exists in the country in which the warehouse is located. The situation of regional warehouses is common. The proposed Commentary should make clear that a warehouse cannot create a PE in relation to sales outside of the country where the warehouse is located nor can sales outside the country where the PE is located be attributed to that PE.

The OECD should clarify that the example provided in proposed Commentary paragraph 22.3. Would the answer differ if the enterprises were connected parties? USCIB is concerned that the proposals under the anti-fragmentation rules would automatically result in a PE, even if the facts were identical to the first part of the example, where no PE is considered to exist. Under the arm’s length principle, results should not differ if related and unrelated parties engage in identical transactions. If there are significant differences, the proposals will distort economic decisions by forcing taxpayers to use unrelated parties. This may increase costs (other than taxes) and discourage cross-border trade and investment.

USCIB’s earlier letter provided extensive comments on why neither a purchasing office nor an office that collects information should be considered a PE. We stand by those comments and believe that even if Option E is ultimately adopted, the OECD should provide extensive comments indicating when a PE should not be considered to exist.

\(^8\) Proposed commentary paragraph 21 through 30 of the RDD.

\(^9\) RDD box on page 24, proposed Commentary paragraph 22.
Fragmentation

In our earlier letter USCIB objected to both options on the grounds that they would significantly undercut the concept of separate entity reporting and create vastly different results for enterprises dealing with related vs. unrelated parties, undercutting the arm’s length standard, which the Action Plan continues to support. In order to avoid these results, companies may reconfigure their operations in ways that might be inefficient and therefore harmful to global trade and investment.

USCIB is very concerned about the continuing lack of clarity and potential scope for a broad interpretation of the language “complementary functions that are part of a cohesive business operation.”10 Given that this proposal would significantly undercut the separate entity principle, it should be framed as an anti-abuse provision that should not apply in the absence of evidence of abuse.

USCIB is also very concerned that this language is broad enough to create PEs when most of the activities of the non-resident connected party take place outside of the local jurisdiction. It is critical that these rules not be used to attribute excessive profits to minimal activities. USCIB remains concerned that so-called “source” jurisdictions will use these rules to attribute profits to the market jurisdiction when value is created by functions, assets and risks outside of the market. Such aggressive assertion of these rules will likely result in double taxation. Business needs an effective mechanism to resolve these disputes, which we believe are inevitable given the lack of clarity.

It is also not clear how this proposal interacts with existing paragraph 7 of the OECD Model. In essence, that paragraph provides that controlled companies do not create PEs for each other. The concept expressed in a parenthetical in Example B, that a local country enterprise has a PE within its own country and those activities could form the basis of PE for a connected party should be carefully considered before adoption. In USCIB’s view this converts a transfer pricing issue into a PE issue and essentially creates a second transfer pricing issue under Article 7.

Example B also raises a series of issues that are unaddressed. First, is the answer different if RCO does not own the warehouse? USCIB believes that it is unlikely that RCO would in fact own the warehouse, so if the answer is different that should be made clear. This is also a case where the profit attribution and PE issues should be considered together. It is unlikely that significant profit would be attributed to the maintenance of inventory in the warehouse. Additionally, would the answer differ both with respect to the PE issue and the profit attributable to SCO if SCO held title to the inventory while it was in the warehouse (particularly if the warehouse were owned by an unrelated party)? It seems that the goal of this example

10 RDD box on page 31.
may be to attribute some profit from bearing the inventory risk either to SCO or to a PE of RCO within Country S. If SCO, in fact, bears the inventory risk, then that would be appropriate. However, the inventory risk may remain with RCO depending on the contractual terms between RCO and SCO. If for example SCO took title to the inventory in the warehouse, but was able to return unsold inventory to RCO would RCO bear the inventory risk?

Example B also seems to undercut the decision, which USCIB supports, set forth in proposed paragraph 32.12 of the Commentary on Article 5.\(^{11}\) That paragraph provides that the activities of a distributor are to be distinguished from the activities of dependent agents and that the activities of a distributor do not create a PE on behalf of the enterprise from which it acquires goods. If, however, in the case of connected parties, the distributor will be considered to create a PE because their activities are part of a cohesive business enterprise, then distributors will, in fact, create PEs in many cases involving connected parties even though the dependent agent rules are inapplicable. Is this really appropriate? In our earlier letter USCIB raised a series of examples that ought to be addressed so that taxpayers could understand the scope of the anti-fragmentation rule; none of those examples have been addressed. Without repeating those examples here, we ask for guidance as to whether a PE would be created in those common cases.

**Overlap with VAT rules**

USCIB urges the OECD to include explicit language in the Article 5 Commentary providing that its proposals to cut the common link between PE determinations and VAT registrations. USCIB understands that there is agreement between Working Parties one and nine that such a link should not exist, but that there is a preference to wait until after the 2015 Action 7 work is completed before making this clear in the guidance to Article 5. This issue is very important to the business community and given that there is agreement and it should not be difficult to solve we suggest the inclusion of the following language in Article 5 of the Commentary:

The term “permanent establishment” as used in the OECD Model Income Tax Treaty is a distinct concept from the “VAT establishment” term used in the International VAT/GST guidelines, such that the existence of one should not in itself result in the other. In addition, while companies might have to register for VAT in order to comply with their national VAT obligations, such registration in itself should not trigger the creation of a permanent establishment for purposes of Article 5.

\(^{11}\) RDD box on page 16.
Thank you for this opportunity to comment.

Sincerely,

William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)