

Base Erosion and Profit Shifting (BEPS)

Public Discussion Draft

BEPS ACTION 7

Additional Guidance on the Attribution of Profits to Permanent Establishments

4 July - 5 September 2016



DISCUSSION DRAFT ON ADDITIONAL GUIDANCE ON THE ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS

4 July 2016

Paragraphs 19-20 of the final version of the Report on Action 7 of the BEPS Action Plan (Preventing the Artificial Avoidance of Permanent Establishment Status) indicate that:

"The work on Action 7 that was done in respect to attribution of profit issues focussed on whether the existing rules of Article 7 of the OECD Model Tax Convention would be appropriate for determining the profits that would be allocated to PEs resulting from the changes included in this report. The conclusion in the Report is that these changes do not require substantive modifications to the existing rules and guidance concerning the attribution of profits to a PE under Article 7 but that there is a need for additional guidance on how the rules of Article 7 would apply to PEs resulting from the changes in this Report, in particular for PEs outside the financial sector. There is also a need to take account of the results of the work on other parts of the BEPS Action Plan dealing with transfer pricing, in particular the work related to intangibles, risk and capital.

Realistically, however, work on attribution of profits related to Action 7 could not be undertaken before the work on Action 7 and Actions 8-10 had been completed. For that reason, and based on the many comments that have stressed the need for additional guidance on the issue of attribution of profits to PEs, follow-up work on attribution of profit 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."

This discussion draft presents the two fact-patterns that would particularly benefit from additional guidance concerning attributions of profits to permanent establishments ("PE"), which are: a) dependent agent PEs, including those created through commissionaire and similar arrangements; and b) warehouses as fixed place of business PEs. For each fact-pattern, and through the use of examples, a number of questions are identified on which comments are sought from commentators.

Interested parties are invited to send their comments on this discussion draft by **5 September 2016** by email to TransferPricing@oecd.org in Word format (in order to facilitate their distribution to government officials). They should be addressed to the Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA. Comments in excess of ten pages should attach an executive summary limited to two pages.

Please note that comments are not sought on the changes to the PE definitions that have been agreed under Action 7 and which were published in the 2015 Final Report, "Preventing the Artificial Avoidance of Permanent Establishment Status." Commentators should concentrate solely on the application of Article 7 to determine the attribution of profits to PEs.

The OECD intends to hold a public consultation on the additional guidance on the attribution of profits to permanent establishments on 11-12 October 2016 at the OECD Conference Centre in Paris, France. Registration details for the public consultation will be published on the OECD website in September. Speakers and other participants at the public consultation will be selected from among those providing timely written comments on the discussion draft.

Please note that all comments on this discussion draft will be made publicly available. Comments submitted in the name of a collective “grouping” or “coalition”, or by any person submitting comments on behalf of another person or group of persons, should identify all enterprises or individuals who are members of that collective group, or the person(s) on whose behalf the commentator(s) are acting.

The proposals included in this discussion draft do not, at this stage, represent the consensus views of the CFA or its subsidiary bodies but are intended to provide stakeholders with substantive proposals for analysis and comment.

DISCUSSION DRAFT ON ADDITIONAL GUIDANCE ON THE ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS

INTRODUCTION

1. Action 7 of the BEPS Action Plan mandated the development of changes to the definition of “permanent establishment” (“PE”) to prevent the artificial avoidance of PE status, including through the use of commissionaire arrangements and the specific activity exemptions. It also mandated that the work should address related profit attribution issues. The conclusions reached are found in the 2015 BEPS Report on Action 7 “Preventing the Artificial Avoidance of Permanent Establishment Status” (the Report on Action 7).

2. The Report on Action 7 provides for changes to be made to Article 5 of the Model Tax Convention (“MTC”)¹ for the following reasons:

- In order to prevent the avoidance of PE status through commissionaire arrangements and similar strategies, the Report concludes 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 a taxable presence in that country unless the intermediary is performing these activities in the course of an independent business. This has resulted in changes to Articles 5(5) and 5(6) and to the Commentary.
- In order to prevent the avoidance of PE status through the specific activity exemptions, the Report concludes that it should not be possible to avoid permanent establishment status by using the exceptions of paragraph 4 of Article 5 of the MTC in the case of activities that are not preparatory or auxiliary or by fragmenting a cohesive operating business into several small operations in order to argue that each party is merely engaged in preparatory or auxiliary activities that benefit from these exceptions. This has resulted in changes to Article 5(4) and to the Commentary to include: a) a “preparatory or auxiliary” condition applicable to all the subparagraphs of Article 5(4) of the MTC; and, b) a new anti-fragmentation rule.
- In order to prevent the avoidance of PE status through the splitting up of contracts to take advantage of the exception of paragraph 3 of Article 5, the Report concludes that the Principal Purposes Test rule (“PPT rule”) should address the BEPS concerns related to the abusive splitting up of contracts for purposes of that exception. In addition to the changes to the MTC under the Report on BEPS Action 6, this work has resulted in: a) the inclusion in the Commentary on the PPT rule of an example regarding the splitting-up of a contract for work on a construction site; and, b) the inclusion in the Commentary on paragraph 3 of Article 5 of the MTC of an alternative provision that States may use to address such splitting-up of a contract.

¹ References to Article 5, Article 7 or Article 9 should be understood to be made to such articles in the OECD Model Tax Convention.

3. The preliminary work on attribution of profit issues that was carried out under the Report on Action 7 focussed on whether the existing rules of Article 7 of the MTC would be appropriate for determining the profits that would be allocated to PEs resulting from the changes included in that Report. The conclusion in the Report on Action 7 is that these changes do not require substantive modifications to the existing rules and guidance concerning the attribution of profits to a PE under Article 7 but that there is a need for additional guidance on how the rules of Article 7 would apply to PEs resulting from the changes in that Report. There is also a need to take account of the results of the work on other parts of the BEPS Action Plan dealing with transfer pricing, in particular the work related to intangibles, risk and capital under the 2015 BEPS Report on Actions 8-10 “Aligning Transfer Pricing Outcomes with Value Creation” (“Report on Actions 8-10”).

4. Realistically, however, work on attribution of profits related to Action 7 could not be undertaken before the work on Action 7 and Actions 8-10 were completed. For that reason, and based on the many comments received from public commentators that have stressed the need for additional guidance on the issue of attribution of profits to PEs, follow-up work on attribution of profit issues related to Action 7 is necessary.

OBJECTIVE AND SCOPE OF THE WORK

5. In order to determine which aspects of the BEPS work require additional guidance concerning the issue of attribution of profits to PEs, it is necessary to understand the exact scope of the changes made to the definition of PE by the Report on Action 7.

6. First, whilst the changes made to Article 5(5) and 5(6) by the Report on Action 7 have modified the threshold for the existence of a deemed permanent establishment under Article 5(5), they have not modified what is deemed to constitute that deemed PE. Both the pre-BEPS and post-BEPS versions of Article 5(5) apply only to the extent that a person is “acting on behalf of an enterprise” and provide that the PE that is deemed to exist if the threshold is met is constituted by “any activities which that person undertakes for the enterprise”. The Commentary on both the pre-BEPS² and post-BEPS³ versions clarify that where the conditions of Article 5(5) are met, the permanent establishment exists “to the extent that person acts for the enterprise, *i.e.* not only to the extent that such a person [*pre-BEPS version*: exercises the authority to conclude contracts in the name of the enterprise] [*post-BEPS version*: concludes contracts or plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise]”. Whilst the Report on Action 7 has modified the threshold (which may now be met even if a person does not habitually concludes contracts in the name of the enterprise), it has not modified what is the nature of the deemed PE. Any guidance on how to attribute profits to a PE that is deemed to exist under the pre-BEPS version of Article 5(5) should therefore be applicable to a PE that is deemed to exist under the post-BEPS version of Article 5(5).

7. An important issue that now needs to be taken into account is the effect of the transfer pricing work under BEPS Actions 8-10 on the determination of the amount of profits attributable to an Article 5(5) PE where the person that acts on behalf of the non-resident enterprise is an associated enterprise that performs control functions related to risks contractually assumed by the non-resident enterprise (see Example 2). It is important to note, however, that that issue arises regardless of whether one is dealing with a deemed PE arising from the post-BEPS version of Article 5(5) or from its pre-BEPS equivalent. It is also important to note that the issue does not arise where the person, although not being entitled to the

² Paragraph 34 of the existing Commentary.

³ Paragraph 34 of the revised Commentary included in the Report on Action 7.

independent agent exception of Article 5(6), does not constitute an associated enterprise (e.g. where the person is an employee, director, partner or other representative).

8. Second, the only practical effect of the changes made to Article 5(4) and of the addition of the anti-fragmentation rule of Article 5(4.1) is to restrict the scope of the exceptions currently found in Article 5(4). As explained in the revised Commentary on Article 5(4) included in the Report on Action 7 (see in particular paragraphs 22.3. and 22.4), a pre-requisite for the application of these exceptions is that an enterprise has a fixed place of business through which its business is wholly or partly carried on and which would otherwise constitute a permanent establishment under Article 5(1). To take one example, under the pre-BEPS version of Article 5, an enterprise of one State that operates, through its own employees, a warehouse situated in another State for the purposes of the storage and delivery of goods or merchandise belonging to third parties is not entitled to the exception of Article 5(4) unless that activity is merely preparatory or auxiliary. As a result of the changes included in the Report on Action 7, the same will now be true if the enterprise carries on identical storage and delivery functions at a similar location with respect to its own goods or merchandise. It is not clear what is the difference between these two cases that would require additional guidance in relation to the issue of attribution of profits. It is true that the question of attribution of profits might be more complicated if all or part of the storage or activities carried on by the enterprise at the warehouse are subcontracted to another enterprise but that complication (which is addressed in Scenario C of Example 5) is not related to the changes made to Article 5(4) by the Report on Action 7.

9. The same can be said with respect to the changes to the Commentary related to the splitting-up of contracts. These changes do not create a new type of PE; they merely deny, in certain limited cases, the application of the exception of Article 5(3), which applies to an Article 5(1) permanent establishment that is a “building site or construction or installation project” provided that this permanent establishment does not meet the time threshold provided in Article 5(3). In other words, where the exception of Article 5(3) does not apply as a result of the new guidance on the splitting-up of contracts (or as a result of the alternative provision on the splitting-up of contracts that is now included in the Commentary), the enterprise has a permanent establishment under Article 5(1), i.e. a fixed place of business through which its business is wholly or partly carried on. The only difference between such a PE and a construction site that constitutes a PE under the pre-BEPS version of Article 5 has to do with the duration of the activities carried on at the construction site by the enterprise itself pursuant to specific contracts. That difference does not appear to raise particular issues related to the attribution of profits.

10. This is not to say that there is no need for additional guidance on attribution of profit issues. As indicated in paragraph 3 above (which reflects paragraph 19 of the Report on Action 7), the follow-up work on attribution of profit issues is not restricted to issues related to PEs that will result from the changes made by the Report on Action 7 but should also “take account of the results of the work on other parts of the BEPS Action Plan dealing with transfer pricing, in particular the work related to intangibles, risk and capital.”

11. The aim of the additional guidance covered is, therefore, to illustrate how the rules for the attribution of profits to PEs apply, taking into account both the changes made by the Report on Action 7 and the changes made to the Transfer Pricing Guidelines.

12. Based on discussions that took place during the development of the Report on Action 7, the fact-patterns that would particularly benefit from additional guidance concerning attribution of profits to PEs are:

- Dependent agent PEs (“DAPES”), in particular under the form of commissionaire and similar arrangements.

- Permanent establishments arising under Article 5(1) to which the exemptions in Article 5(4) do not apply (e.g. warehouses as fixed place of business PE).

13. **This discussion draft concentrates on these scenarios, for which examples are provided together with specific questions on which input is sought from commentators.** It is important to note that:

- The facts of the examples contained in this Discussion Draft have been created solely for the purposes of illustrating the analysis under Article 7 and Article 9. The facts are necessarily limited and have been supplemented by assumptions in order that commentators can follow the illustrated process on which comments are sought. Therefore, these examples do not have applicability beyond the purpose of seeking comments on the process they serve to illustrate and should not be used by taxpayers or tax administrations to interpret superficially similar cases where an analysis under Article 7 and/or Article 9 is required.
- The examples are built on the assumption that a permanent establishment exists, either under Article 5(1) or Article 5(5), considering the revisions to the definition of permanent establishment introduced by the Report on Action 7. No comments are sought on the changes to the PE thresholds set out in the Report on Action 7.
- The manner in which the analysis for each example is presented in this discussion draft is solely for purposes of seeking input from commentators and should not be interpreted as providing guidance on the appropriate transfer pricing analysis or, until the guidance is finalised, on the appropriate approach for addressing the attribution of profits to PEs in any of the two scenarios. In some examples, what could be seen as a single composite activity or transaction is split for illustration purposes only into its component parts, thus in multiple transactions.
- Please note that the profit and loss statement ("P&Ls") included for each example in this Discussion Draft have been created for the purpose of illustrating the mechanics of determining the remuneration of the parties under Article 9 and the attribution of profits of the non-resident to the DAPE under Article 7. They should not be interpreted as exemplifying reporting requirements under any applicable domestic legislation and do not affect the application of any administratively simpler approaches countries may adopt to arrive at a result consistent with the outcomes illustrated.

EXISTING GUIDANCE ON ATTRIBUTION OF PROFITS TO PES

14. For purposes of this Discussion Draft, the analysis of the different fact patterns is performed by reference to Article 7 in the 2010 version of the MTC, and under the principles set out in the 2010 Commentary to the MTC, and the 2010 Report on the Attribution of Profit to Permanent Establishments ("the 2010 Attribution of Profits Report"), which endorse and attribute profits to the PE under the Authorised OECD Approach (the "AOA").

15. It is important to note that: (i) relatively few treaties currently include the new version of Article 7 which was included in the OECD Model in 2010⁴; (ii) through reservations and positions included in the OECD Model, a number of OECD and non-OECD countries have expressly stated their intention not to

⁴ Note, however, that a few countries have decided to apply the full conclusions of the AOA with respect to treaties that contain the pre-2010 version of Article 7.

include the new version of Article 7 in their treaties⁵; and, (iii) the inclusion of the new version of the Article in the UN Model (and, therefore, the implementation of the full AOA with respect to Article 7 of the UN Model) has been expressly rejected by the UN Committee of Experts on International Cooperation in Tax Matters.

16. Apart from differences in the Article itself, the most important differences between the AOA and the interpretation of Article 7 of the OECD Model Tax Convention prior to the adoption of the AOA relate to the issue of the recognition of “dealings”, in particular with regards to the use or transfer of intangibles or rights in intangibles, that would require a country to take account of such “notional” payments. Other parts of the AOA, such as the part dealing with the allocation of “free” capital to a permanent establishment, are not viewed as problematic by most countries⁶. This is confirmed by the fact that the part of the AOA that deals with the allocation of “free” capital to a permanent establishment was expressly included in the 2008 Commentary⁷ and was incorporated in the Commentary on the UN Model in 2011.⁸

GUIDANCE ON PARTICULAR FACT PATTERNS RELATED TO DEPENDENT AGENT PERMANENT ESTABLISHMENTS (“DAPE”)

17. Paragraphs 5 and 6 of Article 5 of the MTC set out the circumstances in which an enterprise is treated as having a permanent establishment in respect of activities undertaken for that enterprise, even though the enterprise may not have a fixed place of business. Where a DAPE arises from the activities of a dependent agent, the host country may have taxing rights over two different legal entities: the dependent agent, if it is a resident of the PE jurisdiction; and the DAPE, which is a PE of a non-resident enterprise (2010 Attribution of Profits Report, Part I paragraph 230).

18. For purposes of determining the profits attributable to the DAPE, Article 7 of the MTC is applicable together with the guidance in Section D.5 of Part I of the 2010 Attribution of Profits Report. According to paragraph 234 of Part I of the 2010 Attribution of Profits Report, “in calculating the profits attributable to the dependent agent PE, it would be necessary to determine and deduct an arm's length reward to the dependent agent for the services it provides to the non-resident enterprise (taking into account its assets and its risks, if any).”

19. There are cases where the dependent agent that performs activities that give rise to a DAPE under Article 5(5) is also, for transfer pricing purposes, an associated enterprise of the non-resident enterprise acting as the principal and is resident in the PE jurisdiction. In those cases, in addition to the attribution of profits to the DAPE, it will also be necessary to determine the arm's length remuneration of the dependent

⁵ See the reservations of Chile, Greece, Mexico, New Zealand, Portugal and Turkey in paragraphs 95, 96 and 97 of the Commentary on Art. 7 as well as the positions of Argentina, Brazil, China, India, Indonesia, Latvia, Malaysia, Romania, Serbia, South Africa, Thailand and Hong Kong in paragraphs 1, 1.1 and 1.2 of the positions on Article 7.

⁶ See observations of Sweden and New Zealand in paragraphs 71 and 74 of the Annex “Previous Version of Article 7 and its Commentary” to the Commentary on Article 7.

⁷ Paragraphs 45-49 of the 2008 OECD Commentary on Article 7.

⁸ See page 158 of the 2011 UN Model and, in particular, the quotation of paragraph 44 of the Commentary on the OECD Model and the additional paragraph according to which “The Committee of Experts considers it preferable to look for a practical solution. This would take into account a capital structure appropriate to both the organization and the functions performed taking into account the need to recognize that a distinct, separate and independent enterprise should be expected to have adequate funding.”

agent enterprise ("DAE")⁹. In the following examples illustrating these cases, the determination of the profits of the dependent agent enterprise and of the DAPE have been performed independently, without any direction about the order in which they should be performed. However, in determining the profits of the DAPE under the AOA, it would be logical and efficient first to accurately delineate the actual transaction between the non-resident enterprise and the DAE and to determine the resulting arm's length profits. This process would provide the arm's length fee deductible in the DAPE in respect of the functions performed by the DAE, as required by paragraph 234 of Part I of the 2010 Attribution of Profits Report.

Question to public commentators

1. Commentators are invited to express their views on whether the order in which the analyses are applied under Article 9 of the MTC and Article 7 of the MTC can affect the outcome, and what guidance should be provided on the order of application.

20. The examples illustrating the attribution of profits to DAPEs present the following fact patterns and address the following issues:

- In Example 1, the non-resident enterprise acting as a principal engages an associated enterprise resident in the host jurisdiction to perform activities that give rise to a DAPE under Article 5(5). This example intends to illustrate the attribution of profits to the DAPE under the AOA in a fact-pattern in which an analysis under Article 9 is also required.
- In Example 2, the non-resident enterprise acting as a principal engages an associated enterprise resident in the host jurisdiction to perform activities that give rise to a DAPE under Article 5(5). The difference in this example compared to Example 1 is that the Article 9 analysis results in the allocation of risk not to the party contractually assuming the risk, but to the party that has control over risk and has the financial capacity to assume the risk. This example intends to illustrate the impact that such allocation of risk may have for the analysis under the AOA.
- In Example 3, the facts are the same as in Example 2, except that the non-resident enterprise acting as a principal sends an employee to the host country to perform activities that give rise to a DAPE under Article 5(5). This example intends to illustrate the attribution of profits to the DAPE under the AOA in a fact-pattern in which an analysis under Article 9 is not required.
- In Example 4, based on the facts in Example 2, the analysis focuses on the activities related to the provision of credit to customers performed by the dependent agent enterprise and the non-resident enterprise. This example intends to illustrate the consequences for the attribution of profits to the DAPE resulting from the attribution of risk under the AOA and the allocation of risk under Article 9 (and in particular Section D of Chapter I of the Guidelines).

⁹ In addition to an associated enterprise (under Article 9 of the MTC), an employee or a separate non-associated enterprise (for transfer pricing purposes) may also act as a dependent agent of the principal, meeting the conditions to create a PE for the non-resident enterprise/principal under paragraphs 5 and 6 of Article of the MTC. In these two additional situations, the remuneration paid to the dependent agent for its services (considering the functions performed, assets used and risks assumed) is generally considered to be arm's length (provided the employment relationship is not subject to the transfer pricing rules under specific domestic legislation). Accordingly, the compensation to the dependent agent in these circumstances would not be subject to scrutiny under Article 9 of the MTC and only Article 7 of the MTC would be applicable.

EXAMPLE 1

21. Prima is a company resident in Country A (hereinafter, "Prima", "non-resident enterprise" or "Principal"). It manufactures consumer products in Country A. Prima's products are sold to unrelated customers worldwide, and in order to do so Prima uses a network of sales agents. Prima has no physical presence in the countries where its products are sold.

22. Sellco is a company resident in Country B (hereinafter, "Sellco" or dependent agent enterprise, "DAE"), and is an associated enterprise of Prima for transfer pricing purposes. Sellco is engaged by Prima to perform selling activities in Country B for Prima. It is assumed for the purposes of this example that Sellco is a dependent agent of Prima, and that the activities performed by Sellco for Prima give rise to a dependent agent permanent establishment ("DAPE") of Prima in Country B.

23. The contract entered into by Prima and Sellco includes the following terms:

CONTRACT	
	<ul style="list-style-type: none"> • Prima engages Sellco as its sales agent in country B. • Sellco is responsible for identifying customers, soliciting, placing and processing customer orders with Prima. • Sellco provides marketing and advertising services by implementing locally the marketing and advertising strategy devised by Prima. • Prima holds title to inventory until the product is delivered to the customer. • Prima invoices customers and bears the credit risk with respect to customer receivables. • Prima agrees to remunerate Sellco with a commission on sales generated.

24. The relevant facts of Example 1 are set out in the following table:

FACTS	
SALES	<ul style="list-style-type: none"> • Prima sets the sales strategy and market share targets in Country B. • Prima selects the sales agent, monitors its performance and makes decisions on whether to continue, adapt or terminate the relations with the sales agent. • Sellco is responsible for identifying customers, soliciting and placing customer orders and processing customer orders with Prima. • Prima is responsible for setting the pricing policy for products, as well as for tailoring that policy to Country B's market through setting specific prices for products offered in Country B.
MARKETING & ADVERTISING	<ul style="list-style-type: none"> • Prima decides the budget, marketing strategy and advertising content globally and for Country B. • Sellco implements the marketing strategy in Country B and is reimbursed by Prima for all expenses incurred in placing local advertising for the products. • Sellco's activities do not create any local marketing intangibles in Country B. Sales channels are generic and not specialised. • Prima is responsible for the legal protection of the Group's marketing intangibles.

INVENTORY	<ul style="list-style-type: none"> • Prima retains title to the inventory until it is delivered to customers. • Prima is responsible for warehousing the inventory and determining and monitoring the inventory levels of the products to fulfil customer orders expeditiously while minimising obsolescence risk and costs.
CREDIT TO CUSTOMERS	<ul style="list-style-type: none"> • Amounts due from customers are for the account and at the risk of Prima, and Prima contractually bears credit risk with respect to customer receivables. • Prima sets parameters within which credit can be extended to customers. • Prima approves every sale to customers made in Country B through the review of the customer's creditworthiness. • Prima handles collection of customer receivables.

Analysis of the controlled transaction between Prima and Sellco under Article 9

25. Given that Prima and Sellco are associated enterprises, an analysis of the controlled transaction between Prima and Sellco is required under Article 9.

26. Under the guidance in Section D of Chapter I of the Guidelines, the accurate delineation of the controlled transaction starts with the examination of the contractual terms of the transaction, taking into account the additional information provided by the other economically relevant characteristics.

27. The analysis of the transaction finds that the contractual arrangement is one under which Prima appoints Sellco as its sales agent to provide stated service levels. Table 1 in the Annex sets out the functional analysis performed under Article 9.

28. Assume that the functional analysis further finds that Prima is the legal owner of inventory, marketing intangibles and receivables, and that Prima, in addition to contractually assuming the risks, it controls the risks associated with these assets, and has the financial capacity to assume these risks. In addition, assume that the functional analysis identifies key risks arising from the arrangements, and that these are controlled by Prima. Sellco controls its own operational risk of performing its sales agency activities competently. In this example, the contractual assumption of risk is aligned with control of risk and the financial capacity to assume such risks.

29. Assume that the outcome of the analysis under Article 9 determines that the profits of Sellco should be 2, taking into account the functions of Sellco including the risks it assumes. For the sake of simplicity only Country B sales have been shown in the summarised financial results of Prima in the table below.

PRIMA (Country A)	
Sales income	200
- COGS	(40)
Gross profit	160
OPEX	
– Sales commission to Sellco	(10)
– Reimbursement of advertising expenses incurred by Sellco	(7)
– Bad debt losses	(4)

SELLCO (Country B)	
Income from sales commission [200 x 0.05] = 10	10
OPEX (other than advertising expenses reimbursed by Prima)	(8)

– Inventory losses	(3)
– Warehousing	(6)
Operating profit	130

Operating profit	2

30. Under the assumptions made in this example, it can be concluded that Prima assumes the economically significant risks related to sales in Country B, including inventory and credit risks, since Prima assumes the risk under the contract, performs in Country A the risk control functions in relation to such risks (e.g. decides sales strategy, projections and market share targets, as well as making the decision to select Sellco as sales agent in Country B; determines pricing policy in general and in particular for the products to be sold in Country B, determines inventory levels, and approves sales to customers) and, has the financial capacity to assume these risks. Sellco assumes the risks inherent to its sales agency activities under the contract and, since it controls its own operational risk of performing its agency activities competently and has the financial capacity to assume such risk, that contractual assumption is recognised in accurately delineating the actual transaction and no further consideration is required under Section D.1.2.1.5 of Chapter I.

31. In summary:

- Total profits in Country A and in Country B: 132
- Total profits in Country A under Article 9: 130
- Total profits in Country B under Article 9: 2
- Total profits of the non-resident enterprise: 130

Attribution of profits to Prima's DAPE in Country B under Article 7

32. Given the assumption that Prima has a DAPE in Country B, Article 7 applies to determine the amount of profits, if any, attributable to the DAPE of Prima in Country B.

Analysis under Article 7 and Step 1 of the AOA

33. Under Step 1 of the AOA, a functional and factual analysis is performed to determine the functions undertaken by Sellco on its own account and the functions undertaken by Sellco on behalf of the non-resident enterprise, Prima. The functions undertaken by Sellco on behalf of Prima are relevant to the attribution of Prima's assets or risks to the DAPE (2010 Attribution of Profits Report, Part I, para 232). Table 1 in the Annex sets out the functional and factual analysis performed under Article 7.

34. Based on the facts and assumptions in this example, the functional and factual analysis determines that the DAPE has not been attributed risks of Prima related to inventory, marketing intangibles or receivables because there are no significant people functions performed by Sellco on behalf of the non-resident enterprise (Prima) in Country B relevant to the assumption of such risks. Furthermore, the DAPE has not been attributed the economic ownership of any assets (inventory, marketing intangibles, or receivables) of Prima because there are no significant people functions performed by Sellco on behalf of the non-resident enterprise (Prima) in Country B relevant to the attribution of economic ownership of such assets. Accordingly, there are no risks or assets attributable to the DAPE and there is no need to attribute capital to the DAPE.

Analysis under Article 7 and Step 2 of the AOA

35. The next step is to determine how much profit is attributable to the DAPE from sales made by Prima in Country B.

36. Under Article 7, the sales income obtained in Country B is attributable to the DAPE of Prima in Country B. Based on the functional and factual analysis under Step 1 of the AOA, the DAPE needs to be attributed:

- Costs of the compensation payable to Sellco (DAE) for the sales-related activities Sellco performs as a sales agent (which according to the Article 9 analysis, amounts to 10); and,
- Costs of the compensation payable to Prima for the functions Prima performs in relation to the sale of products in Country B (reflected in cost of goods sold).

37. In this example, given that there are no risks or assets attributed to the DAPE, there are no profits attributed to the DAPE. Accordingly, given that: 1) third party sales in Country B are 200; 2) the DAPE has an expense of 10 relating to the sales commission to Sellco; and, 3) the profits attributed to the DAPE should be zero, the amount of cost of goods sold ("COGS", which equals "sales" of the other part of the non-resident enterprise, referred to as the "Head Office") is determined such that the operating profit of the DAPE, after payment of an appropriate fee to the DAE determined under Article 9, is zero. This results in COGS of 190.

38. The P&L of the DAPE showing the amounts received and expensed in connection with the sale of products in Country B and the attribution of Prima's profits to the DAPE of Prima can be summarised as follows:

PRIMA'S HEAD OFFICE (Country A)	
Sales income	190
– COGS	(40)
Gross profit	150
OPEX	
– Reimbursement of advertising expenses incurred by Sellco	(7)
– Bad debt losses	(4)
– Inventory losses	(3)
– Warehousing	(6)
Operating profit	130

DAPE (Country B)	
Sales income	200
– COGS	(190)
Gross profit	10
OPEX	
– Sales commission to Sellco	(10)
Operating profit	0

Conclusion under Article 7

39. There are no profits to be attributed to the DAPE since there are no significant people functions performed by Sellco on behalf of Prima in Country B relevant to the attribution of Prima's assets and risks to the DAPE. Therefore, in this example, none of the profits of Prima (130) are attributed to its DAPE but are all profits of Prima's Head Office.

Questions to public commentators

2. Do you agree with the functional and factual analysis performed in Example 1 under the AOA?
3. Do you agree with the construction of the profits or losses of the DAPE in Example 1 under the AOA?
4. What would be the conclusion if, because of the wording of Article 7 in the applicable tax treaty, an approach other than the AOA applied? If the conclusion is different, what would be the differences?
5. In the types of cases illustrated by Example 1, is it appropriate to conclude that, where under the functional and factual analysis under Article 7, the dependent agent enterprise does not perform significant people functions on behalf of the non-resident enterprise, there will be no profits attributable to the DAPE after the payment of an appropriate fee to the DAE under Article 9?

EXAMPLE 2

40. The facts of Example 2 are the same as those of Example 1, except for the following changes in relation to inventory and credit to customer, which are shown as underlined and in bold in the following table.

FACTS	
INVENTORY	<ul style="list-style-type: none"> Prima retains title to the inventory until it is delivered to customers. <u>Sellco is responsible</u> for warehousing the inventory and determining and monitoring the appropriate inventory levels required to fulfil customer orders expeditiously while minimising obsolescence risk and costs.
CREDIT TO CUSTOMERS	<ul style="list-style-type: none"> Amounts due from customers are for the account and at the risk of Prima, and Prima contractually bears credit risk with respect to customer receivables. <u>Sellco sets</u> the parameters within which credit can be extended to customers. <u>Sellco approves</u> every sale to customers made in Country B through the review of the customer's creditworthiness. <u>Sellco handles</u> collection of customer receivables.

Analysis of the controlled transaction between Prima and Sellco under Article 9

41. Given that Prima and Sellco are associated enterprises, an analysis of the controlled transaction between Prima and Sellco is required under Article 9.

42. In applying the guidance in Section D of Chapter I of the Guidelines relating to accurately delineating the actual transaction and determining the assumption of risk, assume that the analysis of the evidence concludes that the contractual assumption of risk is not aligned with control of risk. Table 2 in the Annex sets out the functional analysis performed under Article 9. Based on the assumptions made about the functions performed by each of the parties, it can be concluded that Prima does not exercise control over the following risks contractually allocated to it:

- Inventory risk: Sellco has the capacity to determine warehousing arrangements and the stocking levels, and actually performs the decision-making functions about inventory levels required for sales in Country B. Prima does not take such decisions and produces to Sellco's orders. On the assumption that Sellco has the financial capacity to assume the risk, the inventory risk is allocated to Sellco, instead of Prima, together with the associated costs.
- Credit risk: The receivables balance recorded in the financial statements of Prima is affected by the credit terms extended to Prima's customers and the efficiency of collection. Sellco has the capacity to decide credit parameters within which credit can be extended to customers, and actually performs the decision-making functions. Prima does not take such decisions. It also handles collection of customer receivables. On the assumption that Sellco has the financial capacity to assume the risk, the credit risk is allocated to Sellco, together with the associated costs.

43. There is a further consideration under Article 9 in relation to the analysis of inventory. The inventory risk is assumed by Sellco, but the inventory is legally owned by Prima, and Prima has laid out funds in respect of the inventory. Under the principles of Section D of Chapter I of the Guidelines, since

the only functions of Prima in relation to the inventory is to pay for it, it will be entitled to an appropriate funding return from Sellco based on the functions Prima performs and risks it controls in relation to the funding. Sellco, on the other hand, will bear the consequences of inventory and credit risks materialising, such as inventory obsolescence or the realisation of unrecoverable debts.

44. Assume that the outcome of the analysis under Article 9 determines that the profits of Sellco should be 9, taking into account the functions of Sellco including the risks and the associated costs that Sellco assumes. The analysis under Article 9 also determines an appropriate funding return for Sellco in relation to the funding advanced by Prima in relation to inventory. There are likely in practice to be other interest costs incurred by both companies.

PRIMA (Country A)	
Sales income	200
- COGS	(40)
Gross profit	160
OPEX	
– Sales commission to Sellco	(30)
– Reimbursement of advertising expenses incurred by Sellco	(7)
Operating profit	123
Funding return from Sellco	2
Other interest costs	

SELLCO (Country B)	
Income from sales commission	30
– OPEX (other than advertising expenses by Prima)	(8)
– Bad debt losses	(4)
– Inventory losses	(3)
– Warehousing	(6)
Operating profit	9
Funding return to Prima	(2)
Other interest costs	

45. In summary:

- Total profits in Country A and in Country B: 132
- Total profits in Country A under Article 9: 125
- Total profits in Country B under Article 9: 7
- Total profits of the non-resident enterprise: 125

Attribution of profits to Prima's DAPE in Country B under Article 7

46. Given the assumption that Prima has a DAPE in Country B, Article 7 applies to determine the amount of profits, if any, attributable to the DAPE of Prima in Country B.

Analysis under Article 7 and Step 1 of the AOA

47. Under Step 1 of the AOA, a functional and factual analysis is performed to determine the functions undertaken by Sellco (DAE) both on its own account and on behalf of the non-resident enterprise, Prima. The functions undertaken by Sellco on behalf of Prima are relevant to the attribution of Prima's assets or risks to the DAPE (2010 Attribution of Profits Report, Part I, para. 232). Table 2 in the Annex sets out the functional and factual analysis performed under Article 7.

48. The functional and factual analysis under Step 1 of the AOA shows that Sellco undertakes all the functions involved in identifying customers, soliciting and placing orders and it also implements locally the marketing and advertising strategy devised by Prima. In addition, it is found that Sellco also performs significant people functions in relation to inventory (warehousing and establishing inventory levels) and credit to customers (parameter setting, sales approval based on review of customer's creditworthiness and collection of customer receivables) in Country B.

49. From a legal perspective, the inventory is owned by Prima and inventory risk is contractually assumed by Prima. However, for purposes of Article 7 and the AOA, economic ownership of inventory and inventory risk are attributed to the DAPE because Sellco performs on behalf of Prima in Country B the significant people functions relevant to the attribution of economic ownership of inventory and the inventory risk (see paragraph 243 of Part I of the 2010 Attribution of Profits Report)¹⁰.

50. Similarly, from a legal standpoint, Prima is the owner of customer receivables and it contractually assumes credit risk related to customers in Country B. However, for purposes of Article 7 and the AOA, economic ownership of receivables and credit risk are attributed to the DAPE because Sellco performs on behalf of Prima in Country B the significant people functions relevant to the attribution of economic ownership of receivables and credit risk¹¹.

51. Accordingly, based on the functional and factual analysis in Step 1 of the AOA, the following should be attributed to the DAPE:

- **Inventory risk and economic ownership of inventory**, based on the identification of significant people functions performed by the DAE on behalf of Prima and which are relevant to the economic ownership of such asset and the attribution of the related risk.
- **Credit risk and economic ownership of receivables**, based on the identification of significant people functions performed by the DAE on behalf of Prima and which are relevant to the economic ownership of such asset and the attribution of the related risk.
- **Capital** (free and interest/bearing funding) to fund the risks and assets attributed to the DAPE.

Profit attribution under Article 7 and Step 2 of the AOA

52. The next step is to determine the profits of the DAPE from sales made by Prima in Country B.

53. Under Article 7, the sales income obtained in Country B is attributable to the DAPE of Prima in Country B. The DAPE is the economic owner of the inventory and receivables and assumes the inventory and credit risks. Based on this, the profits attributable to the DAPE must be determined taking into consideration that the DAPE need to:

- Compensate Sellco in accordance with Article 9 for the sales-related activities Sellco performs as a sales agent. In order to do so, it is necessary to determine the arm's length fee payable to Sellco

¹⁰ Given that the Article 7 analysis is presented for purposes of this example as independent of the Article 9 analysis, Step 1 of the AOA does not take into account that, under Article 9, the inventory risk has been allocated to Sellco and that Prima receives a funding return to Prima for the functions it performs in relation to inventory. When the analysis under Article 9 has already been performed to allocate risk to Sellco, the analysis under Article 7 will not attribute the risk to the DAPE.

¹¹ The explanation in the previous footnote applies for credit risk.

considering the functions performed, assets used and risks assumed. The analysis under Article 9 shows that the credit and inventory risks attributable to the DAPE under the Article 7 analysis are actually risks assumed by the DAE (Sellco) under the guidance in Section D of Chapter I. Based on this, it is determined that the arm's length fee payable to Sellco amounts to 30 and that the bad debt losses, inventory losses and the warehousing costs are allocated to Sellco for purposes of computing its remuneration. Irrespective of the order in which the Articles 7 and 9 analyses are performed, to include these costs and write-offs in the P&L of the DAPE as well as in the fee payable to Sellco under Article 9 would result in double counting;

- Compensate Prima for the functions Prima performs in relation to the sale of products in Country B (reflected in COGS); and
- Recognise the appropriate return on its assets and the appropriate interest costs. Under Article 7 the DAPE is attributed the inventory asset, but the commercial return from deploying that asset is included in the fee payable to Sellco under Article 9. If interest costs are allocated to the DAPE in respect of the asset, then the DAPE will show no profits or a loss from the economic ownership of the asset. Under the hypothesis that the DAPE is a separate and independent enterprise from Prima the same reasons that lead to the conclusion under Article 9 that Prima should have a funding return from its functions in relation to its inventory asset apply to the DAPE now that the inventory asset has been attributed from Prima's Head Office to the DAPE. If the Article 9 analysis has already been performed, then the interest income of 2 for Prima would be attributed to its DAPE. Under Article 7 the same reasoning applies to determine that the DAPE has effectively funded the inventory deployed by Sellco.

54. In practice, the profits attributed to the DAPE will provide remuneration for the economic ownership of assets. For purposes of this example, it is assumed that the funding return to Prima of 2 determined under the Article 9 analysis is an arm's length return for holding economic ownership of the assets.

55. Given that: 1) third party sales in Country B are 200; 2) the DAPE has an expense of 30 relating to the sales commission to Sellco; and, 3) the profits attributed to the DAPE should be 0 (before the funding return), the amount of cost of goods sold ("COGS", which equals "sales" of the Head Office) is determined such that the operating profit of the DAPE, after payment of an appropriate fee to the DAE determined under Article 9, is 0 (before the funding return. This results in COGS of 170. Accordingly, the P&L of the DAPE showing the amounts received and expensed in connection with the sale of products in Country B and the attribution of Prima's profits to the DAPE of Prima can be summarised as follows:

PRIMA'S HEAD OFFICE (Country A)	
Sales income	170
– COGS	(40)
Gross profit	130
OPEX	
– Reimbursement of advertising expenses incurred by Sellco	(7)
Operating profit	123
Funding return from Sellco	0
Other interest costs	

DAPE (Country B)	
Sales income	200
– COGS	(170)
Gross profit	30
OPEX	
– Sales commission to Sellco	(30)
– Bad debt losses	(0)
– Inventory losses	(0)
– Warehousing costs	(0)
Operating profit	0
Funding return from Sellco	2
Interest costs (The interest costs depend on relevant borrowings, interest rate, and free capital)	

Conclusion under Article 7

56. Whereas in Example 1 there were no significant people functions performed by Sellco relevant to the attribution of Prima's assets and risks to its DAPE, in Example 2 there are significant people functions performed by DAE (Sellco). These significant people functions result in the attribution of risks and economic ownership of assets for inventory and receivables to the DAPE under Article 7.

57. In this example, the significant people functions result in an attribution of risks to the DAPE which aligns with the assumption of risk by Sellco under Article 9. Therefore, in this example, the profits of 2 attributable to the DAPE under Article 7 result from the return to the economic ownership of assets. The remaining profits of Prima (123) are profits of Prima's Head Office.

Questions to public commentators

6. Do commentators agree with the construction of the profits or losses of the DAPE in Example 2 under the AOA?
7. What would be the conclusion if, because of the wording of Article 7 in the applicable tax treaty, an approach other than the AOA applied? If the conclusion is different, what would be the differences?
8. In your opinion, what would be the consequences if, in the example, Sellco does not have the financial capacity to assume the inventory and credit risks? In that case, to which party would you allocate those risks? How would it affect the fee payable to Sellco and the profits to be attributed to the DAPE?
9. What are your views on the fact that in Example 2 the same functions that are considered under the Article 9 analysis to allocate risks to Sellco, are also taken into account, under Article 7, as the SPF that result in the attribution of economic ownership of assets to the DAPE? What is your opinion about the fact that, in this example, the inventory and credit risks are allocated to Sellco under Article 9 and the economic ownership of inventory and receivables are attributed to the DAPE? Does your reading of the current guidance of the 2010 Attribution of Profits Report, and in particular with paragraphs 230 to 245, support the conclusions of the Example?

EXAMPLE 3

58. The facts are the same as in Example 2, with the exception that Prima does not engage Sellco as its sales agent in Country B. Instead, given that Country B is a neighbouring country, Prima sends one of its employees (hereinafter, "Employee") to perform full-time selling activities in Country B for Prima. Employee has a salary of 20. It is assumed for the purposes of this example that the activities performed by Employee for Prima give rise to a dependent agent permanent establishment ("DAPE") of Prima in Country B (and it is further assumed that there is not a fixed place of business under Article 5(1)).

59. The relevant facts of Example 3 are set out in the following table:

FACTS	
SALES	<ul style="list-style-type: none"> Prima sets the sales strategy and market share targets in Country B. Prima hires the Employee, monitors performance and makes decisions on whether to continue, adapt or terminate the relations with the Employee. Employee is responsible for identifying customers, soliciting and placing customer orders and processing customer orders with Prima. <u>To perform its activities, Employee uses a company vehicle owned by Prima.</u> Prima is responsible for setting the pricing policy for products, as well as for tailoring that policy to Country B's market through setting specific prices for products offered in Country B.
MARKETING & ADVERTISING	<ul style="list-style-type: none"> Prima decides the budget, marketing strategy and advertising content globally and for Country B. Employee implements the marketing strategy in Country B and is reimbursed by Prima for all expenses incurred in placing local advertising for the products. Employee's activities do not create any local marketing intangibles in Country B. Sales channels are generic and not specialised. Prima is responsible for the legal protection of the Group's marketing intangibles.
INVENTORY	<ul style="list-style-type: none"> Prima retains title to the inventory until it is delivered to customers. <u>Employee is responsible</u> for warehousing the inventory and determining and monitoring the appropriate inventory levels required to fulfil customer orders expeditiously while minimising obsolescence risk and costs.
CREDIT TO CUSTOMERS	<ul style="list-style-type: none"> Amounts due from customers are for the account and at the risk of Prima, and Prima contractually bears credit risk with respect to customer receivables. <u>Employee sets</u> the parameters within which credit can be extended to customers. <u>Employee approves</u> every sale to customers made in Country B through the review of the customer's creditworthiness. <u>Employee handles</u> collection of customer receivables.

60. Unlike the previous two examples, Article 9 is not applicable to the relations between Prima and its Employee. The analysis under Article 7 remains relevant.

Attribution of profits to Prima's DAPE in Country B under Article 7

61. Given the assumption that Prima has a DAPE in Country B, Article 7 applies to determine the attribution of Prima's profits to the DAPE of Prima in Country B.

Analysis under Article 7 and Step 1 of the AOA

62. The conclusions of the analysis under Step 1 of the AOA are the same as those reached in Example 2. In addition, the DAPE is attributed the economic ownership of the company vehicle used by Employee in Country B to perform the selling activities on behalf of Prima. Table 3 in the Annex sets out the functional and factual analysis performed under Article 7.

63. Accordingly, based on the functional and factual analysis in Step 1 of the AOA, the following should be attributed to the DAPE:

- **Inventory risk and economic ownership of inventory**, based on the identification of significant people functions performed by the Employee on behalf of Prima and which are relevant to the economic ownership of such asset and the attribution of the related risk.
- **Credit risk and economic ownership of receivables**, based on the identification of significant people functions performed by Employee on behalf of Prima and which are relevant to the economic ownership of such asset and the attribution of the related risk.
- **Economic ownership of the company vehicle**, based on the criterion of place of use (see paragraph 75 of Part I of the 2010 Attribution of Profits Report).
- **Capital** (free and interest/bearing funding) to fund the risks and assets attributed to the DAPE.

Profit attribution under Article 7 and Step 2 of the AOA

64. The next step is to determine the profits of the DAPE from sales made by Prima in Country B.

65. Under Article 7, the sales income obtained in Country B is attributable to the DAPE of Prima in Country B. The DAPE is the economic owner of the company vehicle, inventory and receivables and assumes the inventory and credit risks. Based on this, the profits attributable to the DAPE must be determined taking into consideration that the DAPE needs to:

- Compensate Employee for its sales-related activities in Country B on behalf of Prima. The salary of Employee under its employment contract with Prima amounts to 20.
- Compensate Prima for the functions Prima performs in relation to the sale of products in Country B (reflected in COGS).

66. The DAPE, therefore, needs to be attributed profits that reflect the assets, risk, and capital attributed to it, as well as the functions it performs. The DAPE is effectively operating as a distribution entity in Country B, and in accordance with the assumptions in Example 2 should, if it were a separate and independent enterprise, earn an operating margin of 4.5%.

67. Given that: 1) third party sales in Country B are 200; 2) the DAPE has expenses of 33; and, 3) the profits attributed to the DAPE should be 9, the amount of cost of goods sold ("COGS", which equals

"sales" to the Head Office is determined such that the operating profit of the DAPE is 9. This results in COGS of 158. Accordingly, the P&L of the DAPE showing the amounts received and expensed in connection with the sale of products in Country B and the attribution of Prima's profits to the DAPE of Prima can be summarised as follows:

PRIMA'S HEAD OFFICE (Country A)	
Sales income	158
– COGS	(40)
Gross profit	118
OPEX	
– Reimbursement of advertising expenses incurred by Employee	(7)
Operating profit	111
Interest costs	

DAPE (Country B)	
Sales income	200
– COGS	(158)
Gross profit	42
OPEX	
– Salary of Employee	(20)
– Bad debt losses	(4)
– Inventory losses	(3)
– Warehousing costs	(6)
Operating profit	9
Interest costs (The interest costs depend on relevant borrowings, interest rate, and free capital)	

Conclusion under Article 7

68. There are significant people functions performed by Employee and attributable to the DAPE which result in the attribution to the DAPE of the inventory and receivables risks and the economic ownership of the company vehicle, inventory and receivables, under Article 7. Accordingly, there are profits attributable to the DAPE above the salary paid to Employee. The remaining profits of Prima (111) are profits of the Head Office.

Questions to public commentators

- 10. Do commentators agree with the construction of the profits or losses of the DAPE in Example 3 under the AOA?
- 11. What would be the conclusion if, because of the wording of Article 7 in the applicable tax treaty, an approach other than the AOA applied? If the conclusion is different, what would be the differences?

EXAMPLE 4

69. The facts of Example 4 are identical to those in Example 2, except that the functions in relation to extending credit terms to customers are more complicated. In Example 2, Sellco performs all functions in relation to determining credit terms; however, in this example, both Prima and Sellco perform relevant functions as described in the table below.

FACTS	
CREDIT TO CUSTOMERS	<ul style="list-style-type: none"> • Amounts due from customers are for the account and at the risk of Prima, so that Prima contractually bears credit risk with respect to customer receivables. • There are credit management teams in both Prima and Sellco. Sellco reviews a customer's creditworthiness and decides whether credit is granted in all cases where the customer's initial credit balance does not exceed EUR 1m. Sellco liaises with Prima regularly in making decisions, and consults with Prima in particular on any proposals to deny credit terms or on proposals to extend longer than normal credit periods. In those cases, Prima evaluates the proposals and makes the decision. Sellco also refers to Prima for further review any customers that Sellco thinks may be related to other customers of Prima so that Prima can consider its overall exposure to the MNE group. • Prima requires referrals from Sellco of initial credit balances in excess of EUR 1m, and Prima performs its own creditworthiness assessment, and decides credit terms. Prima also evaluates its exposure to customers who are part of an MNE group. • Sellco performs receivables management services for all customers, irrespective of the size of the original balance, including the monitoring of customer account balances and collection of customer receivables. Sellco proposes account management plans to Prima, and Prima reviews the proposals and takes decisions about actions proposed by Sellco to recover or write-off the receivables. Where recovery problems are encountered, it may not be possible to determine whether the particular customer was originally evaluated by Prima or Sellco, and if by Sellco, the existence or extent of referral and review by Prima.

Analysis of the controlled transaction between Prima and Sellco under Article 9

70. Given that Prima and Sellco are associated enterprises, an analysis of the controlled transaction between Prima and Sellco is required under Article 9.

71. In applying the guidance in Section D of Chapter I of the Guidelines relating to accurately delineating the actual transaction and determining the assumption of risk, assume for the purposes of this example that analysis of the evidence concludes that the receivables balance recorded in the financial statements of Prima is affected by the credit terms extended to Prima's customers and the efficiency of credit management. Assume further that the functional analysis shows that both Prima and Sellco have the capacity to decide whether or not to extend credit, and the terms of the credit, and both actually perform the decision-making functions. Sellco actively manages the recovery of customer receivables resulting from the decisions to extend credit, but significant decisions on account management are taken by Prima¹². Prima contractually bears the bad debt risk, exercises control over the risk, and, it is assumed for the purposes of the example, has the financial capacity to assume the risk. The fact that Sellco also exercises control does not affect the assumption of risk by Prima (see paragraph 1.94 of the Guidelines). Therefore, Prima bears the bad debt losses.

¹² For the purpose of this example it is assumed that it can be demonstrated that Sellco's activities are expected to have an effective influence on the realisation of bad debt risk.

72. Nevertheless, as the guidance in Section D of Chapter I makes clear, Sellco should be appropriately compensated for its control functions in relation to risk, and this may take the form of a sharing in the potential upside and downside commensurate with its contribution to the control functions. In practice, such compensation is likely to be subsumed in the determination of the appropriate profits for Sellco, but for the purposes of the example compensation for the credit management functions is shown separately to the compensation for Sellco's sales agency function.

73. For the purposes of the example it is assumed that:

- An arm's length return appropriate for the credit risk, and which is included in the sales income recorded by Prima, can be valued at 5% of the value of the receivables (determined, for example, through third-party debt factoring arrangements),
- An arm's length service fee for credit risk management is priced at cost plus 10%, and
- Prima and Sellco have a contractual incentive fee arrangement for credit management functions provided by Sellco in respect of Prima's receivables such that Sellco receives a fee equal to 40% of the difference between the value of the credit risk and the bad debt write-off. This is assumed for the purpose of this example to be an arm's length amount.

74. The pricing arrangements assumed to be appropriate under Article 9 for the purposes of this example may be illustrated in two scenarios as follows:

Example 4: Scenario A			
Prima (Country A)		Sellco (Country B)	
Risk return notionally included in income: 5% of debts (A)	5,000	Service fee (cost-plus 10%)	110
		Incentive fee (40% [A-B])	1,200
Credit management costs for Country B	-300	Credit management costs	-100
Fee to Sellco	-1,310		
Bad debts (B)	-2,000		
Operating profit	1,390	Operating profit	1,210

75. In summary, for Scenario A:

- Total profits in Country A and in Country B: 2,600
- Total profits in Country A under Article 9: 1,390
- Total profits in Country B under Article 9: 1,210
- Total profits of the non-resident enterprise: 1,390

Example 4: Scenario B			
Prima (Country A)		Sellco (Country B)	
Risk return notionally included in income: 5% of debts (A)	5,000	Service fee (cost-plus 10%)	110
		Incentive fee (40% (A-B))	-400
Credit management costs for Country B	-300	Credit management costs	-100
Fee to Sellco	290		
Bad debts (B)	-6,000		
Operating profit	-1,010	Operating profit	-390

76. In summary, for Scenario B:

- Total profits in Country A and in Country B: -1,400
- Total profits in Country A under Article 9: -1,010
- Total profits in Country B under Article 9: -390
- Total profits of the non-resident enterprise: -1,010

77. Both scenarios illustrate the ways in which the effects of the sharing in potential upside and downside by Sellco may be interpreted in accordance with the contractual arrangements and the principles of paragraph 1.105 of the Guidelines, and both scenarios show the assumption of risk by Prima. The difference between the two scenarios is the bad debt experience, which then affects the amount of the incentive fee. Scenario A illustrates an outcome where bad debts approximate the expected level, whereas Scenario B illustrates a higher than expected level of bad debts.

Attribution of profits to Prima's DAPE in Country B under Article 7

78. Since this example is built on the facts of Example 2, it is assumed that the non-resident enterprise, Prima, has a DAPE in Country B under Article 5(5). Accordingly, Article 7 applies to determine the amount of profits, if any, attributable to the DAPE of Prima in Country B.

79. Under Step 1 of the AOA, a functional analysis is performed to determine the attribution of risks and economic ownership of assets to the DAPE based on the significant people functions undertaken by the DAE (Sellco) on behalf of the non-resident enterprise.

80. Under the Article 9 analysis, credit risk has been allocated to Prima even though Sellco performs control functions relating to the risk. Under the Article 7 analysis, the attribution of risk within the single enterprise will follow from the identification of the significant people functions relevant to the initial acceptance and subsequent management of those risks. As paragraph 24 of Part I of the 2010 Attribution of Profits Reports states, the credit risk is likely to be regarded as initially assumed by that part of the enterprise which decides to conclude a sale to a particular customer after having reviewed the creditworthiness of this customer. The guidance also indicates that the fact that general parameters for credit risks might potentially be set by another part of the enterprise would not change the assumption of the risk, as the significant people functions relevant to the assumption of risks are those which involve active decision-making. In this example, decisions that lead to the assumption of credit risk are made by Sellco. Credit risk is attributed to the DAPE, together with economic ownership of receivables.

81. However, in this example, the Head Office also performs significant people functions since it makes decisions that lead to the assumption of credit risk, and therefore, only part of the risks and associated receivables asset should be attributed to the DAPE. For the purposes of this example, it is assumed that the appropriate sharing of the risk is based on the sharing of significant people functions measured by the respective contributions to credit management costs for Country B customers (75%/25%). The fee to Sellco is shared in the same proportion since Sellco contributes to the control of risks that are attributed to both Head Office and the DAPE. The following tables illustrate the attribution of credit risk between the Head Office and the DAPE under the two scenarios:

Example 4: Scenario A			
Prima's Head Office (Country A)		DAPE (Country B)	
Risk return (attributed in proportion to share of total credit management costs)	3,750	Risk return (attributed in proportion to share of total credit management costs)	1,250
Fee to Sellco (1310 x 75%)	-982.5	Fee to Sellco (1310 x 25%)	-327.5
Credit management costs for Country B	-300		
Bad debts (attributed in proportion to share of total credit management costs)	-1,500	Bad debts (attributed in proportion to share of total credit management costs)	-500
Operating profit	967.5		422.5

Example 4: Scenario B			
Prima's Head Office (Country A)		DAPE (Country B)	
Risk return (attributed in proportion to share of total credit management costs)	3,750	Risk return (attributed in proportion to share of total credit management costs)	1,250
Fee to Sellco (290 x 75%)	217.5	Fee to Sellco (290 x 25%)	72.5
Credit management costs for Country B	-300		
Bad debts (attributed in proportion to share of total credit management costs)	-4,500	Bad debts (attributed in proportion to share of total credit management costs)	-1,500
Operating profit	-832.5		-177.5

82. In Scenario A, 422.5 of Prima's profits of 1,390 are allocated to the DAPE, with the result that profits in Country A are 967.5 and total profits in Country B arising from the DAPE and Sellco are 1,632.5 (comprised of profits of Sellco under Article 9 of 1210 and profits attributed to the DAPE under Article 7 of 422.5). In Scenario B a loss of 177.5 out of Prima's total loss of 1,010 is allocated to the DAPE, with the result that losses in Country A are 832.5 and total losses in Country B are 567.5 (comprised of losses for Sellco under Article 9 of 390 and losses attributed to the DAPE under Article 7 of 177.5). Relevant interest costs should be determined and allocated to the DAPE together with an appropriate amount of free capital in accordance with the guidance in the 2010 Attribution of Profits Report.

83. The amount of profits or losses in the DAPE will depend in practice on the measurement of risk sharing under Article 7, the level of actual write-downs, and the measurement of the compensation for risk control functions to Sellco under Article 9. Any difference between the fee to Sellco and the profits of the DAPE arises from the difference between on the one hand appropriate compensation under Article 9 for risk control functions, including a sharing of potential upside and downside risk outcomes, and on the other hand, the allocation of actual risk outcomes under Article 7.

84. In this example, there are functions performed by Sellco that do not lead to the assumption of risk by Sellco under Article 9, but which are significant people functions relevant to the attribution of risk to the DAPE of Prima. As a result there are profits in the DAPE, and the potential for losses.

Questions to public commentators

12. Do commentators agree with the construction of the profits or losses of the DAPE in Example 4 under the AOA?
13. Do commentators agree that the profits or losses in the DAPE over and above the fee payable to Sellco arise because the contractual allocation of risk to Prima is respected under Article 9, and is not shared with Sellco, whereas under Article 7 the risk is partly attributed to Prima's Head Office and partly to the DAPE of Prima? In other words, the difference arises from differences between allocation of risk between two separate enterprises and attribution of risk within the same enterprise?

GUIDANCE ON THE ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS ARISING FROM ACTIVITIES NOT COVERED BY SPECIFIC EXCEPTIONS IN ARTICLE 5(4)

85. The Report on Action 7 introduced modifications to paragraph 4 of Article 5 of the MTC, which contains specific activity exceptions to the PE definition. The revised Article 5(4) ensures that that each of the exceptions included in that paragraph is subject to the requirements that the listed activities are of a "preparatory or auxiliary" character. This modification was needed because, since the introduction of these exceptions changes in the way business is conducted have been far-reaching leading to activities previously considered to be merely preparatory or auxiliary in nature becoming core business activities in some circumstances.

86. The example provided is that of a fixed PE arising from the use of facilities, a warehouse, solely for the purpose of storage, display or delivery of goods or merchandise belonging to a non-resident enterprise, and not qualifying as preparatory or auxiliary to the overall business activity of the enterprise under paragraph 4 of Article 5 of the MTC. Given the difficulties of identifying profits when the warehousing activity is carried out as a cost centre representing only one aspect of the MNE Group's activities, this example first supposes that the warehousing activities are conducted as a profit centre by an MNE Group specialising in providing warehousing services to third party customers. Profiling the warehouse in this manner provides a basis for developing guidance on the approach for determining the profits arising from the arrangements when carried out as a cost centre as part of the MNE Group's total activities. The examples are designed to illustrate the application of Article 7 and it is assumed that Article 6 of the MTC has no application.

EXAMPLE 5

Scenario A: Warehousing as the core business

87. Warehouses-R-Us is a company resident in Country A (hereinafter, "WRU" or "non-resident enterprise"). It specialises in providing spare parts inventory-holding services to aeronautical third-party customers who rely on efficient and effective inventory management. The spare parts are owned by those third-party customers, but WRU analyses inventory usage and recommends stock-holding levels and replenishment policies to its customers. Assume that WRU determines from an analysis of growth and trends in its customers that a further warehouse is required. After analysing several possible locations, WRU decides to establish the new warehousing facility in Country W, where it arranges for its construction and fitting out to its specifications at a total cost of 100. WRU arranges financing to acquire the assets and is the legal owner of the warehouse and its fixtures. In addition, WRU has developed specialised know-how and software to run its warehouses efficiently. WRU runs the warehouse through its own employees.

88. It is assumed for the purposes of this example that the warehouse creates a permanent establishment for WRU in Country W, and that it meets the conditions in paragraph 1 of Article 5 of the MTC: a) WRU has a fixed place of business, i.e. the warehouse; b) which is owned by WRU and at the disposal of WRU in Country W; and, c) through which the business of WRU is partly carried on, i.e. providing inventory-holding services of spare parts to aeronautical third-party customers. It is further assumed that the activities are not exempted by Article 5(4) (note, in particular, that Article 5(4)(a) does not apply since the warehouse is not used for the storage of goods or merchandise belonging to WRU).

Attribution of profits to WRU's PE in Country W under Article 7

89. Under Step 1 of the AOA, it is found that WRU in Country A performs all significant people functions in relation to the business and related risk. Such significant people functions performed by WRU in Country A include the analysis of the commercial need for the warehouse, its location, and its configuration. WRU also determines how the warehouse should be operated and decides to use its own employees to do so. Those employees have no specialised knowledge. In terms of running the business, significant people functions relating to the recommendation of levels of inventory to be maintained by customers and replenishment policies are performed by WRU in Country A. In addition, WRU is the legal and economic owner of the intangibles developed and used in running the warehouse facilities, since it performs the significant people functions relating to the intangibles.

90. In relation to the PE of WRU in Country W, the analysis under Step 1 of the AOA finds that the PE should be remunerated for operating the warehouse. In addition, it is attributed the economic ownership of the warehouse since WRU's asset is used in Country W (see Part I, paragraph 75 of the 2010 Attribution of Profits Report). Accordingly, the accounts of the PE of WRU would show the warehouse asset on its balance sheet, and its costs would include depreciation.

91. Under the analysis, the profits attributable to the PE must be determined taking into account that it needs to:

- Compensate WRU's Head Office for the granting of rights to the intangibles used in the warehouse facilities economically owned by the PE under the AOA.
- Compensate the Head Office for the services provided by the Head office in analysing inventory usage and recommending replenishment policies.

- Compensate the Head Office for providing investment advice associated with acquiring the asset (paragraph 221 of Part I of the 2010 Attribution of Profits Report).
- Reflect the employment of the workforce.

Interest costs and free capital would also be allocated to the PE of WRU.

92. Assume that the profits of WRU deriving from third-party fee income for warehousing services amount to 62, and that the arm's length price of the dealings between the Head Office and its PE are determined as shown in the table below. The P&L of WRU's PE can be summarised as follows:

WRU's PE in Country W	
Service remuneration	62
– Cost of workforce	(22)
– Fee to WRU for know-how and software	(10)
– Fee to WRU for services related to inventory usage and replenishment, and investment advice	(20)
Other expenses	
– Depreciation of assets	(5)
Net profit	5
Interest cost	(3)

93. The profits in the PE essentially reflect the reward for the economic ownership of the asset and the routine functions performed at the warehouse, since all the significant people functions in relation to the business and related risk are performed by the Head Office. WRU's head office would no longer have the costs of interest, depreciation, and the employee costs, but would have to recognise compensation relating to the operation of the business, including analysis of usage and replenishment policies for customers. In addition, the Head Office would recognise compensation relating to services in providing know-how and software.

Question to public commentators

14. Do commentators agree with the construction of the profits or losses of the PE in Scenario A of Example 5 under the AOA?

Scenario B - Warehousing as an internal function of the business

94. The facts are the same as in Scenario A of Example 5, except that WRU is engaged in the sale of aeronautical spare-parts to third party customers. WRU's business heavily relies on the ability to promptly deliver its products to customers and on an efficient and effective management of its inventory. Therefore, the warehousing activity is carried out as an internal function. As in Scenario A, WRU runs the warehouse in Country W through its own employees.

95. It is assumed for the purposes of this example that the warehouse creates a permanent establishment for WRU in Country W, and that it meets the conditions in paragraph 1 of Article 5 of the MTC: a) WRU has a fixed place of business, i.e. the warehouse; b) which is owned by WRU and at the

disposal of WRU in Country W; and, c) through which the business of WRU is partly carried on, i.e. selling spare parts to aeronautical third-party customers. It is further assumed that the activities are not exempted by Article 5(4) because these activities are not considered to be preparatory or auxiliary.

Attribution of profits to WRU's PE in Country W under Article 7

96. The conclusions of the analysis under Step 1 of the AOA are the same as in Scenario A. However, in this scenario the warehouse operates as a cost centre, which means that the PE does not obtain third-party revenues for the warehousing activity that can be used in attributing profits to the PE.

97. However, the same principles would apply as in Scenario A. The profits in the PE in both Scenarios A and B essentially reflect the reward for the economic ownership of the asset and the routine functions performed at the warehouse, since all the significant people functions in relation to the business and related risks are performed by the Head Office. Therefore, in the absence of third-party income to calculate the profits of the PE, the attribution of profits to PEs in these cases can be streamlined by attributing to the PE profits commensurate with investment in that asset, taking into account appropriate funding costs and the compensation payable for investment advice, and the performance of routine functions.

Scenario C - Warehousing as an internal function of the business carried out by a separate enterprise

98. The facts are the same as in Scenario B of Example 5, except that WRU appoints Wareco, an unrelated enterprise located in Country W, to run the warehouse under a service level agreement. Therefore, WRU has no employees in Country W. The contract entered into by the parties includes the following terms:

CONTRACT
<ul style="list-style-type: none">• Wareco has the rights of use, access to the warehouse and its fixtures in order to perform the services• Wareco has the right to use the specialised know-how and software (developed by WRU) in order to run the warehouse.• Wareco's remuneration is calculated as 110% of its costs.• WRU determines products ranges and inventory levels to meet the predicted requirements of its customers.• The warehousing facilities remain accessible and at the disposal of WRU.

99. It is assumed for the purposes of this example that the warehouse creates a permanent establishment for WRU in Country W, and that it meets the conditions in paragraph 1 of Article 5 of the MTC: a) WRU has a fixed place of business, i.e. the warehouse; b) which is owned by WRU and at the disposal of WRU in Country W; and, c) through which the business of WRU is partly carried on, i.e. selling spare parts to aeronautical third-party customers. It is further assumed that the activities are not exempted by Article 5(4) because these activities are not considered to be preparatory or auxiliary.

Attribution of profits to WRU's PE in Country W under Article 7

100. The conclusions of the analysis under Step 1 of the AOA are the same as in Scenario B, with the exception that in this scenario, the PE would pay a fee to Wareco for operating the warehouse. As in Scenario B the warehouse operates as a cost centre, which means that the PE does not obtain third-party revenues for the warehousing activity that can be used in attributing profits to the PE.

101. In this scenario, the profits in the PE essentially reflect only the reward for the economic ownership of the asset, since all the significant people functions and risks relating to running the asset are attributed to WRU's Head Office, including appointing and hiring Wareco. Therefore, in the absence of third-party income to calculate the profits of the PE, the attribution of profits to PEs in these cases can be streamlined by attributing to the PE profits commensurate with investment in that asset, taking into account appropriate funding costs and the compensation payable for investment advice.

102. Additional functions and assumption of risk by Wareco would not affect the profits attributed to the PE under Article 7, but would affect only the profits of WRU's Head Office and the profits of Wareco. Any significant people functions performed by WRU in Country W would, however, affect the profits of WRU attributable to its PE.

Questions to public commentators

15. Do commentators agree with the conclusion reached in Scenarios B and C of Example 5 under the AOA?
16. In particular, do you agree that there can be an investment return on the asset or assets creating or being part of the PE when there are no personnel of the non-resident enterprise operating in the PE?
17. Do you agree with the streamlined approach proposed in this example for cases where there are no functions performed in the PE apart from the economic ownership of the asset, i.e. attribute profits to the PE commensurate with investment in that asset (taking into account appropriate funding costs and the compensation payable for investment advice)? How would you identify the investment return?
18. Do you agree that if the non-resident enterprise has no personnel operating at the fixed place of business PE, then significant people functions performed by other parties on their own account in the jurisdiction of the PE do not lead to the attribution of risks or assets to the PE, and no profits would be attributable to the PE? If not, please explain the reasons for taking a different view.
19. Under Scenario C, if Wareco were a related enterprise, and if it is assumed that the arm's length fee is 110% of its costs, would there be any difference to the outcome of the attribution of profits to the PE of WRU?
20. What would the conclusion be if, because of the wording of Article 7 in the applicable tax treaty, an approach other than the AOA applied? If the conclusion is different, what would be the differences?

EXPLORING ADDITIONAL APPROACHES TO CO-ORDINATE THE APPLICATION OF ARTICLE 7 AND ARTICLE 9 OF THE MTC

103. The simultaneous developments under BEPS Actions 7 and 8-10 have 1) reduced the scope to avoid the PE status, and thus have reinforced taxing rights in the source country, and 2) clarified aspects of the transfer pricing guidance which may affect the potential profits available to attribute through the PE mechanism under the AOA. Suggestions for a co-ordinated application of Article 7 and Article 9 to determine the profits of a PE have been included in this Discussion Draft. For some countries it may be the case that uncoordinated implementation of Articles 7 and 9 may lead to situations of double taxation between the taxpayers situated in the host country (that is the DAPE of the non-resident enterprise and the associated DAE).

104. Furthermore, the analysis of one example in this Discussion Draft seems to identify that there could be situations where the profits attributed to the PE are nil. Nevertheless, the existence of a DAPE for corporation tax purposes may arise even when there are no profits attributable to the DAPE, and notwithstanding this, may create filing requirements and may give rise to other tax liabilities.

105. The 2010 Attribution of Profits Report notes that there may be administratively convenient ways of recognising the existence of a DAPE and collecting the appropriate amount of tax resulting from the activity of a DAE (see paragraph 246 of Part I of the 2010 Attribution of Profits Report). In this regard, the question, therefore, arises whether there are mechanisms that could ensure additional co-ordination of the application of Article 7 and Article 9 to determine the profits of a PE without providing opportunities for the re-emergence of BEPS risks that the changes under Actions 7 and 8-10 were designed to reduce. Commentators are invited to respond to this question to inform any discussions on this point by the relevant Working Parties, taking into account that the changes made through the work under Actions 7 and 8-10 have been agreed and are not open for discussion.

Questions to public commentators

21. Do commentators have suggestions for mechanisms to provide additional co-ordination for the application of Article 7 and Article 9 of the MTC to determine the profits of a PE, taking into account the considerations expressed above?

ANNEX 1

The following tables set out the conclusions of the functional and factual analysis performed under Article 9 and under Article 7 for Examples 1 to 3. Not every function, asset, or risk has been identified

TABLE 1 - FUNCTIONAL AND FACTUAL ANALYSIS OF EXAMPLE 1

	Article 9		Article 7		
	Prima in Country A	Sellco in Country B	Prima in Country A	Assets economically owned by and risks attributed to the DAPE based on SPFs performed by Sellco on behalf of Prima	Functions performed by Sellco ¹³
Sales					
Functions:					
<ul style="list-style-type: none"> Setting sales strategy, projections and market share targets in Country B 	√		√		
<ul style="list-style-type: none"> Selection of the sales agent, monitoring of its performance and making decisions on whether to continue, adapt or terminate the relation with the sales agent. 	√		√		
<ul style="list-style-type: none"> Identification of customer, soliciting and placing orders and processing orders with Prima. 		√			√

¹³ The third column replicates the second column of the Article 9 analysis. The analyses under Articles 7 and 9 examine the same functions and have been presented independently.

• Setting general pricing policy for products	√	
• Setting product price for Country B market	√	
Assets:		
• Assets used for sales purposes (premises, vehicles, etc. - other than inventory and marketing intangibles owned by Prima)		√
Risks:		
• Market risk (including price risk)	√	
• Operational risks related to proficient performance of sales agency activities		√

√		
√		
		√
√		
		√

Marketing and Advertising

Functions:		
• Marketing and advertising: strategy development and setting	√	
• Marketing and advertising: local implementation		√
• Prima is responsible for the legal protection of the Group's marketing intangibles	√	
Assets:		
• Marketing intangibles	√	
Risks:		
• Marketing and advertising risks.	√	

√		
		√
√		
√		
√		

Inventory

Functions:		
• Decision-making on warehousing arrangements	√	
• Determination of inventory levels	√	
Assets:		
• Inventory	√	

√		
√		
√		

Risks:		
• Inventory	√	

√		

Receivables

Functions:		
• Parameter setting of customer credit terms	√	
• Approval of customer sales after reviewing creditworthiness	√	
• Handling of customer receivables	√	
Assets:		
• Receivables	√	
Risks:		
• Credit risk	√	

√		
√		
√		
√		
√		

TABLE 2 - FUNCTIONAL AND FACTUAL ANALYSIS OF EXAMPLE 2

	Article 9		Article 7		
	Prima in Country A	Sellco in Country B	Prima in Country A	Assets economically owned by and risks attributed to the DAPE based on SPFs performed by Sellco on behalf of Prima	Functions performed by Sellco ¹⁴
Inventory					
Functions:					
• Decision-making on warehousing arrangements		√			√
• Determination of inventory levels		√			√
Assets:					
• Legal ownership of inventory	√		√		
• Economic ownership of inventory				√	
Risks:					
• Contractual assumption of risk	√		√		
• Assumption of risk under Article 9		√			
• Attribution of risk under Article 7				√	
Receivables					
Functions:					
• Parameter setting of customer credit terms		√			√
• Approval of customer sales after reviewing creditworthiness		√			√
• Handling of customer receivables		√			√
Assets:					
• Legal ownership receivables	√		√		
• Economic ownership of receivables				√	

¹⁴ The third column replicates the second column of the Article 9 analysis. The analyses under Articles 7 and 9 examine the same functions and have been presented independently. For purposes of interpreting this table, please see footnote 12.

Risks:		
• Contractual assumption of risk	√	
• Assumption of risk under Article 9		√
• Attribution of of risk under Article 7		

√		
	√	

TABLE 3 - FUNCTIONAL AND FACTUAL ANALYSIS OF EXAMPLE 3

	Article 7		
	Prima in Country A	Assets economically owned by and risks attributed to the DAPE based on SPFs performed by Employee on behalf of Prima	Functions performed by Employee
<u>Sales</u>			
Functions:			
• Setting sales strategy, projections and market share targets in Country B	√		
• Selection of the sales agent, monitoring of its performance and making decisions on whether to continue, adapt or terminate the relation with the sales agent.	√		
• Identification of customer, soliciting and placing orders and processing orders with Prima.			√
• Setting pricing policy for products	√		
• Setting product price for Country B market	√		
Assets:			
• Assets used for sales purposes (premises, vehicles, etc. - other than inventory and marketing intangibles)	√	√	√
Risks:			
• Market risk (including price risk)	√		
<u>Marketing and Advertising</u>			
Functions:			
• Marketing and advertising: strategy development and setting	√		
• Marketing and advertising: local implementation			√
• Prima is responsible for the legal protection of the Group's marketing intangibles	√		

Assets:			
• Marketing intangibles	√		
Risks:			
• Marketing and advertising risks.	√		
<u>Inventory</u>			
Functions:			
• Decision-making on warehousing arrangements			√
• Determination of inventory levels			√
Assets:			
• Legal ownership of inventory	√		
• Economic ownership of inventory		√	
Risks:			
• Contractual assumption of risk	√		
• Attribution of risk under Article 7		√	
<u>Receivables</u>			
Functions:			
• Parameter setting of customer credit terms			√
• Approval of customer sales after reviewing creditworthiness			√
• Handling of customer receivables			√
Assets:			
• Legal ownership receivables	√		
• Economic ownership of receivables		√	
Risks:			
• Contractual assumption of risk	√		
• Attribution of risk under Article 7		√	