Opinion Statement FC 10/2015

on the revised OECD Discussion Draft on

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

Prepared by the CFE and AOTCA

Submitted to the OECD

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

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

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

1. Introduction

The following comments relate to the OECD's Revised Public Discussion Draft "*Preventing the artificial avoidance of PE status*"[1] (hereinafter, the "*Discussion Draft*"), published on 15 May 2015, pertaining to Action 7 of the OECD/G20 BEPS (Base Erosion and Profit Shifting) Action Plan. They complement the joint CFE and AOTCA Opinion Statement FC 1/2015 of January 2015 on the OECD Discussion Draft of 31 October 2014[2].

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

2. General comments

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

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

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

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

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

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

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

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

[1] http://www.oecd.org/tax/treaties/revised-discussion-draft-beps-action-7-pe-status.pdf
[2] http://www.cfe-eutax.org/node/4092

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

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

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

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

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

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

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

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

Section C. Splitting-up of contracts

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

The two possible alternatives suggested in the Discussion Draft to properly treat contract splitting: (i) option L (i.e., application of a principle purpose test rule), or (ii) option K (i.e., application of an automatic rule) present some implementation difficulties; they may not be easily monitored and may engender some legal uncertainty (as already expressed in CFE's and AOTCA´s comments submitted previously[3]).

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

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

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

For the sake of greater clarity:

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

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

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

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

[3] See footnote 2.