

William Morris
Chair, BIAC Tax Committee
13/15, Chaussée de la Muette, 75016 Paris
France

Marlies de Ruiter

Head, Tax Treaties, Transfer Pricing and Financial Transactions Division
Organisation for Economic Cooperation and Development
2 rue André-Pascal
75775, Paris, Cedex 16
France

Submitted by email: taxtreaties@oecd.org

June 12, 2015

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

Dear Marlies,

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

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

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

It is clear the OECD must deliver proposals by the September 2015 deadline to satisfy the G20 mandate. That deadline could be satisfied by delivering the proposed changes to the language of Article 5, with work extended into 2016 on the profit attribution guidance, **and** on the language of the Commentary. Aligning the work on the Commentary and profit attribution guidance will help to improve the objectivity and practicability of the proposals, and would mitigate, to a certain extent, the risk that governments seek to apply new PE principles before profit attribution guidance has been agreed. As indicated above, BIAC does understand that changes to the PE standard will be made, but it is crucial that the new rules are very clear, and at least as well understood as the rules that they replace, providing the bright line tests that help to promote cross-border trade and investment.

We are, in particular, concerned about potential divergences between the principles supporting the language of Article 5 and those supporting the more extensive Commentary that facilitates its application. It appears from the Discussion Draft that the Commentary reflects a broad interpretation of the Article 5 language. As you will see from our comments, BIAC is concerned that the broad and subjective nature of the Commentary lowers the PE threshold to a much greater extent that would be justified based on an objective reading of the Article 5 proposals.

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

Sincerely,



Will Morris,
Chair, BIAC Tax Committee

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

Dependent agent rule

1. We understand the concerns that have led the OECD to propose changes to the threshold under paragraph 5 of Art. 5. However, we are worried that the proposed Commentary to accompany the revised paragraph 5 of Art. 5 of the OECD model suggests a broader application of the dependent agent rule than is warranted by reference to the text of the revised paragraph 5. In particular, the commentary in proposed paragraphs 32.4, 32.5 and 32.6 all suggest a broad application of the proposed dependent agent rule, including in circumstances where the agent concerned may take no, or very little, substantive role in the process by which contracts are concluded or negotiated. In BIAC's view, the Discussion Draft may be proposing the language of Option B, but the proposed Commentary interprets that language in such a way as to effectively apply the standard contained in Option A. BIAC opposed Option A in its earlier consultation responses, as it was exceedingly ambiguous and overbroad. We urge that the drafting of these important paragraphs be revisited, and the wording amended and clarified to conform to the language of revised paragraph 5 of Art. 5. This should involve accommodating the variety of situations that may arise in practice (for example, where multiple locations play a substantive role leading to the conclusion of contracts).
2. BIAC is also concerned that a number of the Discussion Draft proposals will lead to difficulties in interpretation, and ultimately, disputes. Difficulty in interpretation is exacerbated by the use of several new concepts and terminology. Where new language is proposed, every effort should be made that sufficiently detailed guidance is provided to facilitate objective and consistent interpretation. The following examples are intended to illustrate BIAC's concerns:
 - a. When paragraph 32.5 refers to the "key ingredients" of a contractual relationship, it omits to state that those "key ingredients" may vary depending on the legal system adopted by a particular country. Such differences will likely lead to interpretation issues unless the commentary to Article 5 is very clear and objective.
 - b. Without further guidance, it will likely be difficult to understand in practice when an employee should be considered to have "convinced" a customer to enter into a contract (example in paragraph 32.6).
 - c. It is unclear whether the PE threshold has been breached where a senior representative visits a customer (in the customer's State) to discuss the final aspect of a contract. In such a situation, that same representative may have conducted the vast majority of the negotiations outside of the country – the Discussion Draft appears to suggest that such activities could constitute a PE. At present, a very short visit to a customer's location would not breach the threshold. Depending on how and where the line between PE and non-PE activities is drawn, the administrative burden to ensure compliance could be significant. Such examples illustrate the need for very clear profit attribution guidance to split the value of the negotiating activities between countries. If this part of the Commentary is only intended to apply to a representative that is permanently in the State, then that should be made clear.

- d. The term, to “*habitually conclude or negotiate [...] contracts*” will be of great importance in determining whether a PE is created. Detailed and objective practical guidance is necessary, otherwise it will be almost impossible for taxpayers to understand with a sufficient level of confidence whether they have satisfied their compliance obligations.

Independent agent rule

3. We understand that Working Party 1 will not always agree with the views expressed by commentators in the consultation process. However, it is disappointing that, despite noting the “strong objections” to the proposals for amending the independent agent rule, there is no explanation of why a decision has been made to proceed with the proposed revision relating to connected parties. This is significant because the proposed change seems out of line with what we take to be the essence of the independent agent test, namely whether the agent concerned is, or is not, in reality carrying on the business of the principal. If the proposed change is driven by the OECD’s concerns about manipulation of the test by MNEs, the use of a rebuttable presumption of dependence in the case of connected parties (rather than the proposed outright bar on independent status) would retain the ability to apply the existing test in appropriate cases.
4. In addition to the above comments, we are also concerned at the clarity of the explanation in the Commentary of what it is to be independent. With the removal of the economic dependence test from the commentary, the guidance has, if anything, become vaguer as to what is required if an agent is to be regarded as independent. We recommend that the guidance be expanded to achieve a greater level of clarity on the specific requirements of the test.

Profit Attribution

5. BIAC welcomes the OECD’s decision to undertake further work on its profit attribution guidance. As noted in our cover letter, we would suggest that only the proposed text of Article 5 be finalized in 2015, and that the OECD’s 2016 mandate should include work on profit attribution and the language of the Commentary to ensure that the proposals are as objective and practicable as possible. This would provide the time required to ensure that the clearest and most coherent recommendations are delivered.
6. There are concerns that the proposals to change the dependent and independent agent rules will lead to the creation of multiple PEs where there may be little or no incremental profits attributable over and above the relevant transfer pricing result. Working on profit attribution and the language of the Commentary at the same time would contribute to addressing these concerns.

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

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

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

which have a preparatory or auxiliary character and those which have not” unfortunately does not remove the problem.

8. We therefore encourage the OECD to give further and more specific guidance and to develop a robust framework to implement this proposal on an internationally consistent basis in order to prevent substantial additional uncertainty and deriving disputes between businesses and tax administrations.
9. In this regard, BIAC would welcome further clarity in example 22, to allow taxpayers and tax administrations to better understand what it is about the *“activities that are performed through that warehouse”* that makes them *“an essential part of the enterprise’s sale/distribution business.”* If an elaboration on that conclusion is not possible, it would be helpful to have a second example setting out a similar fact pattern where the warehousing activities are considered to be preparatory and auxiliary. Establishing a number of indicators to assist in determining whether activities are preparatory and auxiliary would help greatly in practical application, and would mitigate, to an extent, disputes over PE status.

B.2. Fragmentation of activities between related parties

10. Of the two options proposed, BIAC did express a preference for Option I as the narrower and more targeted approach. Therefore, we are disappointed that the OECD has selected the more expansive Option J, which will be difficult to operate in practice, moving away from the widely agreed concept of separate entity reporting. We also believe that it is necessary to specify that it is an explicit requirement that the business activities under consideration are conducted through a fixed place of business in the State. Without such a clear provision, the anti-fragmentation rule could be applied inappropriately to bring in activities genuinely carried on outside a jurisdiction solely due to the provision of services to the enterprise by a connected enterprise which independently met the conditions to constitute a local permanent establishment (and was thus recognized and appropriately taxed locally). Our concerns here are linked to the proposals in Paragraph 32.2 of the Discussion Draft that appear to require the notional assumption of a fixed place of business. This provision, when taken in conjunction with the revised anti-fragmentation rules, could lead to inappropriately deemed PEs in relation to activities which should properly be considered as carried on outside the jurisdiction.
11. Under Option J it will be necessary to monitor the activities of each and every business activity on a worldwide basis and to connect those activities to the activities of all other entities. In large multinational enterprises, this task will be extremely difficult to fulfill. We also believe that more detailed guidance is needed regarding the notion of *“complementary functions that are part of a cohesive business operation”*. The two examples given in the Commentary could be helpfully expanded.

C. Splitting-up of contracts

12. Although BIAC welcomes the OECD’s attempt to provide clarity to its proposals, further work is required to explain how the two proposed approaches should be practically applied in a variety of circumstances. In addition, many of the concerns raised by BIAC’s in its previously submitted comments on Options K and L have not been fully addressed.

13. In this regard, Example E does not provide any clear indication as to how the proposed Principal Purpose Test rule would apply in a more complex set of facts and circumstances. Without greater clarity, the proposals will create uncertainty for non-abusive commercial arrangements. Enhanced clarity could be delivered by providing examples of business reasons for the spitting of contracts that would be considered to not represent artificial avoidance of PE status.
14. With respect to the alternative provision, clarification is required to ensure that combining multiple time periods should only be done in cases of abuse.
15. Furthermore, this provision includes a requirement to determine “*whether the conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with that person or related persons*” (emphasis added). More detailed guidance and definitions of key terms (for example “logical consequence”) would be required for practical application. Given the subjective nature of the alternative provision, if definitions or guidance prove difficult, examples could be used to illustrate how the rule would apply in practice.
16. Moreover, BIAC continues to believe that the minimum time-presence of 30-days suggested is too short and would be difficult to administer and monitor. All parts of an MNE may not be fully aware of all the activities of the group as a whole.
17. The alternative provision introduces the term “connected activities” to determine whether different periods of time should be combined. The guidance provided by the Discussion Draft to determine which activities should be considered to be connected is broad and subjective. Clear illustrative examples would be helpful to better understand the intended application.

D. Insurance

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

E. Profit attribution to PEs and interaction with transfer pricing

19. Again, BIAC welcomes the OECD’s decision to undertake further work on its profit attribution guidance, which will assist taxpayers and tax authorities in understanding difficult questions concerning taxable income as more PEs are determined as a consequence of the lower threshold. We have also suggested undertaking further work on the language of the Commentary in 2016 to ensure that the proposals are as objective and practicable as possible. This would provide the time required to ensure that high-quality and coherent recommendations are delivered.
20. Aligning the work on the Commentary and profit attribution principles would provide opportunities to have real-time discussions between government delegates and the broad stakeholder community on how attribution principles will apply in the context of the Commentary, and whether, more often than not, those updated principles will result in an increase in taxable profits, over and above what has already been declared under Article 9

principles (where there are already taxable entities). Although the OECD expects its new PE rules to be enacted through its Multilateral Instrument, it is likely that tax administrations will begin to attempt to apply any new Commentary as soon as it is finalized. In that context, aligning the work on the Commentary and profit attribution guidance would promote consistency. As is noted in the revised discussion draft, clear guidance is needed for all sectors *“to ensure that businesses and tax authorities take a consistent approach.”*

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

F. Other Comments

22. As previously mentioned, BIAC urges the OECD also to consider the likely indirect tax impacts which will result from lowering the PE threshold, and in particular the potential consequences for VAT. The creation of new PEs will likely lead to requiring additional VAT registrations which will add - both for businesses and tax authorities - significant costs and complexity in terms of compliance and tax collection, as well as increasing the risk of disputes due to the lack of legal certainty especially in the context of conflicting establishment definitions and force of attraction rules.
23. Additionally, we encourage the OECD to include explicit language in its proposals to cut the common link between PE determinations and VAT registrations by stressing that “The term “permanent establishment” as used in the OECD Model Income Tax Treaty is a distinct concept from the “VAT establishment” term used in the International VAT/GST guidelines, such that the existence of one should not in itself result in the other. In addition, while companies might have to register for VAT in order to comply with their national VAT obligations, such registration in itself should not trigger the creation of a permanent establishment for purposes of Article 5. BIAC understands that there is agreement between Working Parties one and nine that such a link should not exist, but that there is a preference to wait until after the 2015 Action 7 work is completed before making this clear in the guidance to Article 5. We believe that this point should be clarified as soon as possible.