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ADDITIONAL GUIDANCE ON ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS

Dear Acting Chair and Members of Working Party No. 6,

Thank you for the opportunity to comment on the Discussion Draft: BEPS Action 7 – *Additional Guidance on Attribution of Profits to Permanent Establishments* (the “Discussion Draft”) issued 22 June 2017. The attribution of profits to permanent establishments (“PEs”) is an important and difficult area and we thank the OECD for the time and effort put into this draft guidance.

However, as we have made clear before, given changes to the PE provisions under Article 5 of the OECD Model Tax Convention by the Base Erosion and Profit Shifting (“BEPS”) project, in particular the Dependent Agent PE (“DAPE”) rules, it is crucial for tax certainty and for the avoidance of double taxation that clarity is provided on the attribution of profits. Unfortunately, we do not believe the Discussion Draft provides the detail necessary to address the complexities of profit attribution.

In particular, we disagree, for a number of reasons, with the implication that although there will be an increase in the number of PEs, the principles behind the attribution of profits have not changed. In fact, even before the BEPS project began, the PE attribution rules were acknowledged to be unsatisfactory and were in the course of being updated. Following BEPS and the combination of changes to Chapter I of the OECD Transfer Pricing Guidelines and the changes to Article 5 this need for clarity has further, and dramatically, increased. One reason is because these changes have combined to create, where the facts and circumstances determine it, a much greater attribution of profits to source countries under both Article 7 **and** Article 9, in many cases in relation to the same functions. It is a basic principle of double taxation conventions that guidance should never allocate the same income to the same country twice without a binding method of relieving what would otherwise be double taxation. So, while we welcome the progress of the Discussion Draft in conceptually addressing this point, we are not clear on how binding this solution is and are concerned that double taxation will result until further clarity is provided.

Furthermore, it is important to note that many MNEs that will be impacted have not had the volume of experience in applying profit attribution guidance in practice. The significant lowering of the PE threshold by the Action 7 report, alongside fundamentally more complex guidance on the

application of Article 9, leaves taxpayers feeling that room for different interpretation – and tax uncertainty – has grown dramatically. The administrative burden for tax authorities and taxpayers will also increase if OECD does not go further in addressing administrative approaches that enhance simplification following this lowered threshold. In an effort to assist with this issue, please find a separate detailed letter in Appendix A addressing potential administrative simplification.

In conclusion, BIAC strongly urges the OECD to further develop this guidance on the attribution of profits, providing much greater detail and quantitative examples so that this guidance can become a tool that bolsters both tax certainty and cooperative compliance in taxpayer-tax authority relationships. We also encourage WP6 to consider the impact of any proposed changes to the profit attribution guidance that may be required to remain consistent with upcoming conclusions of the OECD's follow up work on BEPS Action 1 (the tax challenges of the digital economy), and not to finalise one before the other.

Again, we thank you for the opportunity to comment on this subject, and look forward to working with you further.

Sincerely,



Will Morris
Chair BIAC Tax Committee

General Comments

1. BIAC acknowledges that the focus of this public consultation period is on the attribution of profits/losses to PEs and the comments below are specifically focused on this critical issue. However, we continue to believe that the threshold issues associated with the OECD's final recommendations on Action 7 are a far more fundamental concern in relation to the potential compliance burden and risk of double taxation than the attribution guidance. Therefore, we believe it is necessary to reiterate that business would greatly welcome additional clarity over the meaning of terms that apply to the Article 5(5) exemptions. Additionally, a clearer understanding of these thresholds will only help to minimize the complexities associated with the attribution guidance. Specifically, we believe that the complexity created by these rules and the need to simplify their application is evidenced in the ambiguity that remains around the following concepts:

- a. "plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification";
 - The Action 7 report provided limited guidance on the meaning of the term "principal role". This guidance is helpful in a scenario where only one salesperson prepares all relevant offer/tender documents, decides about the content and convinces one representative of the customer to accept a contract. However, in real life scenarios the complexity of modern business models (including in particular the ease of global communications and travel) mean that deal teams (rather than a simple sales individual) are generally quite dispersed.
 - There are several business models that demonstrate this complexity and the key concerns identified are:
 - Can the "principal role" be undertaken by a group of individuals, or is there only one individual that can play the "principal role" on any deal?
 - If a group of individuals can play the "principal role", and they operate in different countries, does this mean that a PE is created in each country (and if so, how should profits be allocated between them)?
 - If only a single individual can play the "principal role" on a deal, how should it be determined which individual this is?
 - If only a single individual can play the "principal role" on a deal, is it the individual, or the local employer, or the foreign enterprise for whom they act who needs to be behaving "habitually" in any country in order to create a PE?
 - In either the case of an individual or a group of individuals, if an individual travels between several countries to habitually meet customer(s), is a PE created in all of the countries to which that individual travelled (and if not, in which country/countries are PEs created)?
 - In either the case of an individual or a group of individuals, if an individual habitually communicates from different countries, with customers from different countries (e.g. over a period of months via telepresence, telephone, email or letter), is a PE created in all of the countries in which they worked on the deal (and if not, in which



country/countries are PEs created)? Additionally, is there a difference in application caused by different methods of communication?

- Where there are several distinct legal “contracting parties” within a group (e.g. one selling an asset and the other providing ongoing services such as maintenance or financing), will this result in several PEs in the same country?
- Finally, we think a clearer definition of the term "principal" would be helpful. We assume that for most sales activities, the “principal” role in leading to the conclusion of contracts would be the salesperson.

b. “artificial splitting up of contracts” ; and

- We believe that additional guidance is required in terms of the new fragmentation clause, notably its limitation to those activities which constitute complementary functions and are part of a cohesive business operation. We would welcome a clear statement that merely being part of a cohesive business operation does not necessarily equate to value being attributable to the new deemed PE; that for groups with different business lines the anti-fragmentation are not expect to extend beyond activities within the specific business lines. The profit attribution to complementary activities should rather be determined by an analysis of the relevant facts and circumstances.
- Without greater clarity in respect of the splitting up of contracts (e.g., by providing a list of circumstances in which non-tax reasons would be assumed or accepted), the guidance will create uncertainty in respect of non-abusive commercial arrangements.
- We would also welcome detailed clarification of the consequences of an abusive structure being asserted.

c. “preparatory and auxiliary activities”.

- Clarification of the meaning of “preparatory and auxiliary” in the Model Tax Convention (MTC) commentary would provide helpful confirmation that the listed activities which are well understood to not constitute a PE still constitute a valid exclusion from the PE requirement. For example, a foreign entity which maintains a stock of merchandise for delivery, where there is no related party commissionaire arrangement in place, and where contracts were never negotiated in the host country, may now be caught as a result of this modification.
- Additional guidance would also be welcome on how to distinguish a separate aftermarket business line from a main business line. For example, a business selling equipment may also have an additional service line selling spare parts, which may have relatively limited value (e.g., less than a third of the value of the main business). It is unclear how this would be dealt with in the context of the new guidance and whether such a service line would be considered merely auxiliary.

2. BIAC strongly endorses pro-growth tax systems which facilitate cross-border trade and investment, enhancing economic growth and efficiencies in the international market place. The

guidance on the attribution of profit to PEs should support cross-border trade and investment by clarifying which jurisdiction has the right to tax income, thus ensuring that income is not subject to double taxation. Therefore, we believe the high-level general principles outlined in paras 1-21 and 36-42 for the attribution of profits/losses to PEs are encouraging. However, high-level general principles that can be interpreted in many different ways are not sufficient to provide businesses with the level of certainty over the elimination of double taxation required to facilitate cross-border trade, investment, and growth.

3. Under the pre-BEPS Article 5, businesses appreciated the certainty that activity exemptions and contract conclusion tests provided. If the new profit/loss attribution guidance is not implemented in a clear and consistent way, cross border investment as a whole will become more administratively complex, more uncertain, and ultimately more costly. As a result, businesses may either seek time-consuming and administratively costly methods of obtaining greater certainty, such as advance pricing agreements, or modify business models or limit cross border investment in order to have certainty over the taxes due (and to mitigate the risk of double taxation).
4. Therefore, BIAC strongly urges the OECD to provide more detailed guidance on the attribution of profits and losses to PEs. For example, the anti-fragmentation rule recommended in the BEPS Action 7 Report is very complex and yet the relevant guidance included in the Discussion Draft is considerably limited. The Discussion Draft provides an outline of the two cases where Article 5(4.1) may arise but does little to guide taxpayers or tax authorities on how the attribution of profits should be performed in these cases. This high-level guidance on such a complex topic will only lead to inconsistent outcomes and further tax uncertainty. Additionally, BIAC encourages the OECD to clarify the status of this guidance as it is not clear what the status of the Discussion Draft will be when it is finalised, and whether taxpayers will be able to rely on its guidance in interpretation of tax treaties.

Changes to Article 5(5) and 5(6) and the Commentary

5. BIAC encourages the OECD to strengthen its support for the Authorised OECD Approach (“AOA”) in the Discussion Draft. The Discussion Draft references the AOA in a number of footnotes but it lacks any explicit support for adoption of the AOA and the consistency that this would provide in such a complex area.
6. In particular, the Discussion Draft provides in para 7 that “any approach 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).” Not only is this language an example of where the Discussion Draft lacks the level of detail and specificity necessary to avoid inconsistent application, but we believe it is misleading in its implication that pre-BEPS guidance was sufficient and pre-BEPS application was consistent. In reality, there were a very wide range of interpretations, even within the two AOAs, and further guidance had already been identified as necessary. Additionally, and perhaps more importantly, the BEPS Project has modified the fundamental rules concerning PEs to such an extent that any reliance on a pre-BEPS approach would be misguided and likely to result in considerable misinterpretation of this guidance.

7. The potential value of the Inclusive Framework (to both businesses and tax authorities) is that greater consistency of application could be reached across 102 countries (and others that sign up to the Inclusive Framework in the future). We continue to believe that in order to achieve this consistency, there must be recognition that a single approach is desirable, and that all future guidance should have the aim of encouraging adoption of this approach. Para 7 actually encourages the opposite, and the rest of the Discussion Draft fails to provide certainty that consistency is either intended or achieved.
8. Additionally, the language of para 7 implies that countries may apply the 2010 AOA method, 2008 AOA method, or indeed any pre-BEPS version of profit and loss attribution as there is no discussion of what methods are actually being applied, thus amplifying the potential for inconsistent application. The Discussion Draft fails to adequately explain that different versions of Article 7 may require somewhat different approaches to profit attribution (and why), but it also fails to provide clarity on how treaties with versions of Article 7 based on the 2008 or 2010 OECD Model should be interpreted.

Attribution of Profits to Permanent Establishments Resulting from Changes to Article 5(5) and 5(6) and the Commentary

9. BIAC believes that the language included in para 8 of the Discussion Draft represents a departure from the analysis under the AOA. Specifically, para 8 provides that “[o]nce it is determined that a PE exists under Article 5(5), one of the effects of para 5 will typically be that the rights and obligations resulting from the contracts to which Article 5(5) refers will be properly allocated to the permanent establishment.” This language appears to eliminate the AOA analysis by replacing the functional analysis with factual assumptions. The AOA requires hypothesising the PE and identifying its dealings with the rest of enterprise to determine where the relevant significant people functions take place. These important steps are overlooked in the language of the Discussion Draft, and as a result many of the recommendations are not compatible with the objective of aligning taxing rights with value creation. As previously mentioned, BIAC urges the OECD to support the universal adoption of the AOA but at a minimum we would expect the Discussion Draft to avoid a full departure from the AOA.
10. BIAC also believes that the language included in para 8 - 19 do not make it sufficiently clear that the analysis may result in losses being attributable to a PE.
11. The Discussion Draft provides in para 12 that “the order in which Article 7 and Article 9 are applied should not impact the amount of profits over which the source country has taxing rights as a result of the activities of the intermediary on behalf of its associated non-resident enterprise in the source country.” Some BIAC members are concerned that there could be a different attribution of profits depending on the ordering used, particularly where the DAPE’s profits are dependent on gross levels of costs, or where the jurisdiction in question is not following the AOA. If any differences were to arise, this would be a difficult situation for taxpayers and tax authorities, so we would welcome stronger confirmation that no double taxation (or double attribution) should arise if the OECD cannot endorse an order.
12. Para 18 indirectly recognises this point, but does not resolve it. In seeking to reconcile how the concepts of significant people functions (under Article 7) and risk control functions (under Article 9) should not result in double taxation in the source country, there is recognition that there is

overlap that could result in double attribution. Whilst we welcome the acceptance that there should be no double taxation within the source country as a result of this, we find it peculiar that there is no recognition of the need to eliminate double taxation between the source and the residence countries (the very concept that double taxation treaties are supposed to ensure) and encourage the OECD to make a recommendation or proposal on the method to eliminate this double taxation.

13. Para 17 notes that significant people functions (under Article 7) and risk control functions (under Article 9) cannot be aligned or used interchangeably for purposes of Article 7 and Article 9. Further work on aligning the analysis under Article 7 and 9 would be appreciated. The draft stops short of reconciling the concept whereas it is not clear what stands behind the non-alignment. In any case, the current guidance could be improved by illustrating how such functions might differ. It also fails to address the consequences of drawing such a conclusion and would appear to further the need for a designated order of application or further alignment between Article 7 and Article 9. An example may be helpful in making this distinction clearer.

Furthermore, it is not clearly explained, how post-BEPS changes resulting from Action 8-10 influences risks allocation alignment for the purposes of Article 9 and Article 7. Therefore, we would welcome further clarification of Paragraph 17 (on correlation between Significant People Function versus control over risk concept).

14. BIAC agrees with the basic premise that if there is a dependent agent PE (“DAPE”) then a taxpayer should (i) undertake an Article 9 analysis to determine the income and expenses of Company A and Company B, then (ii) undertake an Article 7 analysis to determine the income and expenses of Company A Head Office and Company A DAPE. We believe that this sequencing not only provides the most clarity, on a basis consistent with the Action 7 objectives and principles, but may also be either necessary or of assistance, if local consolidated filing options are to be pursued. Additionally, this sequencing appears consistent with the language in para 18 of the Discussion Draft that a risk cannot be considered to be assumed by the non-resident enterprise or the PE for the purposes of Article 7 where that risk is found to be assumed by the intermediary under the guidance in Section D.1.2 of Chapter I. Therefore, BIAC strongly urges the OECD to mandate this sequencing in the final guidance to avoid any uncertainty regarding the order of application.

15. As a practical matter we would suggest starting with a functional analysis of the activities undertaken in Country B and whether, within the context of the extended Action 7 PE concepts, that should be viewed as a domestic Article 9 supply to a DAPE which is thereby created, or as a cross-border supply to Country A (i.e. one which creates income in country B and expense solely in Country A, rather than expense in a Country B DAPE of the Country A host). It is not clear to us that there cannot be the “mirror image” domestic to domestic Country B supplies from the DAPE to the DAE (because local functions are carried on by the DAE), but if there can be such mirror image domestic functions, then those should also be identified. We would suggest that a logical sequence to subsequently follow is:

- a. Make all Article 9 charges other than these domestic Country B to Country B charges;
- b. Make an Article 7 determination as to what taxable profits are, in aggregate, properly attributable to Country B before considering domestic Article 9 charges within Country B. For this purpose all functions performed in Country B are treated as if they are performed by the Company for whom the Article 7 analysis is being performed; and

- c. Make Article 9 charges within Country B so as to separate local taxable profits/losses between local entities or presences.
16. Alternatively, before the order of Article 9 and Article 7 analyses are considered, it may be worth providing taxpayers with the option of the performance of a broader functional analysis of DAE/DAPE (potentially leveraging the presumed Article 5 analysis). This analysis could be beneficial in terms of both efficiency and consistency (i.e. if no activities/risks were attributed to DAPE there would be no need for any Article 7 analysis and if activities/risks were attributed to DAPE it could be ensured that they differed from those attributed to DAE). The aim would be to avoid double counting of activities and/or risks in Country B and ensure that the activities/risks of DAPE are rewarded under Article 7 and those of DAE are rewarded under Article 9.
 17. The Discussion Draft also noted in para 12 that “[t]he approach adopted by a jurisdiction should be applied consistently and could be made public for purposes of transparency and certainty for taxpayers.” While BIAC commends the OECD for its attempts at supporting transparency and consistency in this area, we believe this language should be much stronger. BIAC urges the OECD to strongly encourage countries to share their respective approach regarding the sequencing of Article 7 and Article 9. This is especially necessary if the final guidance will not include a clear order of application.
 18. BIAC welcomes the OECD’s acknowledgment that administrative approaches to enhance simplification are important. However, the administrative complexity surrounding the existence of a PE under Article 5(5) requires a much stronger push from the OECD for countries to introduce domestic legislation that will allow for administrative simplicity and considerable more detail into the analysis that is necessary. Given the importance of this topic, we have attached as Appendix A an additional comment letter solely focused on administrative approaches to enhance simplification in this area. We are hopeful that a separate detailed letter on this topic will highlight the importance of this issue and help to find a solution that will alleviate the compliance burdens facing both taxpayers and tax authorities.

Examples

19. BIAC urges the OECD to include numerical examples in the final report. We understand that numerical examples have not been included to avoid drawing conclusions from this guidance on the level of profitability of the intermediary or the PE. However, BIAC believes that the examples included in the Discussion Draft lack clarity and completeness, and the addition of quantified examples would make the examples considerably more useful for taxpayers and tax authorities and could be drafted in a manner to continue avoiding conclusions being drawn on the level of profitability. For example, Examples 1 and 2 require more detail as to what should be expected regarding the arm’s length remuneration of SellCo. Without numbers, it is difficult to understand what profits could be attributed to the PE where a local entity receiving an arm’s length remuneration already exists.
20. We are concerned that in every example (however simplified) it is assumed that a PE exists and a profit/loss attribution calculation must be performed. We believe this is a fundamental departure from the previously held practice that companies could opt to incorporate local subsidiaries and undertake robust transfer pricing analyses to limit the risk of PE challenge when operating overseas. It would be helpful to have a threshold example or, at least, an example

showing exactly where a PE would not exist for the purposes of this guidance.¹ Additionally, each of these examples should explicitly reference that a determination of whether a PE exists will require a case-by-case and country-by-country analysis of all facts and circumstances including consideration of each country's position regarding Articles 5(5) and 5(6) of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("MLI"). This is necessary not only to ensure there is no inconsistency in the way that countries use functional analyses to assert PEs under Article 5, but also as the fundamental starting point for an Article 7 analysis.

21. We do not believe that creating PEs wherever a subsidiary exists was the intention of the revised wording for Article 5 of the MTC, and would welcome additional examples of where a related enterprise does not create a PE in order to remove uncertainty in this respect. This is important given that Article 5.7 establishes that the existence of a subsidiary company does not, of itself, constitute that subsidiary company a permanent establishment of its parent company.
22. In addition to strengthening its support for the AOA approach, we would welcome OECD to provide examples illustrating the main differences between profit/loss attribution to PE under the AOA and any other approaches used to attribute profits, especially when taking into consideration Article 7 (3) of the UN Model Tax Treaty, under which no deduction shall be allowed in respect of amounts, paid by the permanent establishment to the head office of the enterprise or any of its other offices. The difference in attribution of taxable base under each scenario may question whether taxation actually follows economic substance and value creation in each situation.
23. BIAC would also encourage the OECD to alter the facts in additional examples to include circumstances where local marketing and/or sales support is remunerated on a cost plus basis. Each of the examples included in the Discussion Draft envision a commissionaire agreement which provides limited guidance for MNEs operating in a different arrangement.
24. In Example 4 we would welcome an OECD clarification whether the proposed simplified approach is applicable separately to each of the PE or whether it should be considered collectively as part of a larger set of business activities conducted in the source country.

¹ BIAC would recommend WP6 working closely with WP1 to develop more comprehensive guidance in this regard.

Appendix A – Administrative Simplification

The BEPS Action 7 Report (“Action 7 Report”) made changes to Article 5(5) and 5(6) of the OECD Model Tax Convention (MTC) which substantially lower the threshold for the existence of a deemed PE and will result in a significant increase in the number of PEs in territories where taxpayers already have established legal entities. While BIAC commends the OECD for providing additional guidance on the issue of attribution of profits to PEs (and also encourages further guidance on the thresholds themselves), there is a significant void with regard to the guidance on administrative simplification referenced in the Discussion Draft.

The Discussion Draft notes in para 20 that “there may be administratively convenient ways of recognising the existence of a PE under Article 5(5) and collecting the appropriate amount of tax resulting from the activity of the intermediary”. Additionally, para 21 provides that “the potential burden on a non-resident enterprise of having to comply with host country tax and reporting obligations in the event it is determined to have an Article 5(5) PE cannot be dismissed as inconsequential, and nothing in this guidance should be interpreted as preventing host countries from continuing or adopting the kind of administratively convenient procedure mentioned above.” BIAC welcomes these references to administrative simplification but believes they fall considerably short of addressing and providing practical solutions for what is a significant obstacle facing all MNEs.

Example 1 of the Discussion Draft notes in para 26 that “[f]or reasons of administrative convenience, the tax administration in Country S may choose to collect tax only from SellCo even though the amount of tax is separately calculated by reference to the tax liability of SellCo and the PE.” BIAC strongly supports this single taxpayer method but this language is significantly lacking in commitment and detail. BIAC believes that the message from the OECD should be much stronger than to simply provide a possible option that a tax administration *may* adopt. This undermines the importance of finding a solution that will work for tax authorities and tax administrations.

There is a considerable risk that without additional detailed guidance on this single taxpayer method tax administrations may adopt such an approach without a full understanding of the nuances that will need to be addressed or will forego such an approach due to the lack of guidance. Adoption of a simplified approach without the necessary guidance could be as detrimental as no approach at all. For instance, there is no discussion on the framework that will need to be adopted by jurisdictions for taxpayers and tax authorities to agree on the appropriate amount of profit attributable to the DAPE. The language in para 26 also does not provide any guidance for a tax administration seeking to apply this approach that may have a separate corporate income tax rates (for example due to BEPS Action 6 compliant preferential regimes, or different sized companies). While this may seem to be an issue that could be easily addressed, any guidance provided by the OECD is expected to be relied on by all members of the Inclusive Framework and some developing countries may not have the experience necessary to navigate these questions.

Lastly, the language in para 26 does not address a significant portion of the anticipated compliance burden which is the added registration requirements that will occur for VAT/GST and legal purposes. Again, this added compliance obstacle provides no benefit to tax administrations but comes at a considerable cost for taxpayers.

BIAC anticipates that the modifications to the threshold levels for PEs as well as the anti-fragmentation rule will result in a significant administrative, compliance, and financial burden for taxpayers and tax authorities alike. Given the vastly different business models of different industries, this is likely to hit some taxpayers or industries worse than others. Specifically, many MNEs expect to have PEs in countries without that company being physically present (“non-present PE” or “NPPE”). This will undoubtedly lead to taxpayers and tax authorities needing to address issues such as (but not limited to):

- (i) registration requirements for large (but unknown) numbers of NPPEs, including choice of address, branch registration, local governmental registration filings, and complex correspondence;
- (ii) determination of balance sheet and income statement of NPPE;
- (iii) audit and other administrative requirements (*e.g.*, books and records kept locally in accordance with local language and accounting standards);
- (iv) knock-on effects from registration (*e.g.*, VAT compliance);
- (v) policing and monitoring of compliance requirements; and
- (vi) allocation of internal resources and human capital.

Whilst it is not within the OECD’s remit to mandate administrative simplification methods, BIAC believes it is important for the OECD to strongly communicate the benefit of administrative simplification to tax administrations and encourage pragmatism in their domestic legislation. We are aware of the difficulties that many tax administrations face with regards to resources. Additionally, the IMF/OECD Report for the G20 Finance Ministers on tax certainty noted that tax uncertainty often derives from a poor relationship between business and the tax authority which is partly due to administrations seeing taxpayers as aggressively pursuing tax minimization. BIAC believes that administrative simplification provides an opportunity to address both of these issues.

By limiting the amount of resources that tax administrations will need to allocate to monitor and address the considerable number of new DAPEs, tax administrations will be able to efficiently allocate resources to other critical initiatives such as Country-by-Country Reporting. Perhaps more importantly, the adoption of administratively convenient ways to collect the appropriate amount of tax resulting from the existence of a PE under Article 5(5) would significantly improve the relationship between tax administrations and taxpayers. This is not an issue of aggressive tax minimization. Without administrative simplification, this financial and compliance burden will simply work against the larger common goal of promoting tax certainty as a tool for enabling cross-border trade and investment.

Suggested scope of work in finding solutions

The OECD noted in the Action 7 Report that “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”. The Discussion Draft echoes this point by noting that “[d]epending on the facts and circumstances of a given case, the net amount of profits attributable to the PE may be either positive, nil or negative (*i.e.*, a loss). In particular, when the accurate delineation of the transaction under the guidance of Chapter 1 of the TPG indicates that the intermediary is assuming the risks of the transactions of the non-resident enterprise, the profits attributable to the PE could be minimal or even zero.”

BIAC believes that this language is supportive of the idea that the issues around administrative simplification are entirely separate from any discussion on the amount of profit that should be allocated to a particular PE. The considerable drain on capital and resources, with no added benefit to taxpayers or tax administrators, will be identical whether all or none of the profits in question are attributed to a DAPE. This reality, along with the weight of the burden facing MNEs that we have mentioned throughout, should highlight the considerable need for the OECD to address this issue separately and in significant detail.

1. Analyse the current position

As a starting point, BIAC would encourage the OECD to analyse unilateral actions taken by countries to address these issues. For example, Italian tax authorities have recently adopted legislation whereby a company belonging to a group with a threshold amount of worldwide turnover and Italian revenue will have the opportunity for an open discussion with Italian tax authorities as to the existence of a DAPE and the amount of income attributed such that no separate PE filing obligation or registration for VAT purposes would be required. As a minimum this would be useful for other tax authorities in developing unilateral solutions.

2. Develop innovative multilateral solutions or best practices

However, multilateral or an agreed best practice bilateral or unilateral solutions would be preferred. To this end, the OECD should investigate the merits and disadvantage of the approaches identified, and innovate solutions that may be true best practices. A discussion draft on this topic with an opportunity for stakeholders to provide commentary would not only bring this significant issue to light but would also represent a tremendous step in arriving at a solution that works for both taxpayers and tax authorities. Our members would be happy to support this study, and have already identified some potential solutions that could be further developed.

A survey of our members suggested the following options that could be considered by the OECD in tandem with a single taxpayer approach:

- a. De minimis thresholds where sales to resident customers are low (or nil);
- b. Exemptions for SMEs;
- c. Article 7 safe harbours (such that no detailed TP analysis is required); and/or
- d. The ability to discuss and agree with the tax authority (and obtain acceptance by the other State tax authority) the “overall” compensation that would be due under Article 9 and 7, leading to either (i) amendment of the contracts such that the DAE legally takes on the deemed risks and received the appropriate compensation of the DAPE, or (ii) a TP adjustment in the DAE to the same effect. In this case, in lieu of filing tax returns each year, the non-resident company could file an annual self-declaration to confirm if there is any change to its business model as well as its risk, function and assets arrangements.

The proposed “safe harbour” requirement could be as follows. Where it is clear that the following four conditions are met, there should not be a requirement to review the position further or to file a nil tax return for the non-resident entities:

- a. The transfer pricing policy sufficiently rewards the parties to the controlled transaction based on the functions performed, risks assumed and assets owned/utilised;
- b. The controlled transaction is accurately delineated;

- c. The transfer pricing outcome is aligned with the economic activity that produced the profits (including SPFs), rather than the contractual allocations; and
- d. The transactions are sufficiently documented in accordance with Action 13.

In addition to removing the burden of filing additional tax returns, a safe harbour would also mitigate potential confusion over additional (and unintended) VAT/GST obligations.

3. Support tax authorities' efforts to audit effectively

Finally (or simultaneously) the OECD could comment on how taxpayers and tax authorities will deal with the auditing of the potentially greatly increased number of PEs. The taxable basis of a PE is not easy to define and, in order for any PE to be properly audited, management accounts are usually used. Although we note that the link between management accounts and local accounts is not always easy to demonstrate, it is important that the OECD makes clear tax administrations should not seek to audit the entire P&L of an entity when only a small part of that entity gives rise (or potentially gives rise) to a PE. Any work that the OECD Forum for Tax Administrations (FTA) is doing to improve auditing, tax compliance and work relating to cooperative compliance, should be taken into account and consider opportunities to improve the increased PE related compliance. Risk based approaches and triages should be considered in this respect, when considering the limited resources tax authorities may have, especially many members of the Inclusive Framework.

We hope that these observations will constitute the start of a dialogue, rather than being viewed as a standalone submission. We believe that the OECD must take the lead in providing participating countries with innovative, pragmatic, and consistent solutions regarding domestic implementation of administrative solutions and the OECD is ideally suited to do this. We would welcome the opportunity to discuss these matters in more detail (either formally or informally).