

# Action 7 of BEPS: Avoidance of PE Status

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## BEPS Action 7

### **ACTION 7 – *Prevent the Artificial Avoidance of PE Status***

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

# Work by the WP1 on action 7

**Discussion draft (First) released on 31 October 2014**

**Public comments received (approx. 850 pages)**

**Public consultation meeting of 21 January 2015**

- *Proposals not clear enough*
- *Proposals will generate important compliance costs*
- *Proposals will generate double taxation*
- *Negative consequences for taxation of employees*
- *Proposals will increase disputes*
- *Proposals would have an impact on trade and investment*

**New discussion draft (second) released on 15 of May**

## **where are we now?**

- Review by CFA on 21-22 September
- 1 October OECD council approval
- 5 October public release

## The issues under action 7

- Artificial avoidance of PE status through *commissionnaire* arrangements and similar strategies
- Artificial avoidance of PE status through the specific activity exemptions
  - List of activities included in Art. 5(4)
  - Fragmentation of activities between related parties
- Splitting-up of contracts
- Insurance
- Profit attribution to PEs and interaction with action points on transfer pricing

# First draft proposals

- – 4 options (Options A to D) for changes to Art. 5(5) and (6) of the OECD Model concerning the artificial avoidance of PEs through commissionaire arrangements and similar strategies;
- – 4 options (Options E to G) for changes to Art. 5(4) of the OECD Model (which includes a list of specific PE exceptions);
- – 2 options (Options I and J) for changes to Art. 5(4) that would address concerns with fragmentation of activities in order to benefit from the exceptions provided by that provision;
- – 2 options (Options K and L) on how to deal with the splitting-up of contracts for the purposes of benefiting from Art. 5(3) of the OECD Model (the rule according to which a construction site is not a PE unless it lasts at least 12 months);
- – 2 options (Option M and N) on how to deal with insurance companies that sell insurance in a local market without having a PE in that market.

# *Commissionnaire* arrangements

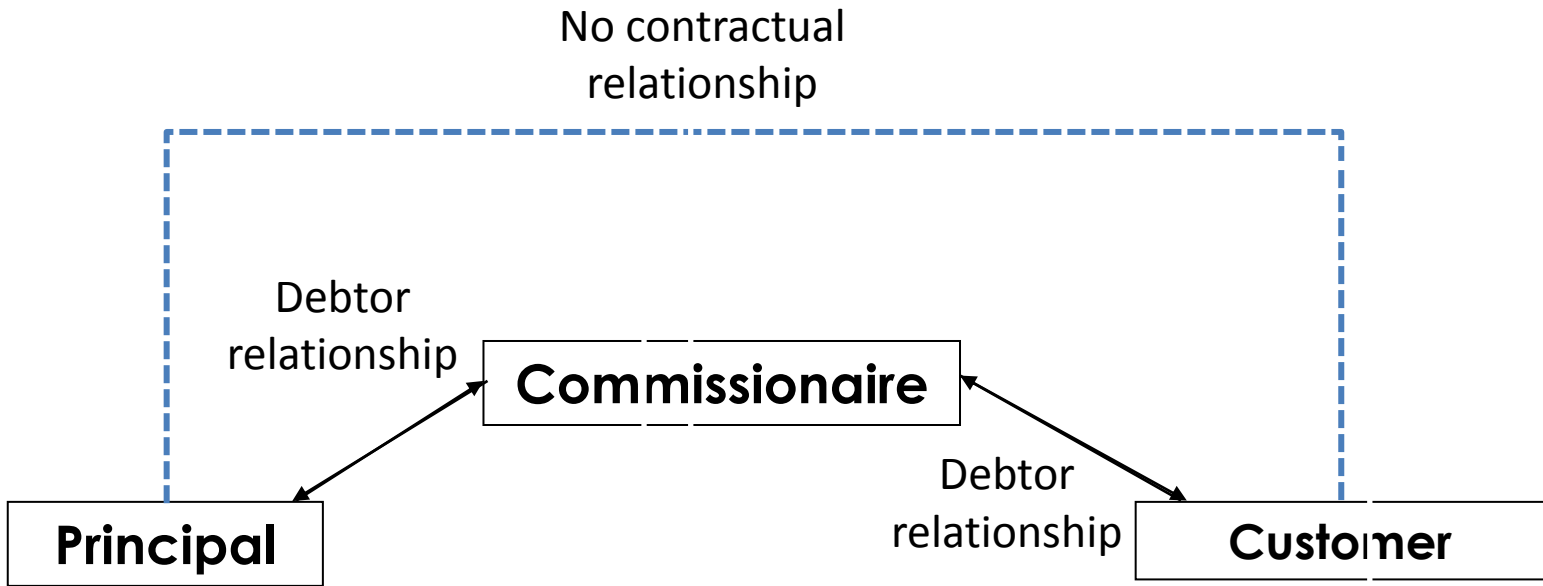
Example:

XCO is a company resident of State X. It specialises in the sale of medical products.

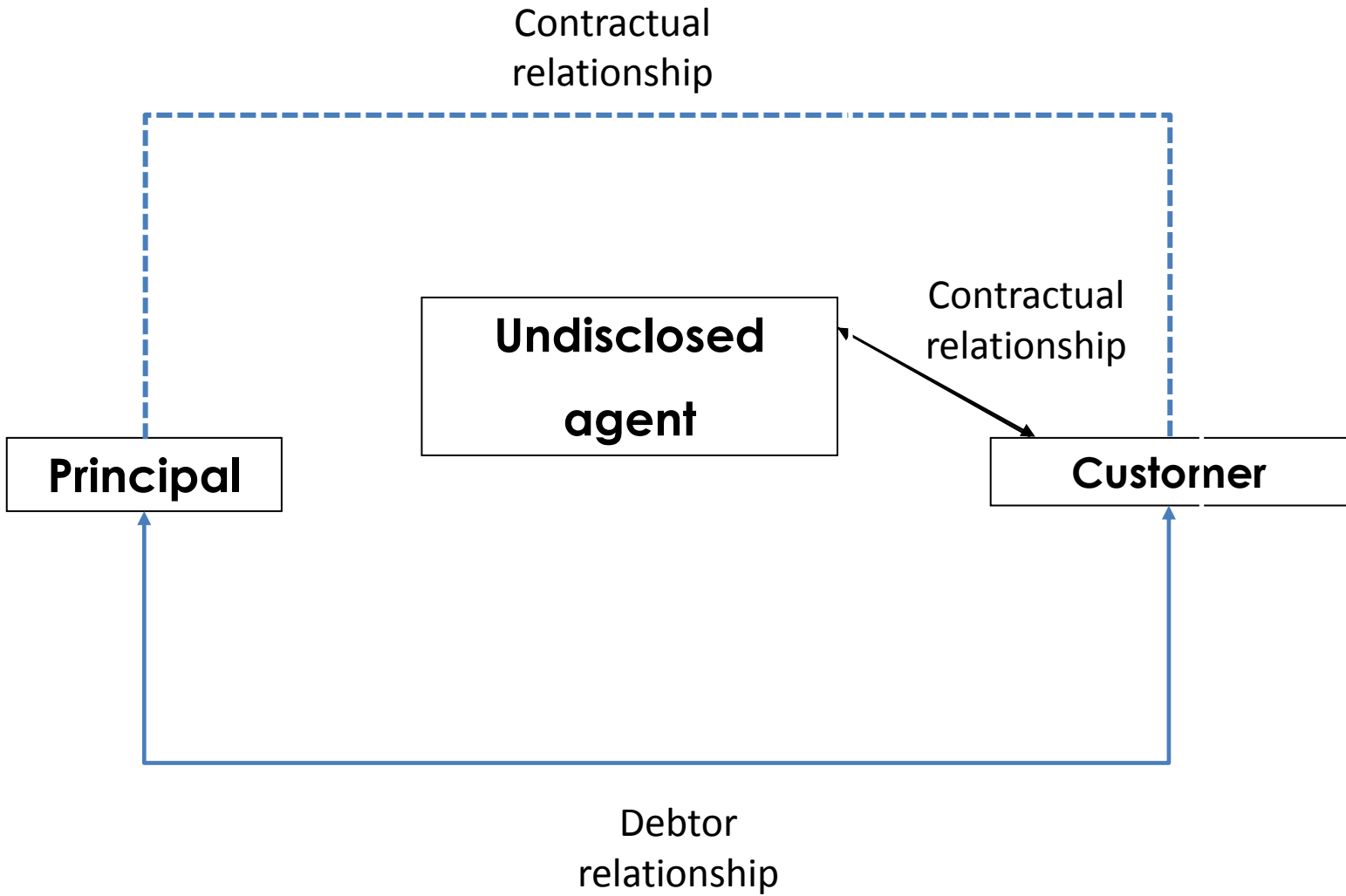
Until 2000, these products are sold to clinics and hospitals in State Y by YCO, a company resident of State Y. XCO and YCO are members of the same multinational group.

In 2000, the status of YCO is changed to that of *commissionnaire* following the conclusion of a *commissionnaire* contract between the two companies. Pursuant to the contract, YCO transfers to XCO its fixed assets, its stock and its customer base and agrees to sell in State Y the products of XCO in its own name (YCO), but for the account of and at the risk of XCO.

As a consequence, the taxable profits of YCO in State Y are substantially reduced.







# Selected proposal May 2015

## A. Artificial avoidance of PE status through commissionaire arrangements

...

5. Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, or negotiates the material elements of contracts, that are

a) in the name of the enterprise, or

b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or

c) for the provision of services by that enterprise, that enterprise ...

# Selected proposal May 2015

## A. Artificial avoidance of PE status through commissionaire arrangements

### New paragraph 6 (the independent agent paragraph)

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

***b) For the purpose of this Article, a person shall be connected to an enterprise if one possesses at least 50 per cent of the beneficial interests in the other (or, in the case of a company, at least 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person possesses at least 50 per cent of the beneficial interest (or, in the case of a company, at least 50 per cent of the aggregate voting power and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise. In any case, a person shall be considered to be connected to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises.***

# Selected proposal May 2015

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

### 1. List of activities in Article 5 (4)

Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include:

- a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity ~~of a preparatory or auxiliary character~~;

f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), ~~provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character~~,

***provided that such activity or, in the case of subparagraph f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.***

# Selected proposal May 2015

- B. Artificial avoidance of PE status through the specific activity exemptions
- 2. Fragmentation of activities between related parties

*Add the following new paragraph 4.1 to Article 5*

4.1 Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or **a connected** ~~a associated~~ enterprise carries on business activities at the same place or at another place in the same Contracting State and

*a)* that place or other place constitutes a permanent establishment for the enterprise or the **connected** ~~associated~~ enterprise under the provisions of this Article, or

*b)* the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or **connected** ~~associated~~ enterprises at the two places, is not of a preparatory or auxiliary character,

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or **connected** ~~associated~~ enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

## Selected proposal May 2015

### C. Other strategies for the artificial avoidance of PE status

#### 1. Splitting-up of contracts

- Only changes to the Commentary
- Anti abuse provisions
- “..., States that do not include paragraph 7 of Article [X] in their treaties should include an additional provision to address contract splitting.”

## Selected proposal May 2015

- C. Other strategies for the artificial avoidance of PE status
  - 2. Selling insurance in a State without a PE

- No special rule for Insurance business
  
- Address the strategy through general changes

## Selected proposal May 2015

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

- Many commentators concerned with the lowering of the PE threshold proposed under action 7
- Article 7 difficult to apply
- Little or no additional profit
- Increase in disputes
- Conclusion: follow up work to provide necessary guidance



# Chilean tax treaty practice

## Article 5 paragraph 4 (Chile – Brazil)

No obstante lo dispuesto en los párrafos precedentes de este Artículo, se considera que la expresión "establecimiento permanente" no incluye:

(a) ...

(b) ...

(c) ...

(d) ...

**(e) el mantenimiento de un lugar fijo de negocios con el único fin de hacer publicidad, suministrar información o realizar investigaciones científicas u otras actividades similares que tengan carácter preparatorio o auxiliar para la empresa.**

**(f)**