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BUSINESSEUROPE position on the Public Discussion Draft on BEPS Action 7: Additional Guidance on the Attribution of Profits to Permanent Establishments

Through its members, BUSINESSEUROPE represents 20 million European small, medium and large companies. BUSINESSEUROPE's members are 41 leading industrial and employers' federations from 35 European countries, working together since 1958 to achieve growth and competitiveness in Europe.

BUSINESSEUROPE is pleased to provide comments prepared by the members of its Tax Policy Group, chaired by Krister Andersson, on the OECD Discussion Draft entitled "BEPS Action 7: Additional Guidance on the Attribution of Profits to Permanent Establishments" (hereinafter referred to as the Draft).

BUSINESSEUROPE welcomes and supports the objective of the Draft to provide guidance on the attribution of profits to the permanent establishments that arise from the revisions to Article 5(5) and 5(6) of the Model Tax Convention (MTC) made by the Report on Action 7 that was finalised in 2015, with that guidance being relevant for all countries and applying principles that are agreed by all countries. While the Draft sets out high-level general principles, its usefulness to both tax administrations and tax payers would be significantly increased if there was more detailed guidance, with more examples to illustrate some of the more complex circumstances and outcomes.

While BUSINESS EUROPE appreciates the comment in the introduction to the draft that numerical examples have not been included".. to avoid drawing conclusions from this guidance on the level of profitability of the intermediary or the permanent establishment." it is unfortunately inevitable that the outcome is a lack of insight or guidance from the simple and non-numeric examples that are used, and the purpose of the examples is obscured where numbers would have made the purpose much clearer. On balance, BUSINESS EUROPE would therefore recommend the reinstatement of numeric examples, and the inclusion of more examples to illustrate particular issues.

BUSINESSEUROPE welcomes confirmation in Paragraph 7 that the changes made to Article 5(5) and 5(6) have not modified the nature of a PE that is deemed to arise under either the pre-BEPS or post-BEPS versions of the Article: it would be helpful if specific reference to this was included in the updated Commentary on the Model Tax Treaty, a draft of which was published on July 11.

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Although specific reference to this additional guidance in the Commentary to the Model Tax Convention would be helpful, a particular challenge of the BEPS project and the involvement of the Inclusive Framework in future changes to international tax agreements, combined with the implementation of the Multilateral Instrument (MLI), is that all countries that may in future implement changes to the equivalent of Articles 5(5) and 5(6) in their bilateral tax treaties will not be members of the OECD or otherwise committed to the OECD guidance and interpretation of tax treaties. In this future international tax environment, where increasing numbers of countries may amend tax treaties in line with the Action 7 recommendations and the MLI allows more rapid implementation of treaty changes, the status of guidance on the attribution of profit to PEs becomes more important to both tax payers and tax administrations. It is not clear what the status of this Draft will be once it is finalised, and whether tax payers will be able to rely on its guidance in interpretation of tax treaties: clarification of its future status would therefore be of great benefit.

A particular difficulty with the interpretation of the guidance in the Draft is caused by the lack of a clear support for the Authorised OECD Approach ("AOA") under Article 7. Unless all participating countries can agree to adopt the AOA, this potentially valuable guidance on the attribution of profits to PEs will not be useful in practice and will contribute to creating further confusion. BUSINESSEUROPE would therefore strongly encourage the OECD to make explicit its support for adoption of the AOA and the consistency that this would provide in this difficult area.

The Draft states in paragraph 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)."*; This statement implies that guidance in the Commentary to the MTC before the BEPS project was sufficient, consistent and unambiguous. This was not the experience of BUSINESSEUROPE members, and the need for clarification and further guidance to reconcile very divergent interpretations had been identified prior to the BEPS project.

The language of paragraph 7 also suggests that countries may apply any previously used profit attribution method, including the 2010 AOA method, 2008 AOA method, or any other pre-BEPS method. The value of the Inclusive Framework (to both businesses and tax authorities) should be that greater consistency of application could be reached across all 102 countries and we would recommend that, in order to achieve this consistency, there must be a recognition that a single approach is desirable, and that all future guidance should have the aim of encouraging adoption of this approach, based on the 2010 AOA method.

BUSINESSEUROPE is concerned that the Draft fails to address the lack of clear recommendation in the Commentary to the MTC on the order of application of Articles 9 and 7 in determining the profit attributable to a PE. Paragraph 12 concludes that the order in which Articles 7 and 9 are applied should not impact the amount of profit over which a country has taxing rights and states an expectation that jurisdictions should make arrangements to eliminate double taxation. This conclusion has no justification within the Draft, and BUSINESSEUROPE does not agree that the order of application will not, in practice, have an impact on the amount of profits over which the source

country has taxing rights. The Draft should include stronger guidance on the order of application and stress the need for transparency and consistency including publication of the approach taken by countries, particularly those which seek to apply Article 7 before Article 9.

It appears that the language included in paragraph 8 represents a departure from the expected analysis under the AOA. The statement *"[o]nce it is determined that a PE exists under Article 5(5), one of the effects of paragraph 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."* appears to eliminate the AOA analysis by replacing the functional analysis required under the AOA with assumptions about the rights and obligations of the parties. This is unlikely to support the OECD's objective of aligning taxing rights with value creation. The confirmation in Paragraph 14 that *"...the allocation of risks for transfer pricing purposes does not change the facts on which the application of Article 5(5) is predicated..."* is particularly welcome, and it would be particularly helpful if this was also confirmed and emphasised in the Commentary to the MTC.

BUSINESSEUROPE would encourage the OECD to clarify Paragraph 17 on significant people functions and risk control functions: in its current format it is capable of different interpretations and therefore does not assist either tax administrations or tax payers seeking definitive guidance. An example may be helpful in making the meaning clearer. Paragraph 18 seeks to reconcile how significant people functions (under Article 7) and risk control functions (under Article 9) should not result in double taxation in the source country, and acknowledges that there is overlap. While this recognition is welcome, it is disappointing that the Draft does not then make any recommendation or proposal on the method to eliminate this double taxation between the source and the residence countries.

In Paragraph 19 it is recognised that the arm's length net profit attributable to a PE could be positive, nil or negative. This recognition is significant, and it should have greater prominence to counter the assumption that is made by many tax jurisdictions that the presence of a PE carries an automatic presumption of a taxable profit.
However, this welcome recognition then appears to be somewhat negated by the next sentence that states that where an intermediary assumes risk, the profits attributable could be "minimal or even zero", and does not acknowledge that the attributable result could be negative.

As there is acknowledgement that the PEs that are recognised under the amendments to Articles 5(5) and 5(6) introduced in the 2015 Report could result in a profit attribution that is positive, zero or negative, guidance or confirmation of how a negative outcome should be treated should also be included in the Draft.

Where non-numerical examples are used, BUSINESS EUROPE would recommend that in each example there is a short paragraph reiterating that the net profit attributable to the PE may be positive, zero, or negative

BUSINESSEUROPE welcomes the implied approval in Paragraphs 20-21 of mechanisms that achieve administrative simplification and cost reduction. To assist other countries in implementing such simplification methods, examples of good practice would be helpful and this should be accompanied by a recommendation that such practices should be adopted by all jurisdictions. *Consideration should also be given to a consistent approach on the filing of nil returns where tax payers consider that there is no attributable profit, avoiding potential penalties and statute of limitation issues.*

Paragraph 21 comments on the burden of reporting, but there is no reference to, or recommendation on the adoption of de minimis or similar approaches, where there is a practical recognition that, where a PE results in a zero or very small profit, it is in the interests of both tax administration and tax payer to agree that no reporting or other administrative burden should be undertaken where the costs of administration will permanently exceed any taxes collected. This should be distinguished from simplification of payment of tax where there is another resident tax payer.

The draft amended MTC published on July 11 includes comment on VAT registration not being evidence of the existence of a PE. This Draft should have a complementary comment that a deemed PE is not prima facie evidence of the existence of a VAT establishment

The examples use simplified assumptions, which include a presumption that relevant comparables are available. As this will not always be the case, guidance on what actions should be taken by the tax payer or tax administration in computing the attributable profit should be included in the Draft.

There is no example on the application of the anti-fragmentation rule: the inclusion of such an example would be useful guidance for tax administrations and tax payers, incorporating guidance on quantification of the attributable profit to an activity or presence that would not otherwise qualify as a PE.

There is also no helpful guidance in the examples on the allocation of risks between the head office and the PE: such guidance would be particularly useful where the PE is a Dependent Agent PE, with the sharing of risks between the head office, PE and a related party resident enterprise.

Yours sincerely,

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