

PRESENTED BY:

The 2015 OECD International Tax Conference

June 10-11, 2015
Four Seasons Hotel
Washington D.C.



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VI. Permanent Establishments and Profit Attribution to Permanent Establishments

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Panelists

- Rob Heferen, Deputy Secretary, Revenue Group, The Treasury of Australia
- Henry Louie, Deputy to the International Tax Counsel (Treaty Affairs), U.S. Treasury
- Quyen Huynh, Associate International Tax Counsel, U.S. Treasury
- Michael Monroe, Tax Counsel, BASF
- Barbara Angus, Principal, Ernst & Young LLP
- Jesse Eggert, Senior Advisor, BEPS Project, OECD

Overview

- Background
- Australia's Multinational Anti-Avoidance Law
- Commissionnaire Arrangements and Similar Strategies
- Artificial avoidance of PE status through the specific activity exemptions
- Fragmentation
- Splitting-up of contracts
- Insurance
- Profit attribution

Background

- Action 7: Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.
- October 31, 2014: First discussion draft on Action 7, describing PE avoidance strategies and alternative options to address them
- 21 January, 2015: Public consultation

Revised Discussion Draft

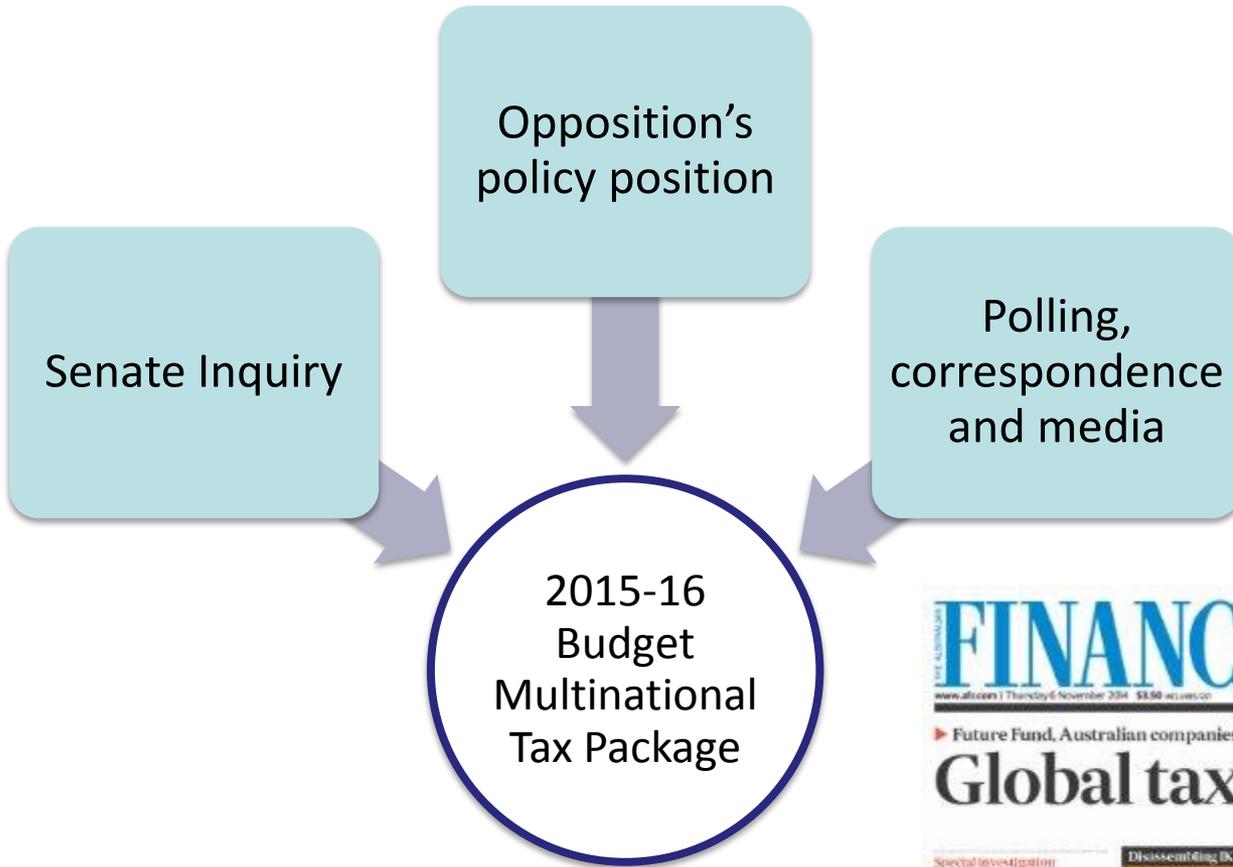
- Released 15 May 2015
- Narrows down from multiple options to a single proposal for addressing each PE avoidance strategy previously identified
- Comments due by 12 June 2015
- Those comments will be taken into account by Working Party 1 in its 22-26 June meeting so that proposed changes to the OECD Model Tax Convention can be finalized



Australian Government

The Treasury

Australia's Multinational Anti-Avoidance Law



FINANCIAL REVIEW
 www.af.com.au Thursday 6 November 2014 \$3.90 (incl GST)

▶ Future Fund, Australian companies in leaked PwC deals ▶ Luxembourg 'clips ticket' ▶ ATO probe

Global tax schemes exposed

Disassembling IKEA Australia's finances
 Total IKEA turnover, profit and tax paid, 2002-13

Turnover \$4.76b
Declared pre-tax profit \$103m
Tax paid \$31m

Over the past 12 years, IKEA's Australian arm has paid less than 1% of its turnover in tax

Sales at IKEA's Australian arm have risen but declared profit has flattened

Year	Turnover (\$m)	Declared pre-tax profit (\$m)	Tax paid (\$m)
2002	~100	~10	~3
2003	~150	~15	~5
2004	~200	~20	~7
2005	~250	~25	~9
2006	~300	~30	~11
2007	~350	~35	~13
2008	~400	~40	~15
2009	~450	~45	~17
2010	~500	~50	~19
2011	~550	~55	~21
2012	~600	~60	~23
2013	~650	~65	~25

IKEA's design for big profits and little tax

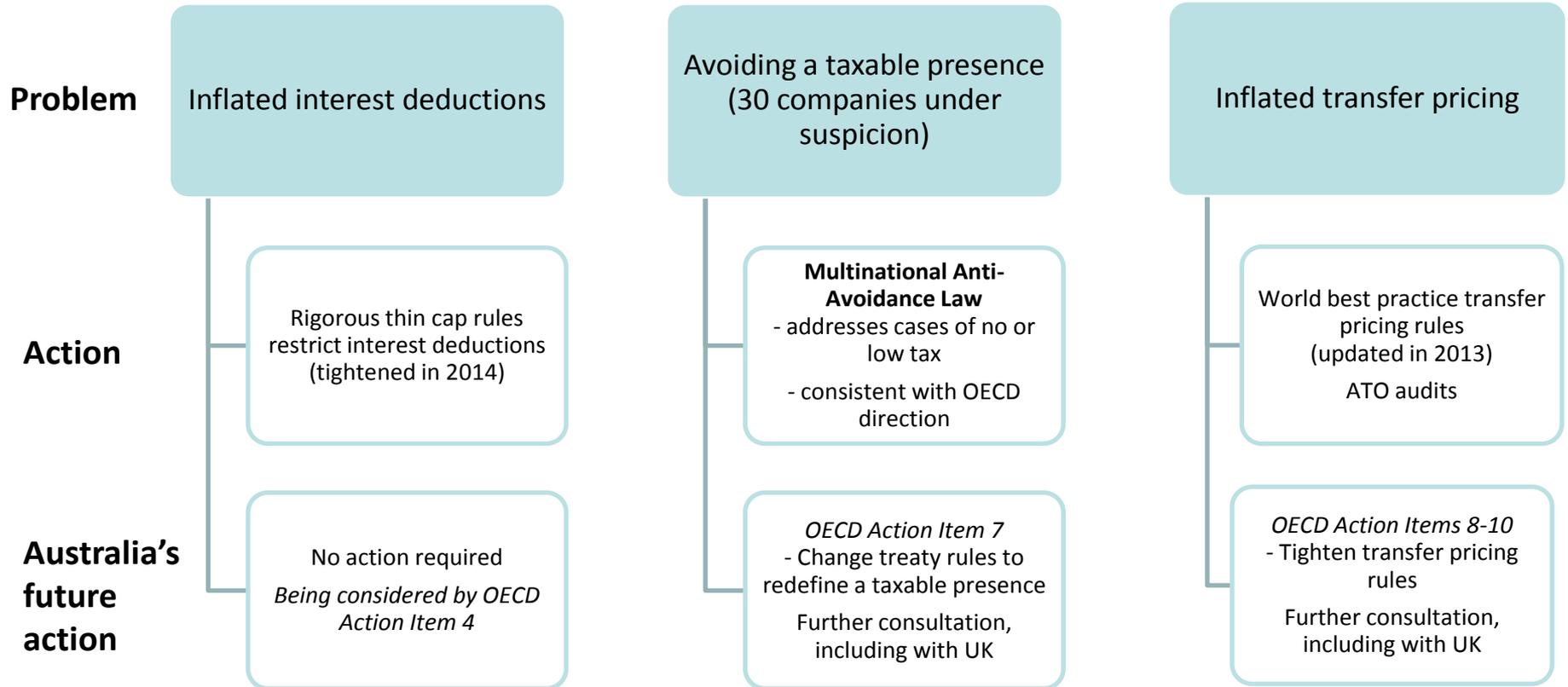
Exclusive
 Neil Chenoweth

Despite reporting decades of miserable financial results, the Australian arm of furniture company IKEA has earned an estimated \$1 billion in profits since 2005 - and almost all of it has been transferred tax-free to Luxembourg and the Netherlands.

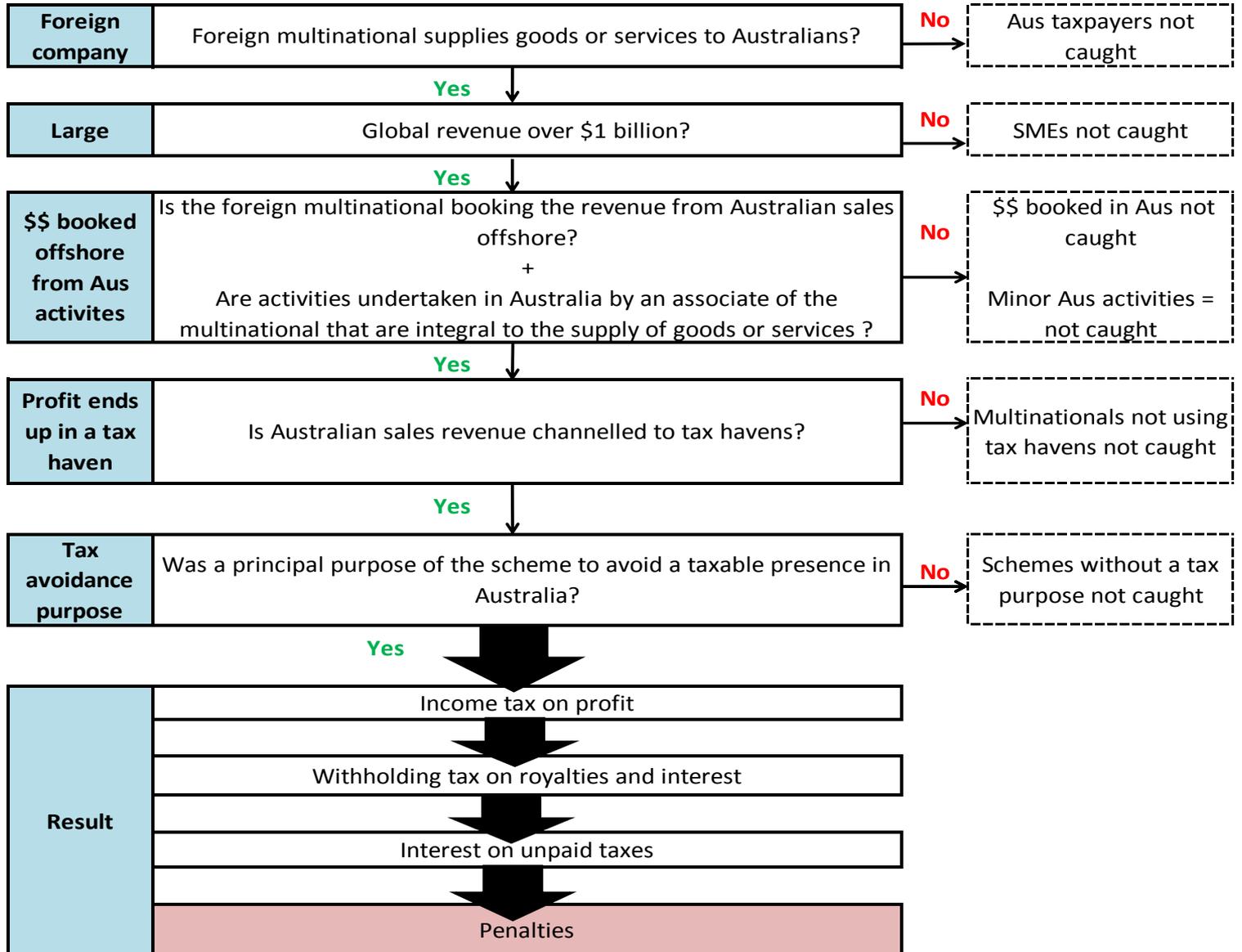
Leaked PwC tax documents help to lay out one of the strategies of Australia resulting from the fatpack giant.

By operating two independent entities, the Swedish group can charge itself for its

Methods of multinational tax avoidance



Application of the Multinational Anti-Avoidance Law



Commissionnaire Arrangements and Similar Strategies

- Core policy: where an intermediary exercises activities in a country that are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise should be considered to have a PE unless the intermediary is acting in the course of an independent business
- Original draft put forward four alternative options (A, B, C & D) intended to reflect that policy without allowing avoidance strategies
- Comments expressed a number of concerns about all of the options, but the majority of those that expressed a preference for one option chose option B.
- Revised discussion draft included a proposal based on option B

Commissionnaire Arrangements and Similar Strategies

- Changes proposed to paragraph 5 of Article 5:
 - Apply where a person “concludes contracts, or negotiates the material elements of contracts”
 - Supplement the phrase “contracts in the name of the enterprise” with contracts for transfer of ownership or granting of right to use property owned by the enterprise or for provision of services by that enterprise; and

Commissionnaire Arrangements and Similar Strategies

- Changes proposed to paragraph 6 of Article 5:
 - Modifying the “independent agent” exception in Art. 5(6) so that it is not available to agents that act exclusively or almost exclusively for connected enterprises
 - This was narrowed from the previous discussion draft to:
 - Limit application to agents acting for “connected” enterprises (rather than the broader category of associated enterprises); and
 - Avoid automatically excluding an unrelated agent acting exclusively for a single unrelated enterprise

Artificial avoidance of PE status through the specific activity exemptions

- The previous discussion draft identified four issues with the list of exceptions under Article 5(4) that were seen as potentially raising BEPS concerns:
 - The fact that the exceptions are not restricted to preparatory or auxiliary activities
 - The reference to “delivery” in subparagraphs a) and b) of paragraph 4
 - The exception for purchasing goods or merchandise or collecting information
 - The fragmentation of activities between related parties
- Four options were proposed, which ranged from deleting references to specific activities to making all exemptions subject to the condition that the activity be preparatory or auxiliary

Artificial avoidance of PE status through the specific activity exemptions

- Business comments indicated strong objections to all four options
- Of the four, option E, which made all exemptions subject to the condition that the activity be preparatory or auxiliary, was considered least objectionable
- Comments noted, however, that the phrase “preparatory or auxiliary” was uncertain, and asked for additional guidance
- Comments also suggested that the changes would create PEs with very little attributable profit

Artificial avoidance of PE status through the specific activity exemptions

- The revised discussion draft proposes original Option E, accompanied by commentary intended to provide additional detail about what the phrase “preparatory or auxiliary” means

Fragmentation of activities between related parties

- Paragraph 27.1 of existing Commentary on Article 5 concludes that an enterprise cannot fragment a cohesive business into several small operations in order to claim that each is engaged only in prep/aux activity
- An issue arises as to whether this rule should be limited to fragmentation within a single entity, or whether it should extend to cases where places of business belong to related parties

Fragmentation of activities between related parties

- The October 2014 discussion draft proposed two alternative rules to take into account activities of related parties for purposes of applying Art. 5(4):
 - Option I: applying only to situations in which one of the enterprises maintains a fixed place of business that would constitute a PE;
 - Option J: applies where the combination of activities of the related entities goes beyond preparatory or auxiliary, even where no single entity would have a PE based on its activities

Fragmentation of activities between related parties

- Comments generally expressed strong objections to both options based on:
 - Uncertainty of language
 - Concern that the approach would undermine the separate entity principle
 - Risks of double taxation due to multitude of new PEs

Fragmentation of activities between related parties

- Revised discussion draft retains a modified version of Option I, proposing that 5(4) will not apply to a place of business if:
 - the same enterprise or a connected enterprise carries on business activities at the same place or another place in the same State; and
 - the activities exercised at these places:
 - constitute “complementary functions that are part of a cohesive business operation”; and
 - go beyond the “preparatory or auxiliary” threshold
- New commentary provisions would be added to clarify the meaning of “complementary functions that are part of a cohesive business operation.”

Splitting-up of Contracts

- Splitting up contracts to abuse the exception in paragraph 3 of Article 5 is discussed in paragraph 18 of the Commentary to Article 5
- The October 2014 discussion draft suggested two options to address this issue, either through a mechanical rule or through the “principal purpose test” proposed under Action 6

Splitting-up of Contracts

- Comments objected to both options proposed, but expressed a preference for addressing through the PPT rule
- The revised discussion draft proposes no changes to Article 5, but includes a proposal to add a new example to the Commentary on the PPT addressing splitting-up of contracts.

Insurance

- October 2014 discussion draft included two options aimed at situations in which a foreign insurance company does large-scale business in a State without a PE
 - The first option was to adopt a provision similar to Article 5(6) of the U.N. Model providing for a PE if an enterprise collects premiums or insures risks through a person other than an independent agent.
 - The second was to rely on general changes proposed to Article 5(5) and (6) to deal with commissionaire arrangements and similar strategies.
- Following consultation, the revised discussion draft concludes that no specific rule for insurance enterprises should be added to Article 5

Profit Attribution to PEs and Interaction with Action Points on Transfer Pricing

- Action 7 provides that work “will also address related profit attribution issues”
- The October 2014 discussion draft stated that while preliminary work had identified some areas in which additions/clarifications would be useful, it had not identified substantial changes that would need to be made to existing rules and guidance if the proposed changes were adopted.
- It acknowledged, however, that work on other parts of the BEPS Action Plan might involve reconsideration of some aspects of existing rules and guidance

Profit Attribution to PEs and Interaction with Action Points on Transfer Pricing

- A large number of comments focused on attribution of profits, and many comments indicated that more work should be done.
- Comments noted that there were multiple different interpretations, as many countries had not adopted the AOA
- Some comments suggested as well that there was inadequate guidance on profit attribution outside the financial services sector

Profit Attribution to PEs and Interaction with Action Points on Transfer Pricing

- Revised discussion draft acknowledges the need for additional guidance on profit attribution, but notes that this cannot realistically be undertaken before the work on Action 7 and Actions 8-10 have been completed
- Follow-up work will therefore be carried on after September 2015, with a view to providing guidance before end 2016, in advance of deadline for completion of the multilateral instrument that would implement the results of the work on Action 7