Attribution of Profits to Permanent Establishments

Approach to be used for attribution of profits to PEs

Bill Sample, Chair, Tax Committee, USCIB
USCIB believes that the discussion draft should be modified to:

- More closely follow the AOA – the discussion draft does not identify nor determine the nature of the dealings between the PE and the non-resident enterprise, a necessary step in applying the AOA, nor does it discuss the selection of the most appropriate transfer pricing method in light of the nature of the PE;

- Provide additional guidance on how the 2008 version of the AOA would apply to the examples;

- Limit the ability to adopt the PE changes as part of the multilateral instrument to those countries that accept the AOA;

- Clarify the determination of the economic ownership of inventory -- the discussion draft in places seems to apply a significant people function test, rather than the general rule for tangible property based on the place of use;

- Recommend the adoption of simplifying administrative practices.
The mandate under Action 7 is to provide additional guidance on how the rules of the Authorized OECD Approach (AOA) apply to the new forms of permanent establishment (PE) created by the BEPS changes to Article 5, without making substantive modifications to those rules.

USCIB believes it is important to frame the new guidance consistently with the existing guidance provided by both the 2008 and 2010 Reports on the AOA.

The OECD should use this opportunity to make clear that the operation of the AOA requires careful functional analysis to identify and determine the nature of the dealings between the head office and the PE and once that functional analysis has been performed and the PE has been so characterized, to identify the most appropriate transfer pricing method that will apply by analogy to the dealings between the head office and the PE. These steps have been omitted from the discussion draft.

Because the OECD’s mandate does not permit it to make substantive modifications to the AOA, it is difficult to see how the OECD could apply any other standard, since to do so would be to make substantive modifications to the AOA.
• Countries signing onto the PE rules in the multilateral instrument should publicly confirm that they have a common understanding of both the definition of a PE and the rules for attributing profit to those PEs.

• The usual negotiations that take place when treaties are modified bilaterally will not take place when countries modify their treaties by signing onto the MLI. This will lead to controversy unless it is very clear what the countries are agreeing to and the profit attribution standard to be applied.

• Countries are free to agree to another standard other than the MLI, but in the context of applying the OECD standards there are only two real options, the full AOA or the partial AOA.