



Papers on Selected Topics in Protecting the Tax Base of Developing Countries

Draft Outline - Paper No. 8

May 2013

Preventing Artificial Avoidance of PE Status

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PROTECTING THE TAX BASE OF DEVELOPING COUNTRIES: ACTION 7 BEPS PLAN ON PREVENTING ARTIFICIAL AVOIDANCE OF PE STATUS

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1. Introduction to the context of BEPS Action 7 and the reasons why the PE problem is catching the attention of tax administrations and taxpayers:

- a. The works of the OECD on attribution of profits to PEs (increase in potential profits attributed to PEs makes this issue more relevant for tax administrations)
- b. Business restructuring (Chapter 9 OECD TP Guidelines and PEs) and tax competition for headquarters / principals of multinationals
- c. The need to clarify the concept of PE (a fundamental threshold of tax treaties is not clear for tax administrations and taxpayers):
 - i. 'Changing mood' of some tax authorities and judicial decisions in some countries supporting a more or less aggressive concept of PE for source countries (e.g. Mred, Borax, Roche, Dell, Honda in Spain, or decisions in India –E-Bay, Nokia, v. Boston Scientific in Italy, Zimmer, France, Dell in Norway etc¹)
 - ii. The source v. residence debate:
 1. The progressive lowering of thresholds in art. 5 OECD MC (2003 onwards), especially with regard to the 'fixed place of business'
 2. Art. 5-7 UN MC 2011: relevant differences
 3. The OECD drafts on art. 5 OECD MC (2011-2012)
 - iii. Economic v. legal interpretation of the concept of PE:
 1. Vulnerability of 'legal tax planning' in a world sliding towards 'substantialism' / 'economic interpretation'
 - iv. Evolution of sources of international tax law: the role of soft-law

2. The limited scope of Action 7 of the BEPS Action Plan (Preventing the Artificial use of PEs):

- a. The contrast between the importance of PEs and the context defined in 1 and the limited scope of Action 7:
 - i. Was the action being limited by the business response to the proposed changes in the Drafts on art. 5 OECD MC?
 - ii. Were the proposed changes a source of uncertainty (reactions from business)?
- b. The original limits of Action 7 BEPS Action Plan:
 - i. Commissionaire arrangements
 1. The competing interpretations of art. 5.5. OECD MC
 - ii. Artificial fragmentation
 1. The problems with art. 5.4 OECD MC

¹ If there are other decisions / case-law in developing countries it would be good to know them.

2. The reaction on para. 27.1 in the OECD's Drafts on the concept of PE: use of legislative and judicial anti-abuse rules
 3. The connection of the problem with (1) art. 5.1 OECD and art. 5.3. (the geographical and commercial coherence test) and (2) the lack of (clear) rules on attribution of profits in these situations.
- c. Changing the (strict) limits of Action 7?
- i. Some ambiguities in the initial BEPs Plan:
 1. Will rules on attribution of income to PEs be changed (unlikely but some references in the OECD documents suggest that some changes might be possible: e.g. clarification of problems with dependent agents)?
 - ii. Has the consultation process initiated by the OECD on 22 October 2013 (invitation to submit comments "on strategies that may result in the artificial avoidance of the PE status") meant a change of direction?
 - iii. Changes to the 'fixed place of business test'?
 1. Are they needed in view of the trends in recent years?
 2. Are they possible (time-constraints of the project)?
 - iv. Action 7 BEPS Action Plan and other Actions, for instance:
 1. Action 1 (digital economy)
 - a. Problems derived from the Draft Report on this action* (just to connect it with this paper, since the issue will be dealt with in another chapter)
 2. Action 6 (treaty abuse)
 3. Action 13 (CbC Reporting)
 4. Action 14 (resolution of disputes), etc.

3. Connection with art. 5-7 UN MC and other initiatives in the context of the UN MC (the issue of services will be dealt with in another paper)

4. Possible reactions (advantages and disadvantages / limits):

- a. Regulation of the concept of PE and the system of attribution of profits admitted in the specific jurisdiction in line with preferred model (one of the main problems is that either countries do not have the concept of PE or that they do not regulate specific issues such as attribution of profits, which creates legal uncertainty on the position of that country; whether a country follows a more legal or economic, static or dynamic, approach should be made clear in legislation, administrative circulars etc.)
- b. Administrative rules to control fragmentation of activities / commissionaire agreements or dependent agents (access to country by country information as a useful tool of risk management)
- c. Effects of GAARs / SAARs in the context of PEs and with regard to fragmentation of activities
- d. Application of transfer pricing rules (taking into account the context defined by the UN Manual on Transfer Pricing for Developing Countries: para. 1.64-65 (disregard doctrine / commercial

rationale), specific rules on valuation of business restructuring and transactions after the restructuring

- e. System of advance rulings on PE concept/ compacts in specific sectors (e.g. extractive industries) / improvement of systems of resolution of disputes
- f. Changes in tax treaty policy / models (connection of Action 7 and 15)
- g. Other suggestions or specific solutions by officials from different countries?