NovioTax

A wake-up call for companies with commissionaire and similar structures

January 2017

Following discussion draft titled BEPS Action 7: Additional Guidance on the Attribution of Profits to Permanent Establishments, amendments to the OECD Model Convention ("OECD MTC") have been announced that will impact the attribution of profits to permanent establishments ("PEs") with respect to warehouses as fixed place of business. Accordingly, amendments have been announced that will impact the status of dependent agents, including those created through commissionaire and similar arrangements. This is currently clarified in Article 5(5) of the OECD MTC.

Impact BEPS Action 7

In the discussion draft, the attribution of profits to a dependent agent PE is illustrated in four examples all involving a fact pattern in which a non-resident enterprise, acting as a principal, engages an associated enterprise resident in the host jurisdiction or sends an employee to the host jurisdiction to perform activities that give rise to a dependent agent PE under Article 5(5) of the OECD MTC. A dependent agent PE is therefore created by the activities of either an associated enterprise or otherwise by an employee of the non-resident enterprise. The key question in the assessment of the existence of a dependent agent PE is whether or not the dependent agent performs any significant people functions on behalf of the non-resident enterprise.

The BEPS Focus Group on the Artificial Avoidance of PE Status intends to tackle legal structures that do not align to economic reality. In case law published in 2010 and 2011 (the cases Zimmer and Dell), local Courts in France and Norway confirmed that commissionaire arrangement should be excluded from the deemed PE in article 5(5) OECD MTC. However, as a consequence of international pressure, these arrangement were categorized as artificial and widely considered as being put in place primarily in order to erode the taxable base of the State where the sales take place. This ultimately has led to BEPS Action 7 and the proposed amendments in the OECD MTC.

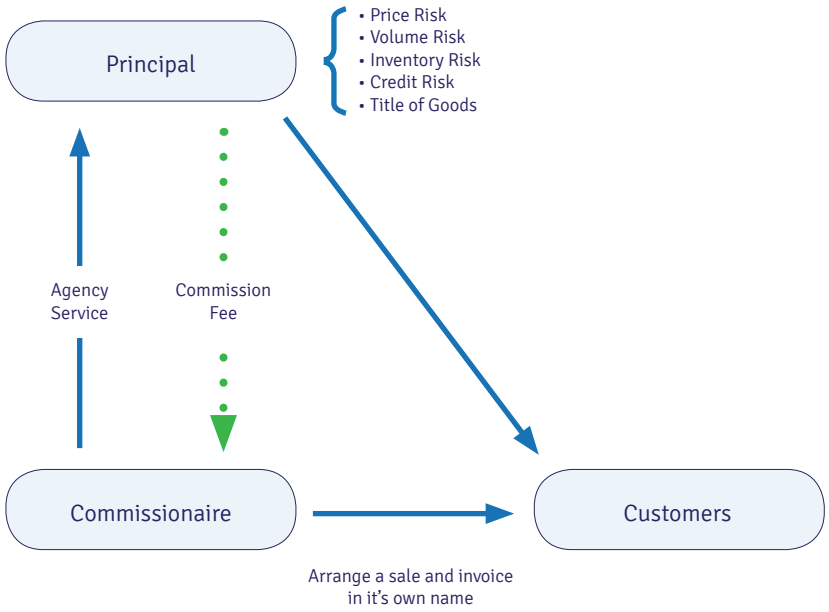
In a typical commissionaire arrangement, a person (the agent) concludes contracts for the sale of products in a certain jurisdiction in its own name. However, the sale is made on behalf of an overseas principal (typically an enterprise) that also owns the products and fulfils the contract. No enforceable rights and obligations are being created between the overseas principal and the customer buying the product. Under the current OECD MTC, it is generally accepted that such commissionaire structures does not give rise to a PE in the sale State, on the basis that the contracts are not in the name of the overseas principal and do not bind it. In these arrangements, the commissionaire is normally only taxable on its remuneration (typically a small percentage of the costs). The more significant share of the profit is attributed to the overseas principal.

Newly proposed text of the OECD MTC

Based on the newly proposed text of the OECD MTC, a commissionaire arrangement can still give rise to a PE if the contracts concluded are for the transfer of ownership of property owned by that enterprise, or for the provision of services by that enterprise. By doing so, the OECD attempts to ensure that Article 5(5) OECD MTC also applies to situations where contracts effectively are carried-out by the enterprise rather than the commissionaire being contractually obliged to do so. This means the legal structure is of less importance – more decisive would be the attribution of the material risks. In other words: where there would be a claim by a customer, will either the commissionaire or the enterprise be requested for remedy? In advice for our clients, we not only focus on the legal side but always try to pay attention to what actually happens. This is also the rationale behind a number of BEPS items.

An area that has been clarified by the OECD is on so-called limited risk distributors. The BEPS Focus Group indicated that amendments on Article 5(5) are not intended to address concerns related to the transfer of risks between related parties through low-risk distributor arrangements, where sales generated by a local sales workforce are attributed to a resident taxpayer. Such structures are different from traditional commissionaire structures, under which the relevant profits are allocated to the principal. It has been argued that these arrangements could still be tackled by BEPS Action 9, which deals with the allocation of risks and capital among group members and / or BEPS Action 10, which deals with transfer pricing methods in the context of global value chains. Based on the 2016 Reports involving especially Action 8 (e.g. the objective of the original BEPS Action 9 has been integrated in Action 8) it appears that the role of capital-rich, low-functioning entities in BEPS planning has or will become less relevant. The focus however has been on risks relating to intangibles and not on the risks relating to distributing activities. See for instance the deliverables in respect of Action 8 and the revised chapter VI on transfer pricing aspects involving intangibles.

Article 5(6) of the OECD MCT contains a provision dealing with the independent agent exemption. An exemption of a dependent agent PE applies if the agent is acting as an independent agent and acts for the enterprise in the ordinary course of that business. However, an agent shall not be considered to be an independent agent if that agent acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related. This "closely related" requirement is based on all the relevant facts and circumstances, but effectively should come down to the question if one has control of the other or both are under the control of the same persons or enterprises. For this purposes, a percentage of 50% in shares and/or equity interest is proposed. The Commentary on the OECD Model provides some guidance on the wording of "closely related companies" by mentioning that if sales of an agent to "non-closely related companies" would be less than 10% of the agent's total sales, the agent would be deemed to act (almost) exclusively on behalf of the closely related enterprises. Additionally, the Commentary provides guidance on when an agent would be considered to act in the ordinary course of the business.



Although some further process is required before the amendments are formally adopted, it is expected that the proposals will be implemented in the OECD MTC as it is supported by the OECD. However, it is questionable if and to which extent an amendment of the OECD MTC impact bilateral tax treaties. In order to achieve a widespread implementation the OECD is therefore also working on a multilateral instrument ("MLI"). The MLI allows the relatively rapid inclusion in existing bilateral tax treaties of measures against treaty shopping and artificial avoidance of the PE definition, as clarified above. Hence the MLI provisions will not be included in specific bilateral treaties through an amendment of the text of those treaties. Instead, the MLI provisions need to be read and applied alongside these treaties. In a recent positioning paper on the MLI, the Dutch Ministry of Finance has set out its preferences. The Netherlands intends to implement the MLI provisions in its tax treaties as broadly as possible. In this respect it has a preference to, among other elements, implement the amended PE definition following the amendments to the OECD MTC as clarified above. It will be very interesting to see which progress the OECD is able to make on this area going-forward. From a legal point of view the MLI provisions need to be analyzed in close cooperation with the existing bilateral tax treaties (i.e. whether the MLI provisions overrule existing treaties).

What should MNEs do?

As commissionaire arrangements most likely will be scrutinized by local tax authorities in the near future, going-forward we tend to advise our clients to review the positions in the various jurisdictions in respect of these agreements. Based on an analysis and interpretation of the facts and circumstances, it could be considered to legally convert these traditional structures into distributors that economically assume some degree of risk (which could reflect Low Risk Distributors: "LRDs"). Normally, although dependent upon the particular case, the taxable base would increase via a LRD conversion. This may provide some certainty and / or safeguard the support from the local tax authorities in case of mutual agreement procedures (e.g. which outcome ultimately depends upon the interpretations of the facts and circumstances).

It should however be noted that the work in respect of BEPS Actions 8 - 10 has not been finalized. To this extent also LRDs may be affected by the BEPS Actions, especially if they contractually assume limited risk contrary to the functional analyses. In this respect the OECD Discussion Draft (on BEPS Actions 8 - 10) on the revised guidance on profit splits should be monitored since this ultimately may affect the global value chain of MNEs. The Discussion Draft invites responses to questions that seek to gain insight about experiences and best practices in applying transactional profit splits, and views on how current guidance might be amended in order to ensure that transactional profit splits can be applied such that the transfer pricing outcome is in line with value creation. We are awaiting the outcome of this discussion and will inform our clients.

We would also like refer to two previous blogs (amended PE definition for auxiliary services and the Spanish landmark Dell decision). Companies may have to review and reconsider their existing PEs and identify whether or not they align with the amended PE provisions. In particular companies that have fragmented their foreign activities and webshops that typically have warehousing and distributing activities should monitor their tax position. In addition the Spanish landmark decision (Dell Computers), if used by tax administrations in other countries, may be far-reaching and affecting many businesses engaged in cross-border activities (even before the Action 7 anti-BEPS measures are implemented).

ABOUT NOVIOTAX

NovioTax is a Dutch research-oriented tax consultancy firm with offices in Amsterdam and Nijmegen. Our employees are members of the Dutch Association of Tax Advisers (NOB) and the International Fiscal Association (IFA), have many years of experience and some are much sought-after guest speakers on tax policy and other topics that fall within their field of expertise. We typically serve midsized and large MNE clients, coordinate discussions with the DTA and closely cooperate with international law and tax law firms.

DISCLAIMER

Patrick Schrievers
+31(0) 6 10 24 61 40
patrick.schrievers@noviotax.com

Gert-Jan Hop
+31(0) 6 27 32 86 47
gert-jan.hop@noviotax.com