

NovioTax Dell case: Why do we need the BEPS project?

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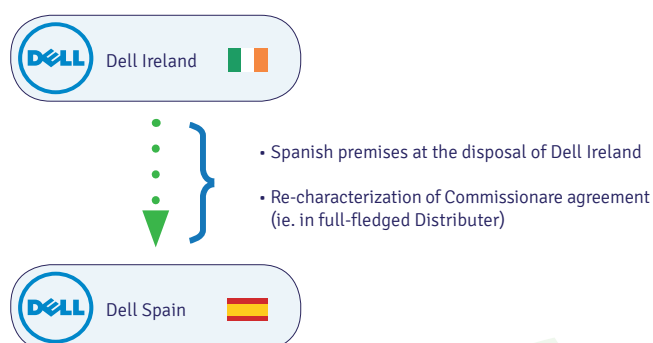
Recently the Spanish Supreme Court made a landmark decision on the existence of Permanent Establishments (“PEs) in foreign jurisdictions. This decision, if used by tax administrations in other countries, may be far-reaching and may affect many businesses engaged in cross-border activities. Interestingly it is not the proposed Action 7 BEPS measures that should concern businesses. Instead, the broad approach to the interpretation of PEs should be their main concern as this potentially is a source of uncertainty. Even before the Action 7 BEPS measures are implemented, companies may have a PE abroad. The decision of the Spanish Supreme Court in the Dell case illustrates that tax authorities may apply a broad interpretation in this respect.

Case explanation

The case concerned a discussion between the Spanish tax administration and the Dell group over whether Dell Ireland had a PE in Spain under articles 5(1) (i.e. fixed PE) and 5(5) (i.e. dependent agent PE) of the Double Taxation Avoidance Agreement (“DTAA”) between Spain and Ireland. The Irish Dell company was responsible for the commercialization of Dell computers in Europe. Sales however were carried out through local subsidiaries located in other European countries (Dell Ireland had neither personnel nor premises abroad). Dell Spain functioned as a distributor for the Spanish market, which included a number of activities complementary to the sales functions (technical support, logistics, warehousing, marketing, after-sales services and administration of the Spanish online store).

From the start the Spanish company acted as a full-fledged distributor. As from 1995, the customer portfolio was transferred to Dell Ireland including inventory risk, claims et al. Thereafter Dell Spain became a commissionaire (i.e. Dell Ireland acting as the principal). The Spanish tax authorities reasoned that the premises of Dell Spain was at the disposal of the Irish Dell company and subsequently formed a fixed place of business through which Dell Ireland carried out its business activity (article 5(1) DTAA Spain - Ireland) and, subsequently, that Dell Spain acted as a dependent agent (article 5(5) DTAA Spain - Ireland) of Dell Ireland.

Following several court proceedings, the Spanish Supreme Court eventually, on 20 June 2016, ruled that Dell Ireland indeed had a fixed PE in Spain. It argued contrary to the legal documentation and contracts. Factually the location of Dell Spain made it possible for the Irish company to carry out its activities and thus was at the disposal of the Irish company. By doing so, the Spanish Supreme Courts effectively re-characterized the commissionaire structure in, we expect, a full-fledged distributor. Interestingly the case also clarified that the activities performed in Spain were an essential part of the business activities of Dell Ireland. Hence, Dell could not benefit from the exemption of article 5(4) DTAA Spain - Ireland, which is the “preparatory and auxiliary” exemption as seen in most DTAAAs.



As a result, the DTAA Spain - Ireland did not protect Dell from a broad interpretation of the PE requirement. This has practical implications for taxpayers and tax authorities with regards to commissionaire dealings and sales / distribution activities conducted in Spain. We expect that the Spanish tax administration will discuss and challenge Dell related set-ups. This may create uncertainty and – eventually – taxable income for foreign companies in Spain.

Comprehensive point of view

From a more comprehensive point of view, the Dell case should be placed in relation to the French Zimmer case (2010), where the French Supreme Administrative Court had to rule about a similar structure and denied the existence of a PE. The Zimmer case was one of the drivers behind the Action 7 BEPS measures, which aim to tackle tax avoidance strategies used to circumvent the PE-definition. This relates to the use of agency or commissionaire arrangements and the exploitation of the existing exceptions to the PE-definition, in particular those relating to activities of a “preparatory and auxiliary” nature. In this respect the Final Report on BEPS Action 7 proposes among other an anti-fragmentation rule. This rule prevents splitting up activities into several smaller operations in order to argue that each part is only engaged in preparatory or auxiliary activities. According to the new rule, supporting activities that form part of an integrated business will not benefit from the auxiliary exemption if there is (among other elements) an existing PE. The BEPS Action 7 Report also proposes to amend the rules on independent agents to prevent the use of exclusive or almost exclusive (i.e. representing more than 90% of the sales conducted) agents, who factually may be dependent.

Takeaways

- Conclusion of the Spanish Dell case is that the broad interpretation of the PE concept could be a source of uncertainty for companies. Even before the implementation of the Action 7 BEPS measures, companies may have a PE abroad, effectively overruling commissionaire and agency structures into full-fledged distributors.
- Businesses may have to review and reconsider their existing sales and commissionaire structures and identify whether or not they align with the facts and circumstances, to prevent them from taxation in other countries.
- It even might be beneficiary for companies to recognize a PE based on the facts and circumstances by using the Dell court ruling. In this respect companies may (amongst others) rely on the observations made in the Dell case in respect of article 5(8) DTAA Spain - Ireland (i.e. seen in other DTAA's as well), which does not exclude the possibility of a subsidiary being a PE of another group entity if the activity of that entity is carried out through the subsidiary.

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 mid-sized and large MNE clients, coordinate discussions with the DTA and closely cooperate with international law and tax law firms.

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