European Banking Federation

Chief Executive

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*Subject:* *Comments on the OECD Revised Discussion Draft on BEPS Action 7 "Preventing the Artificial Avoidance of PE Status"*

Dear Mrs de Ruiter,

The European Banking Federation (EBF) welcomes the OECD's attempt to provide further clarity on its proposals. Nevertheless, further work is required to give additional detailed guidance and clarification for practical application, especially concerning the impact on banks and the whole financial sector which would arise from the proposed changes.

The EBF remains concerned that the current proposals for preventing the artificial avoidance of permanent establishment (PE) status

- go beyond the intention of the project to tackle base erosion and profit shifting through a wider reconsideration of the allocation of taxing rights between the PE country (source country) and head office country (residence country);
- show a lack of clear principles or consensus on the interpretation of standards;
- include undefined terms;
- substantially lower the threshold for what constitutes a PE;
- would lead to an increase in disputes with the local/national tax authorities which would be difficult to resolve, at least on double taxation issues and potential disputes between jurisdictions if both source and residence countries sought to apply taxing rights to the same activity.

We do not believe that this would be a desirable outcome.

We encourage the OECD to develop a sufficiently robust framework on an internationally consistent basis in order to prevent uncertainty and ensuing disputes between businesses and tax administrations. Furthermore, we suggest limiting BEPS opportunities by giving clarity for practical application.

Artificial avoidance of PE status through commissionaire arrangements and similar strategies

Commissionaire and similar arrangements are frequently employed in non-abusive cases. Allowing multinational enterprises, especially banks, the possibility to work via properly implemented and business-driven commissionaires (brokers, general commission agents) is therefore only fair. There is consequently no reason to broaden the scope of the Agency PE provision.

The EBF remains concerned that the proposed measures will not only impact commissionaire arrangements, but also a wide range of arrangements providing marketing and/or sales functions.

The new Agency PE definition is to be brought fully into line with the legal agency concept. Deviations from the legal agency concept will inevitably lead to legal uncertainty and will almost certainly lead to court cases where the outcome might not be what the OECD and governments have in mind with the BEPS project.

Reference to the banking sector, especially brokers or general commission agents:

When the question arises as to how much taxable profit should be allocated to an Agency PE, general transfer pricing rules would be better able to resolve this in a satisfactory manner. The determination of allocable taxable profit should be based on functions and risks, but only if the functions are really materially performed and the risks are actually materially managed in the correct legal entity. What about the commissionaire? The commissionaire is a civil-law type of agent without the power of representation. A commissionaire in a multinational enterprise (MNE) environment is typically a group company (legal company) with a marketing and/or sales function. No risk is taken on. From a business perspective, one cannot claim that a commissionaire is an artificial set-up. From a tax perspective, however, one could argue that a commissionaire is an agent who very much resembles the agent in the future Agency PE definition in Article 5(5) of the OECD Model. If an agency concept is introduced which is devoid of civil law or common law definitions, it might be considered a reasonable approach to include the commissionaire in the Agency PE definition. In our view, however, this would violate the core of the Agency PE concept, namely the legal agency concept.

Furthermore, the addition of the notion in paragraph 5 of Article 5 “negotiating the material elements of contracts” could lead to the recognition of a permanent establishment each time, for example, a sales force negotiates the material elements of the contract. This notion is far too subjective and open to interpretation: this could lead international groups to declare a permanent establishment in each country where you find one or more sales representatives resulting in a cumbersome and unnecessary administrative burden disconnected from the aim of BEPS. We think that the transfer pricing methodology is far more relevant.

Artificial avoidance of PE status through the specific activity exemptions

The proposed wording does not add much more clarity than the previous wording. Deleting the sentence “It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not” provides no new insight.

To avoid uncertainty and with the principle of the unity of the legal framework in mind, the EBF suggests that the OECD give additional guidance and/or clarification and uses the regulatory framework (especially for banks) to define the threshold for the existence of a PE (for banks and other parts of the financial sector).

Regulatory law is of fundamental importance when it comes to judging whether or not a bank has set up a permanent establishment. Preparatory or auxiliary functions can be performed by a so-called representative office/agency to a certain extent. Representative offices/agencies are not usually set up to process bank transactions (for a definition, see local/national regulatory law). Under most national regulatory legislation, moreover, this would not be allowed. Instead, the main purpose of the representative office/agency is to initiate and maintain business contacts for the head office (residence office). The function is of a preparatory and auxiliary nature (see Article 5(4) of the OECD Model) and does not mean that a PE has been set up.

Article 5(4) of the OECD Model does not set a clear-cut threshold showing where a preparatory or auxiliary activity ends and where a main activity starts. This absence of absolute clarity is problematic, especially with respect to the question of whether the alleged preparatory activity goes so far that tax authorities can claim it is actually being performed by a PE.

In principle, we believe it is essential that the criteria set out in Article 5(1) und (4) of the OECD Model for determining the existence of a PE are not undermined by creating a PE agency.

We therefore reject example 30.3. The described activity in State S of the bank resident in State R – namely the verification of information provided by clients – is not an artificial avoidance of PE status, but is of an auxiliary nature. The activity in State S is business-driven, or to be more precise represents compliance with regulatory requirements; there is no risk attached to the activity (no key entrepreneurial risk function). From the point of view of attributing income, this activity is not a tool to shift risk and as a result shift profit. Example 30.3 undermines the wording and sense of the general criteria for determining PE status.

Splitting-up of contracts

Undefined terms like “logical consequences” in the sentence, “whether the conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with that person or related persons” give no objective guidance for practical application. Furthermore, specific guidance regarding the service-PE concept is needed.

Issues related to attribution of profits and interaction with Action Points on Transfer Pricing

The proposals will probably lead to a significant number of new PEs. Clear guidance is therefore needed for all sectors “to ensure that businesses and tax authorities take a consistent approach”.

For the banking sector, we believe most inappropriate profit shifting by means of shifting risk could be solved by a clear analysis of the elements of attributing income. It would be sufficient to indicate the relevance of the key entrepreneurial risk functions. We suggest referring to the

2010 OECD Report on the Attribution of Profits to Permanent Establishments, Part ii (Banks) and Part III (Global Trading of Financial Instruments).

Final remarks

States should endeavour to make tax effects on profits and losses more symmetrical in order to ensure that private investors, particularly in the banking sector, can make efficient investment decisions. As things stand, the aim appears to be:

- to extend the definition of permanent establishment on an unsound, and therefore inadequate, basis; and

- to ultimately benefit from the taxation (at source) of (high-risk) investments or activities while simultaneously disallowing full compensation of financial losses at national/local level and the mere shifting of risk within a multinational entity (risk premiums, contractual shifting of risk).

Yours sincerely,

Wim Mijs