OECD PE Focus Group Considering Four Proposals to Tackle Commissionaires

by Kevin Bell

The Organization for Economic Cooperation and Development is considering four alternative proposals to change the wording of paragraphs 5 and 6 of Article 5 of the OECD model tax treaty in order to address the taxation consequences of commissionaire structures. The OECD's Focus Group on the Artificial Avoidance of PE Status said in a Oct. 31 discussion draft that it “is clear that in many cases commissionaire structures and similar arrangements were put in place primarily in order to erode the taxable base of the State where sales took place.” The Oct. 31 draft—“BEPS Action 7: Preventing the Artificial Avoidance of PE Status”—asks stakeholders to comment on four alternative proposals, A, B, C and D, to change Article 5. Option A proposes adding to Article 5, “a reference to contracts for the provision of property or services by the enterprise,” replacing the language “conclude contracts” with “engages with specific persons in a way that results in the conclusion of contracts,” and strengthening the requirement of “independence.”

Under the international base erosion and profit shifting (BEPS) action plan, the OECD has until September 2015 to make changes to the PE definition under the organization's Model Tax Convention to prevent the artificial avoidance of PE status regarding BEPS through commissionaire arrangements and specific activity exemptions. The OECD's Sept. 16 report on tax challenges of the digital economy under BEPS Action 1 recommended that the PE focus group, working on BEPS Action 7, analyze whether preparatory and auxiliary activities have become significant components of businesses in the digital economy. The Sept. 16 report also recommended that the PE focus group decide how to change the definition of PE to address artificial arrangements relating to the sales of goods, or services, of one company in a multinational group, effectively resulting in the conclusion of contracts, such that the sales should be treated as if they had been made by that company.

On June 13, 2013, an outraged U.K. parliamentary committee found clear evidence that London-based Google Ltd.’s sales to its major U.K. clients take place in the United Kingdom, and not in Ireland as the company claimed—meaning that H.M. Revenue and Customs should have concluded that Google Ireland had created a U.K. permanent establishment. In its June report, the Commons' Committee of Public Accounts concluded that Google Ltd. was able to avoid U.K. corporation tax on its enormous U.K. profits by successfully making the argument that Google Ltd.‘s advertising sales to its major U.K. clients took place in Ireland.

Under a commissionaire arrangement, a person sells products in a state in its own name but on behalf of a foreign enterprise that is the owner of the products. The foreign enterprise is able to sell its products in a state without having a PE to which such sales may be attributed for tax purposes. Because the person who concludes the sales does not own the products that it sells, it cannot be taxed on the profits derived from such sales and may only be taxed on the commission that it receives for its services.
The Oct. 31 draft gave an example of BEPS concerns arising from commissionaire arrangements. The example is based on a court decision that found that the foreign enterprise did not have a PE.

In the OECD's example, XCO is a company resident in State X. It specializes in the sale of medical products. Until 2000, these products are sold to clinics and hospitals in State Y by YCO, a company resident of State Y. XCO and YCO are members of the same multinational group.

In 2000, the status of YCO is changed to that of a commissionaire following the conclusion of a commissionaire contract between the two companies. Under the contract, YCO transfers to XCO its fixed assets, its stock and its customer base and agrees to sell in state Y the products of XCO in its own name, but for the account of, and at the risk of XCO. “As a consequence, the taxable profits of YCO in State Y are substantially reduced.”

*This article first appeared in BNA’s Transfer Pricing Report.*