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Dear Marlies,

PE Representations

Detailed comments from the PwC network of firms on the new Discussion Draft on BEPS Action 7, dated 15 May, follow below. We note by way of preliminary comments, however, that the approach on Action 7 should take account of the progress on the work on improving the effectiveness of dispute resolution under Action 14. If the Action 14 work does not deliver the intended solutions identified in the Action Plan, this suggests that a cautious approach should be adopted in any expansion of the scope of the threshold PE rules (especially where this is achieved using new concepts and thresholds) given the widespread concerns relating to incremental double taxation from the Action 7 proposals.

Dependent Agent PE test

We have no further comments on the proposals for the amendment of Article 5 (5) itself, but do wish to comment on the proposals for the amendment to the Commentary on that provision, which deems a PE to exist if a dependent agent concludes contracts or negotiates material terms of the contract. We are concerned that the discussion in a number of the proposed new paragraphs (in particular, paragraphs 32.4, 32.5 and 32.6) goes well beyond the plain meaning of the proposed language and will leave room for agents to be regarded as falling within the rule when their activity would fall well short of a substantive role in the process for the conclusion or negotiation of contracts. This is at odds with the terms of the revised Article 5 (5) itself. It would also achieve very little given that the relevant profit attribution to any PE in such a case is unlikely to differ from the corresponding transfer pricing reward that would typically otherwise be relevant in the absence of a PE (see further below). We would urge that these paragraphs be re-assessed. It would also seem necessary to clarify in the Commentary that, in all cases, the agent must always play a real and substantial role in the process of negotiation or conclusion of contracts if the threshold test in Article 5 (5) is to be met. Further, it would help to add some further guidance on the scope of the phrase “the material elements of contracts”, particularly as the proposal in new paragraph

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32.5 makes it clear that the meaning of that phrase may vary depending on the nature of the contract concerned.

Independent Agent test

We welcome the revision to this test to the effect that an agent acting exclusively for one unrelated principal is not automatically excluded from qualification as an independent agent. However, we consider that the logic should apply regardless of whether the agent is unrelated. In our view, the independent agent test should generally and as a matter of principle be directed to address whether the agent is in any particular case carrying on the business of the principal. On that basis, the focus should be on the nature of the agent's activities, not the relationship between agent and principle (i.e. whether or not connected). In the absence of further explanation, this discrimination against connected parties seems hard to justify in principle. It would place a business in the awkward position of having to choose an unrelated party over its own affiliated entity to avoid adverse tax consequences where both agents are fulfilling the same function.

A second concern in relation to this proposal concerns the lack of clarity in the explanation of what it is to be an independent agent. The guidance in the existing Commentary is not particularly clear but the revisions proposed have the effect of making it less clear than it now is. The proposed removal of the economic independence test materially re-orientates the existing guidance, putting much greater emphasis on the "legal" independence test (which is basically concerned with the operational independence of the agent) and this in turn shifts the focus from any "entity" perspective in relation to the agent to a focus directed at the individuals (or "humans") carrying on the agency functions. Proposed amendments to the Commentary add a clarification of what is *not* independent and emphasise that all the facts and circumstances need to be taken into account but the attributes of independence themselves are not particularly clear. Given that these proposed changes will clearly have a material impact in a number of cases, further clarification of the requirements of the independent agent test (and their rationale) seems essential.

Exempt activities

We have no further comments on this point.

Anti-fragmentation

The critical phrases "complementary functions" and "cohesive business operation" are not defined or clarified beyond the two examples that are proposed for the new paragraph 30.3. Given the potential significance of these terms, some further clarification would seem to be necessary of the intended scope of the test and we would suggest further examples would be helpful.

Splitting up of contracts

We have no further comments on this point.



Insurance

We welcome the decision to drop the proposal for a specific PE rule for the insurance sector.

Profit attribution issues

We have material concerns on this point. Our primary concern in relation to the OECD's proposal for follow-up work on the attribution of profits issues is that it will in practice make it very difficult to address PE threshold and PE attribution issues in tandem, which in our view is clearly required. We, and very many other commentators, have to date expressed very strong concerns that the ongoing work on article 5 which involves lowering the existing PE threshold will lead to the creation of multiple PEs where there is no additional profit at stake, compared with the profit that would arise from what may be referred to as the corresponding transfer pricing arrangements that would typically otherwise apply in the absence of a PE. By disengaging the work on the profit attribution as is now proposed, those concerns will be much more difficult to address. Accordingly, if the work on the profit attribution issues cannot be accelerated, we would recommend that final decisions on Article 5 be taken only when the results of the work on the profit attribution are available.

Yours sincerely

Richard Collier