



Bundessteuerberaterkammer
KÖRPERSCHAFT DES ÖFFENTLICHEN RECHTS

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5. September 2016

Public Discussion Draft on Additional Guidance on the Attribution of Profits to Permanent Establishments

Dear Mr. VanderWolk,

Thank you for the opportunity to comment on the Discussion Draft on Additional Guidance on the Attribution of Profits to Permanent Establishments (hereinafter referred to as: "the Discussion Draft") issued on 4 July 2016.

The German Federal Chamber of Tax Advisers (hereinafter referred to as: "Bundessteuerberaterkammer") represents the interests of more than 95,000 tax advisers in Germany vis-à-vis the Bundestag, the Bundesrat, the Federal Ministries, the top echelons of the civil service, the courts and the institutions of the EU and OECD.

The objectives and competencies of Bundessteuerberaterkammer include inter alia facilitating public discussions on tax matters, analysing and giving opinions on draft tax legislation and all other legislative areas that affect the tax profession in Germany and exchanging information about tax laws and professional law.

We would be pleased to discuss any questions you have on our comments and would welcome the opportunity to contribute to the discussion as part of the public consultation meeting in October.

Yours sincerely,

i. V. Claudia Kalina-Kerschbaum
Geschäftsführerin

i. A. Cornelia Metzger
Referentin

Encl.



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Enclosure

Public Discussion Draft:
Additional Guidance on the Attribution of Profits to
Permanent Establishments

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I. General Remarks

Bundessteuerberaterkammer welcomes that the OECD is consulting with public on its profit attribution guidance. Clear guidance will assist tax authorities and taxpayers as well as their advisors applying the AOA to the revised PE definition. Further, we support the objectives of the discussion draft to illustrate how the rules for the attribution of profits to permanent establishments apply, taking into account both the changes made by the Report on Action 7 and the changes made to the Transfer Pricing Guidelines. However, it is critical that any guidance given by the OECD is workable and tax authorities in all countries and taxpayers take a consistent approach. Furthermore it may be useful if the examples were expanded.

Although the OECD expects the revised definition of PE to be enacted through its Multilateral Instrument, it is likely that tax administrations will begin to attempt to apply any new Commentary as soon as it is finalised. In that context, aligning the work on the Commentary and profit attribution guidance would promote consistency.

II. Questions for Consultation

1. Order of application and guidance on this order

From our perspective, the order in which the analyses are applied should not affect the outcome; no guidance on this order appears to be necessary.

2. Agreement with the factual and functional analysis in Example 1

We agree with the functional and factual analysis under Article 9 and Article 7 and step 1 of the AOA, and in particular with the conclusion that there are no risks or assets attributable to the DAPE and that there is no need to attribute capital to the DAPE. It appears to us, however, that allocating the sales income to the DAPE under step 2 is not in line with the functional and factual analysis under step 1, since the sales activities performed by Sellco for Prima are limited to identifying customers, soliciting and placing customer orders, and processing customer orders with Prima. Recall that there are no significant people functions performed by Sellco on behalf of the non-resident enterprise (Prima) in Country B relevant to the attribution. In particular, “the DAPE has not been attributed the economic ownership of any assets (inventory, marketing intangibles, or receivables)”.

3. Agreement with the construction of profits or losses in Example 1

In principle, agreed; we wonder, however, if it is in line with the proper application of the authorized OECD approach to attribute the sales committed by the DAE to the DAPE despite the fact that no significant people function is carried out in this DAPE.

Besides running counter to the basic principle that assets, risks, capital, and third party transactions are attributed to the permanent establishment carrying out significant people functions, attributing both the sales volume and, thus, the costs of goods sold would imply that the sales margin is earned in the DAPE (and passed on to the DAE). In our understanding, the profit and loss account of the DAPE in example 1 should take the following form:

+ Commission income	10
= Gross profit	10
- Commission to Sellco	(10)
= Operating profit	0

Having said that, it would be interesting to see how the OECD would attribute the assets and the capital involved to the head office and the DAPE in this example. One may say that where the goods are sold to the third party customer, no assets and capital would remain to be allocated to the DAPE. However, if the “balance sheet” for tax purposes is set up according to proper bookkeeping principles, recording cost of goods sold would require that the goods themselves are recorded as assets to be attributed to the DAPE. Moreover, showing the goods as assets of the DAPE would also imply that the company records a goods dealing between the head office and the DAPE which would have to be taken into account at the market price (arm’s length price) of the goods.

4. Conclusion if in Example 1 an approach other than the AOA applied

No other conclusion would have to be drawn if the attribution of profits to permanent establishments followed the Relevant Business Approach.

5. No profits attributable to the DAPE in Example 1

Yes, in our understanding it is indeed appropriate to conclude that there will be no profits attributable to the DAPE after the payment of an appropriate fee to the DAE under Article 9.

In this regard, we would like to point out that despite there being no change in the allocation of taxable income taxpayers will face a significant increase of compliance and associated costs.

Further, we are concerned that the fact that a DAPE is established under the revised definition tax authorities may perform the analysis not consistently and allocate a taxable income to the DAPE. There are concerns that dissenting interpretations by tax authorities in different countries may lead to an increased risk of double taxation for taxpayers and to increased tax compliance costs for dispute resolution.

6. Agreement with the construction of profits or losses in Example 2

In principle, agreed; please note, however, that the facts and circumstances in Example 2 do not make it perfectly clear whether the “responsibility” of Sellco indeed gives rise to reporting sales and cost of goods sold in the DAPE.

First, the facts tell us that Sellco is responsible for warehousing the inventory and determining and monitoring the appropriate inventory levels. The presentation of the facts, however, does not make clear the terms and conditions of Sellco’s responsibility on which Prima and Sellco would have reached agreement in a third party context. Moreover, the presentation of the facts does not go into the question of where this warehouse is located. Since it is said that the facts in Example 2 are the same as those in Example 1, there is good reason to believe that this warehouse is operated in Country A.

Second, the analysis of the controlled transaction between Sellco and Prima under Article 9 is based on the assumption that Sellco has the capacity to determine warehouse arrangements and the stocking levels, and actually performs the decision-making functions about inventory levels required for sales in Country B. Moreover, it is said that, contrary to the contractual agreement, Prima does not take such decisions and produces to Sellco’s orders. Here, the presentation of the facts is silent on whether Sellco’s capacity is that of a service provider or that of a principal company (even if the OECD concludes that Prima produces to Sellco’s orders, i.e., deeming that Sellco operates in the capacity of a principal company).

Third, the facts make it clear that Sellco carries out comprehensive functions with respect to customer credit including the collection of customer receivables. Here again, the presentation of the facts does not elaborate on whether Sellco’s functions are those of a financial service provider, those of a principal company, or those of, for example, a factoring company.

Having said that, regarding the analysis of the controlled transactions between Prima and Sellco under Article 9 it is somewhat unclear precisely what type of risk is allocated to Sellco. Recall that the inventory ownership is with Prima until title passes directly to the customers and the warehouse may be operated in Country A. Where ownership of inventory and receivables belong to Prima, inventory losses and bad debt losses can hardly be allocated to Sellco. This holds even more so as/if the warehouse is operated in Country B (although there may well exist some kind of compensation claim on the part of Prima vis-à-vis Sellco). By the same token we do not understand, how, from the accounting perspective, commission income fits with bad debt losses and inventory losses where the receivables and the inventory are reported in the financial statement of Prima (even if it is taken into account that the commission income includes some risk premium).

As far as the analysis under Article 7 and step 1 of the AOA is concerned, the significant people functions of DAE on behalf of Prima give rise to the allocation of inventory and receivables to the DAPE.

We do not think, however, that we should go so far as to say that such significant people functions constitute “economic ownership” for the DAPE in inventory and receivables since the concept of economic ownership may vary among the OECD countries, and we should take into account that legally, the DAPE forms part of Prima, which is the (legal) owner of these assets.

Under Article 7 and step 2 of the AOA it should be taken into account that, where inventory and receivables are allocated to the DAPE, this permanent establishment should also be allocated the possible inventory losses and bad debt losses (taking into account possible compensation claims vis-à-vis the DAE). Such representation of the DAPE P/L does not have to lead to different results. Therefore, depending on the precise type of risk allocated to Sellco, we agree on the conclusion that the DAPE reports sales return, COGS, and sales commission to Sellco and is allocated a funding return from its functions in relation to its inventory assets.

7. Conclusion if in Example 2 an approach other than the AOA applied

If the attribution of profits to permanent establishments followed the Relevant Business Approach, there would be no significant people function to advocate the attribution of inventory and receivables to the DAPE. Therefore, leaving aside the fact that Article 9 now requires additional income remunerating possible risks allocated to the DAE (which is outside the scope of the AOA or RBA), no funding return from DAPE’s functions in relation to its inventory assets and receivables would be allocated under the RBA. However, it should be noted that proper attribution of income based on the causation principle should result in no different allocation of profits to a DAPE.

8. Consequences if in Example 2 Sellco does not have the financial capacity to assume the inventory and credit risks

Allocating risks under Article 9 requires that the company needs to control the risk and has the financial capacity to assume the risk. Where no associated enterprise can be identified that both exercises control over risk and has the financial capacity to assume the risk, the OECD/G20 BEPS report on action items 8- 10 proposes to perform a rigorous analysis of the facts and circumstances of the case in order to identify the underlying reasons and actions that led to this situation. Since such an analysis is not possible in the case at hand, it is difficult to come up with a ready-made solution. However, if the case may be that Sellco’s activities regarding inventory and credit to customers take the form of an outsourced service on behalf of Prima, according to which Prima sets the objectives of the outsourced activities, assesses whether these objectives are met, and has the power to hire or fire the service provider, Prima would exercise control over inventory risk and credit risk. If it is found that Sellco performs significant people functions on behalf of Prima in relation to inventory (warehousing and establishing inventory levels) and credit to customers (parameter setting, sales approval based on review of customer’s creditworthiness and collection of customer receivables), for purposes of Article 7 and the AOA, inventory, receivables, inventory and credit risk would have to be attributed to the DAPE.

This is because Sellco performs the significant people functions relevant to the attribution of inventory, receivables and the corresponding risks on behalf of Prima in Country B.

9. Views relating to the fact that in Example 2 the same functions that are considered under the Article 9 analysis are also taken into account under Article 7

It appears somewhat puzzling that the inventory and credit risk is allocated to both the DAPE and the DAE. This holds even more so as Prima is the owner of the corresponding assets, effectively carries the risk, and, due to the lack of any contractual agreement, has no legal means to claim for any compensation. The reason for this atypical outcome lies in the discrepancy between the allocation of asset ownership to Prima on one hand and the allocation of risk of bad debt and inventory losses to the agent (Sellco) on the other (see above answer to question number 6). Whereas the allocation of both ownership and ownership risk to the DAPE is a matter of fact leaving the legal attribution unchanged (i.e., it stays with Prima), carrying “ownership risks” in economic terms requires a legal instrument on the basis of which such risks may materialize on the part of the “economic owner” (for example on the basis of an insurance contract). Where such legal means are missing, it should be necessary to identify the missing legal relationship in order to be in line with what third parties do. Abstaining from such identification of the (possible) legal relationship underlying the transactions between third parties may adversely affect the analysis of risks in commercial and financial relations in terms of transparency and traceability.

10. Agreement with the construction of profits or losses in Example 3

Agreed

11. Conclusion if in Example 3 an approach other than the AOA applied

If the attribution of profits to permanent establishments followed the Relevant Business Approach, there would be no significant people function to advocate the attribution of inventory and receivables to the DAPE. Therefore, leaving aside the fact that Article 9 now requires additional income remunerating possible risks allocated to the DAE (which is outside the scope of the AOA or RBA), no funding return from DAPE’s functions in relation to its inventory assets and receivables would be allocated under the RBA. However, it should be noted that proper attribution of income based on the causation principle should result in no different allocation of profits to a DAPE.

12. Agreement with the construction of profits or losses in Example 4

Agreed

13. Agreement with profits and losses in Example 4 over and above the fee payable to Sellco

From our perspective, in Example 4 allocating profits and losses resulting from credit risk and bad debts under Article 9 and Article 7 and step 1 AOA appears not to be contradictory (see the “whereas” in question 13). In the first case, the allocation is made on the basis of the (possible) contractual agreement between Sellco and Prima (i.e., head office plus DAPE), which according to the OECD’s assumptions for this example is in line with the arm’s length principle (were this not so, in case of doubt a different allocation basis would have to be found). The second case, however, is a matter of allocation between the head office and the DAPE, which in the (inevitable) absence of any contractual basis takes place based on the sharing of significant people functions measured by the respective contributions to credit management cost for Country B customers. This is what was assumed for purposes for the example, although it is possible to assume otherwise (in Germany, for example, this risk would in principle have to be allocated to the head office since this permanent establishment of Prima takes on the main responsibility, and is in charge of the main decisions, in this respect). In any case this latter allocation of profits and losses to the head office and the DAPE must also be in line with the arm’s length principle.

14. Agreement with the construction of the profits or losses in Scenario A of Example 5 under the AOA

Agreed; again, the question is, however, whether “economic ownership” (here, of the warehouse) can be allocated to the permanent establishment as part of a company which is the legal owner. We would prefer to talk about attribution of the warehouse in terms of significant people functions.

Moreover, a future revision of 2010 Report on the Allocation of Profits to Permanent Establishments should consider placing the focus more generally on “people functions” when attributing assets (as is the case, for example, in the context of attributing assets based on the place of use) and risks.

15. Agreement with the conclusion reached in Scenarios B and C of Example 5 under the AOA

We agree with the conclusion reached in Scenario C.

However, in relation to Scenario B we have the following comments. We understand that warehousing is not the core business of WRU and the warehouse PE operates as a cost centre. As the employees only perform routine functions on behalf of WRU, there is only a limited base for allocating taxable (sales) income to the PE. Further, we think the PE should be allocated a service fee which basically equals the cost of workforce and running expenses. Where warehouse operates as a cost centre and only routine functions are performed by its employees there should be no (additional) fees payable for know-how or services related to inventory usage. In this context the provision of know-how etc. are auxiliary means.

Therefore, taxpayers should be spared the complex determination of a transfer price for a sheer internal provision of auxiliary services.

16. Agreement with the attribution of an investment return where no personnel of the non-resident enterprise is operating in the PE

Agreed, since the warehouse is run by a service provider under a service level agreement.

17. Agreement with the streamlined approach in this example (no functions performed in the PE); how would you identify the investment return?

Basically yes. Please note, however, that in scenario B and C (to which this question refers) the warehouse is run by employees or a service provider on behalf of the non-resident company in the PE country. From an accounting perspective, the company would have to report the remuneration for routine services and the cost of workforce or the fee to Wareco for operating the warehouse in its P/L. Where the non-resident enterprise would be subject to the obligation of setting up a financial statement for its PE in Country W, no simplification would arise from such streamlined approach for tax purposes. In order to identify the investment return, the return on assets of selected leasing companies for property could serve as appropriate comparables.

18. Agreement with attributing no profits to the PE where the non-resident enterprise has no personnel operating at the fixed place of business PE and significant people functions performed by other parties on their own account do not lead to the attributions of assets and risks to the PE

Agreed

19. Any difference in the outcome in the attribution of profits if Wareco were a related enterprise

We do not see any difference.

20. Conclusion, if in the applicable tax treaty an approach other than the AOA is applied; what would be the differences?

If the attribution of profits to permanent establishments followed the Relevant Business Approach, there would be no people function to advocate the attribution of the warehouse to the PE since WRU's asset is used in Country W. However, immovable property creating a permanent establishment is always attributable to this PE since according to DTC's the taxing rights on immovable property are allocated to the country hosting the permanent establishment. As a consequence, we would see no difference.