

# **Libero Istituto Universitario**

## **Carlo Cattaneo**

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*Permanent establishments*

Prof. Marco Cerrato

# **Permanent establishment**

## **“International legal framework”**

- The 1923 Report of the Economists Group
- The 1925 Report
- The 1927, 1928, 1931, 1933 Models
- The Mexico and London Model Tax Conventions
- The OECD Model Tax Conventions
- OECD BEPS Final report on Action 7 and the Multilateral Instrument (MLI)

# Permanent establishment

## “International legal framework” – MLI

- Four BEPS actions propose changes to tax treaties:
  - hybrid mismatches (Action 2)
  - treaty abuse (Action 6)
  - the artificial avoidance of PE status (Action 7)
  - improvements to dispute resolution (Action 14)
- With over 3,000 bilateral tax treaties, the MLI constitutes a vehicle for the quick implementation of treaty-related BEPS measures
- Mechanics of the MLI:
  - parties may opt out of provisions of the MLI (or part of a provision in some cases) through specific provisions allowing for reservations
  - some provisions (including the one relating to the PE) allow Parties to choose to apply one or none of two or more options
  - where a Party selects a particular option, the option will generally apply only to the Treaties for which the other Party has chosen the same option (NB this is not the case with the minimum standard)

# Permanent establishment

## “Italian legal framework”

- **Legislative Decree 12 December 2003, No. 344:**
  - **Art. 162** of the Presidential Decree 22 December 1986 No. 917 (Consolidated Income Tax Act, “CITA”);
    - **PE definition:**
      - Applies for **Income Tax** and **IRAP** (regional tax on productive activities) purposes only (not applicable for **VAT** purposes);
      - Differences and relationship with Treaties;
    - Additional definition of PE: a “*significant and continuous economic presence in the territory of Italy, built in such a way that it will not result in a physical presence in Italy*”
  - **Art. 152 of the Presidential Decree 22 December 1986 No. 917** (Consolidated Income Tax Act, “CITA”);
    - Determination of the incomes of Italian PEs;

**"MATERIAL" PE**

# Permanent establishment

## “Basic rule”

- In order for a PE to be deemed to exist, there must be a **place of business**:
  - **Fixed** from a geographical as well as a temporal perspective;
  - **at the disposal** of the enterprise;
  - through which its **business** is carried on.
- The relation of instrumentality between the PE and the foreign enterprise's business activity;

# Permanent establishment

## “Place of Business”

- Physical characteristics;
- The human presence is irrelevant;
- No formal legal right to use the fixed place is required;
- Irrelevance of the exclusive availability of the place of business by the foreign enterprise;
- **Case No. 8 of the OECD Discussion Draft:**
  - General Contractor resident in State R which carried on its business activities in State S by means of a Sub Contractor;
  - **Working party:** the place where the Subcontractor carries on its activities should be deemed to be “**at disposal**” of the General Contractor where the latter has the legal possession of the place, controls access to and use of the place and has overall responsibility for what happens at that location during that period.

# Permanent establishment

## “Fixed Place of Business”

- Fixed place and movable activities;
- Fixed place and activities carried out within a specific geographic area;
- **Case No. 5 of the OECD Discussion Draft:**
  - Shop located on a ship that navigates in international waters;
  - **Working party:** There is no PE (*“unless the operation of the ship or boat is restricted to a particular area that has commercial and geographic coherence”*).



# Permanent establishment

## “Permanence”

- Fixed place and activities carried out within a specific geographic area;
- Irrelevance of the time period provided for construction sites;
- International duration vs actual duration;
- *Dies a quo* and termination of the PE.

# Permanent establishment

## “Permanence”

- **Temporary interruptions and activities repeated over the time:**
  - **Case No. 6 of the OECD Discussion Draft:**
    - An enterprise of State R carries on drilling operations in State S. The seasonal conditions at that location prevent such operations from going on for more than three months each year but the operations are expected to last for 5 years.
    - **Working party:** The time requirement for a permanent establishment is met due to the recurring nature of the activity regardless of the fact that any continuous presence lasts less than 6 months.
  - Movable and seasonal activities;
  - Services and consultant industries.

# Permanent establishment

## “Positive list”

- **The expression "permanent establishment" shall include (illustrative list):**
  - a place of management;
  - a branch;
  - an office;
  - a factory;
  - a workshop;
  - a mine or an oil or gas well, a quarry or other place for the extraction of natural resources, including areas outside the territorial waters.
- Relationship between the illustrative list and the basic rule;
- Italian observation to the OECD MTC.

# Permanent establishment

## BEPS Action 7

- According to the existing provisions, a PE arises when work on a construction site lasts at least 12 months
- In order to prevent splitting up contracts artificially into shorter periods, the OECD advocates for a principal purposes test, or a specific provision that **allows for combining the activities of the related enterprises carried out at one construction site during different periods of time**, each exceeding 30 days, when determining the duration of work
- **MLI - Most relevant countries that have opted out:** Italy, Germany, Luxemburg, UK, Austria → no changes to the Treaties concluded

# Permanent establishment

**“Construction, assembly or installation site”**

- Origin of the provision;
- Consequences of the autonomy definition and significance of the twelve month threshold;
- Offices related to construction sites;
- Peculiarity of Art. 162 CITA: duration and supervision activities.

# Permanent establishment

## “Negative list”

- History of the negative list;
- Relationship with basic rule, positive list, construction sites and agents;
- The use of a place of business for the sole purpose of carrying out any other preparatory or auxiliary activities for the enterprise;
- The concept of “*essential and significant part of the activity for the enterprise as a whole*”;
- The importance of the fact that the place of business carries on preparatory or auxiliary activities only;
- The importance of the fact that the preparatory or auxiliary activities are carried out for the enterprise.

# Permanent establishment

## “Negative list”

- The term “**permanent establishment**” shall be deemed **not to include** (Art. 5(4) OECD MTC):
  - a) the **use of facilities** **solely** for the purpose of **storage, display or delivery of goods or merchandise** belonging to the enterprise;
  - b) the **maintenance of a stock of goods or merchandise** belonging to the enterprise **solely** for the purpose of **storage, display or delivery**;
  - c) the **maintenance of a stock of goods or merchandise** belonging to the enterprise **solely** for the purpose of **processing by another enterprise**;

# Permanent establishment

## “Negative list”

- d) the **maintenance** of a **fixed place of business** **solely** for the purpose of **purchasing goods** or merchandise or of **collecting information**, for the enterprise;
- e) the maintenance of a fixed place of business **solely** for the purpose of carrying on, for the enterprise, **any other activity** of a **preparatory or auxiliary character**; **(BEPS concern)**
- f) the **maintenance** of a fixed place of business **solely** for **any combination of activities** mentioned in subparagraphs a) to e), provided that the **overall activity** of the fixed place of business **resulting from this combination is of a preparatory or auxiliary character**.



# Permanent establishment

## “Negative list”

- **Combination of preparatory or auxiliary activities:**
  - The condition according to which **all the combined activities** are carried out **within the same place of business**;
  - The condition according to which **all the combined activities should lie within the negative list**;
  - The condition according to which **the activity resulting from such combination** has, in turn, **a preparatory or auxiliary nature**;
  - Art. 162 CITA and the Italian Treaty practice.

# Preparatory and Auxiliary activities

## “BEPS Action 7”

- **BEPS concerns:**

- Depending on the circumstances, activities **previously** considered to be merely preparatory or auxiliary in nature may **nowadays** correspond to **core business activities** (i.e. **digital economy**);
- **Fragmentation of a cohesive operating business** into several small operations in order to argue that each part is merely engaged in preparatory or auxiliary activities that benefit from the exceptions of Art. 5(4).

# Preparatory and Auxiliary activities

## “BEPS Action 7”

- **Solutions:**
  - **Amendments** to **Article 5(4)** in order to ensure that each of the exceptions included therein is restricted to activities that are otherwise of a “preparatory or auxiliary” character;
  - Introduction of **Art. 5(4.1)**:
    - **Anti-Fragmentation rule.**

# Preparatory and Auxiliary activities

## “BEPS Action 7”

- The Activities provided by Art. 5(4) **should not be automatically considered “auxiliary and preparatory”**;
- The nature of such **activities** should be **assessed** on the basis of the **overall business activity**;
- It should be ascertained whether the activities performed within the same State:
  - “constitute **complementary functions**”;
  - “are **part of a cohesive business**”.

# Preparatory and Auxiliary activities

## “BEPS Action 7”

- **Preparatory Activity**

- “...is one that is carried on in **contemplation** of the carrying on of what constitutes the **essential and significant part of the activity** of the **enterprise as a whole**.”;
- “carried on during a relatively **short period**”.

- **Auxiliary Activity**

- “...carried on to **support, without being part of, the essential and significant part of the activity** of the enterprise as a whole.”;
- “It is unlikely that an activity that requires a significant proportion of the assets or employees of the enterprise could be considered as having an auxiliary character.”.

# **Preparatory and Auxiliary activities**

## **“BEPS Action 7”**

- **MLI - Countries that have opted for the amendment of the Treaties with regard to the specific activity exemptions:** Austria, Germany, Italy, Netherlands, Russia

# Anti-Fragmentation-rule

## “BEPS Action 7”

### Art. 5(4.1) OECD MC:

*“Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and*

*a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or*

*b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,*

***provided that the business activities*** carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, ***constitute complementary functions that are part of a cohesive business operation.***”

# Anti-Fragmentation-rule

## “BEPS Action 7”

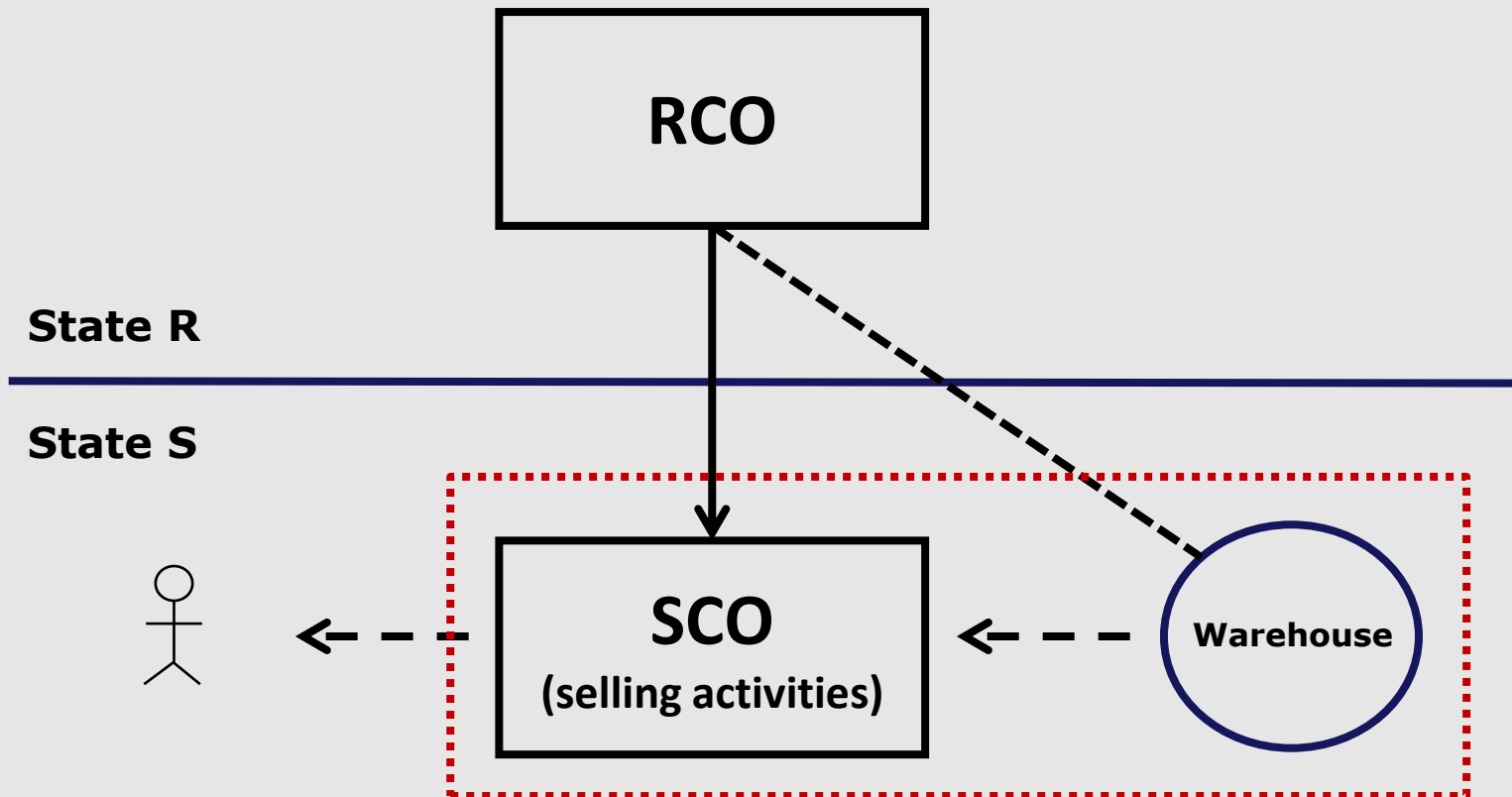
- **Example:**

- **RCO manufactures** and sells appliances;
- **SCO** owns a **store** where it **sells appliances** that it acquires from RCO;
- **RCO** owns a small **warehouse** in State S where it **stores** items that are identical to some of those displayed in the store owned by SCO;
- When a customer buys such a large item from SCO, SCO employees go to the warehouse where they take possession of the item before delivering it to the customer;
- The ownership of the item is only acquired by SCO from RCO when the item leaves the warehouse;
- Para. 4.1 prevents the application of the exceptions of para. 4 (i.e. the negative list) to the warehouse and it will not be necessary, therefore, to determine whether sub-para. 4 a), applies to the warehouse.



# Anti-Fragmentation-rule

## “BEPS Action 7”



**Complementary functions that are part of a cohesive business operation**

# Anti-Fragmentation-rule

## “BEPS Action 7”

- **Existence of a PE since:**
  - SCO and RCO are closely **related enterprises**;
  - **SCO’s store constitutes a permanent establishment of SCO** (the definition of permanent establishment is not limited to situations where a resident of one Contracting State uses or maintains a fixed place of business in the other State; it applies equally where an enterprise of one State uses or maintains a fixed place of business in that same State); and
  - The **business activities carried on by RCO** at its **warehouse** and by **SCO** at its **store** constitute **complementary functions** that **are part of a cohesive business operation** (i.e. storing goods in one place for the purpose of delivering these goods as part of the obligations resulting from the sale of these goods through another place in the same State).

# **Anti-Fragmentation-rule**

## **“BEPS Action 7”**

- **MLI - Countries that have opted for the amendment of the Treaties with regard to the specific activity exemptions:** Belgium, France, Italy, Netherlands, Norway, Russia, Spain

# **AGENCY PE**

# Permanent establishment

## “Agency PE”

- “Material” PE vs Agency PE;
- Dependent vs Independent agent;
- Subjective requirements of the Agency PE and the meaning of “person”.

# Permanent establishment

## “Agency PE”

- **Powers of the “person”:**
  - Irrelevance of “in the name of..” in the context of the sale (i.e. substance over form approach);
  - Conducting binding negotiations is considered as exercise of the power to conclude contracts (Supreme Court No. 7682/2002 and No. 17206/2007: the participation in negotiations has an evidential value);
  - Transposition of the concept of “Agency PE” to the UN Model as regards situation where there is no “power of representation”.

# Permanent establishment

## “Agency PE”

- Subject of the contracts concluded by the intermediary;
- Negative list: differences between the OECD MTC and the Art. 162 CITA;
- The habitual exercise of the authority to conclude contracts (Art. 162 CITA);
- Irrelevance of the place of residence of the intermediary;
- The effects of the Agency PE.

# Permanent establishment

## “Agency PE”

- **No Agency PE if the intermediary is independent provided that it acts in the ordinary course of its business:**
  - Derogation provision and types of intermediary;
  - Independence:
    - **Action 7 BEPS:** an agent acting exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related shall not be considered to be an independent agent;
  - The Independent Agent must act in the **ordinary course of its business**;
- **Art. 162 TUIR: No PE in case of shipping agents**



# **Permanent establishment**

## **“PE and Corporate Control”**

- The irrelevance of the corporate control under the Model Tax Conventions;
- Corporate Control and Agency PE;
- Corporate Control and “Material” PE (office and/or place of management);

# Permanent establishment

## “ Corporate Control - The Italian case law ”

- **Supreme Court Decision No. 7862 of 25 May 2002 (Philip Morris):**
  - the **supervision or control** of the performance of a **contract** between a resident entity and a non-resident entity **cannot be considered**, in principle, to be an **auxiliary activity** within the meaning of Art. 5(4) OECD Model;
  - the **participation** of representatives or employees of a resident company in a phase of the **conclusion of a contract** between a foreign company and another resident entity may fall within the concept of authority **to conclude contracts in the name of** the foreign company; and
  - the fact that the non-resident company entrusted the resident company with the **management** of some **of** its **business operation** makes the latter a **PE** of the former.
- **Amendments to the OECD Commentary and Italian observation (jurisprudence is not to be ignored)**

# **Permanent establishment**

## **“ Corporate Control - The Italian case law”**

- **Supreme Court Decisions No. 6799/2004, No. 13579/2007 and No. 3769/2012:**
  - Circumstantial evidence of the corporate control
- **Supreme Court Decisions No. 17206/2006:**
  - Circumstantial evidence of the facts that the same individuals operate within the group (principle mitigated by the Supreme Court Decision No. 3769/2012)

# Commissionnaire arrangements

## “Key issues”

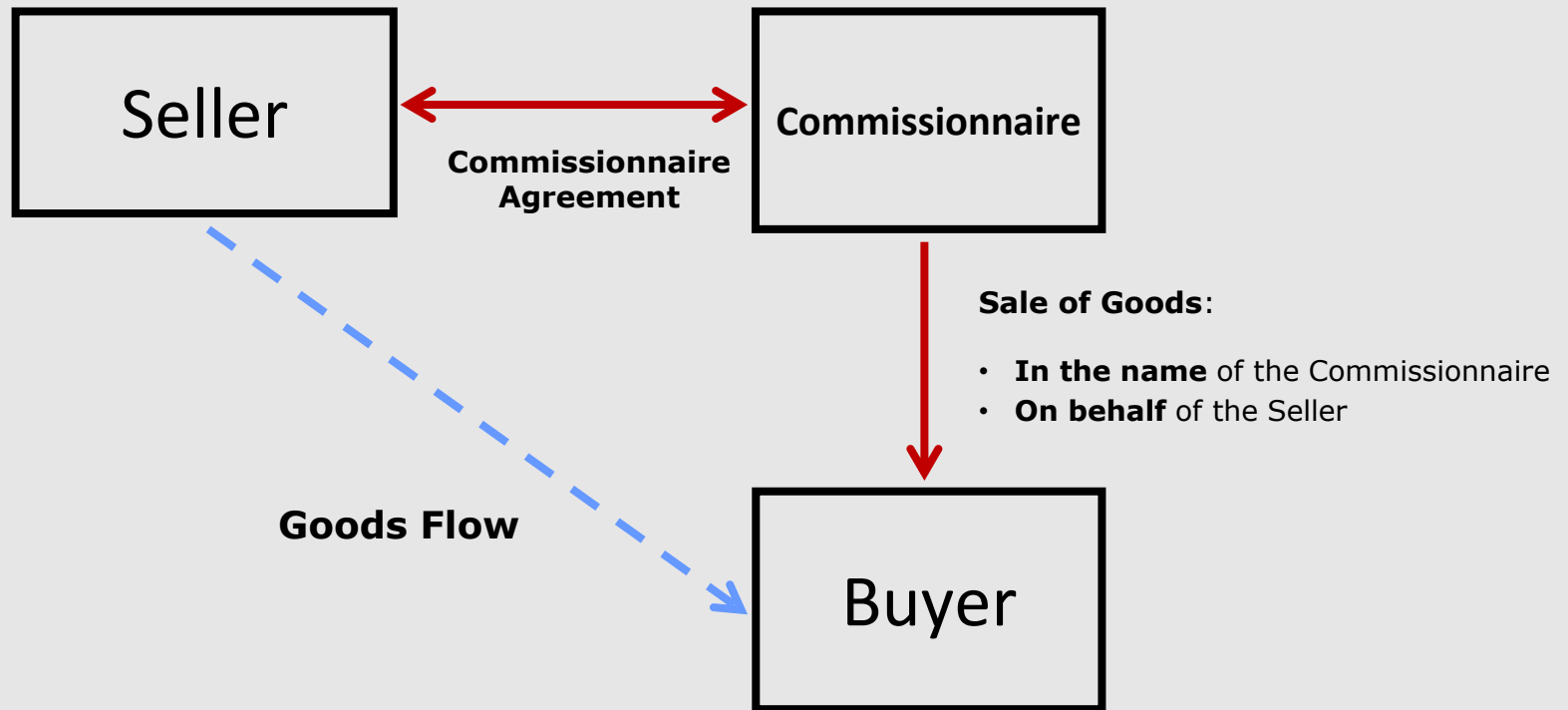
- **Key issues:**

- Arrangement through which a **person sells** products in a State in **its own name** but **on behalf of a foreign enterprise** that is the owner of these product;
  - The **foreign enterprise** is able to **sell** its products in a State **without having a PE** and, therefore, without being taxable in that State on the profits derived from such sales;
  - The **commissionaire** cannot be taxed on the profits derived from such sales (it does not own the products that it sells) and **may only be taxed on the commission** it receives for its services;

# Commissionnaire arrangements

## “Exemplification”

- Italian Tax Authorities: Commissionnaire = Dependent Agent



# Commissionnaire arrangements

## "Italian Case Law"

- **Regional Tax Court, No. 137/2009, Supreme Court n. 3769/2012 ("Boston" case):**
  - Judgments in favor of the taxpayer;
  - The stock control may not be used as the sole element to establish the degree of dependency of the subsidiary;
  - The indication by the parent company of the directors and auditors of the subsidiary are an "inevitable event" and irrelevant;
  - Evidences of Independency:
    - The client, in case of product defectives, may act against the Italian company only;
    - The subsidiary may transfer its own trade receivables autonomously.

# Commissionnaire arrangements

## "Italian Case Law"

- **Regional Tax Court No. 125/02/11:**
  - Judgment in **favor of the taxpayer**;
  - An Italian company acting as **commissionnaire** for its parent **does not qualify as a PE** if, as from the **contract**, it may be **assumed** that:
    - It assumes all the **business risks** related to the activities performed;
    - It may not enter into contracts **in the name of** and **on behalf of** its **parent company**.

# Commissionnaire arrangements

## "International Case Law"

- **French Supreme Administrative Court, 31 March 2010, ("Zimmer" case) and Norwegian Supreme Court, 2 December 2011 ("Dell" case):**
  - **Formalistic approach:**
    - A commissionaire should not be deemed to be an Agency PE whether the contracts concluded in its own name and on behalf of the principal are not binding for the principal;
    - However, The Tax Authorities may still reject the nature of the contract;



# Commissionnaire arrangements

## "International Case Law"

- **Spanish Supreme Court, 12 January 2012, ("Roche" case):**
  - **Substantial approach:**
    - The promotional activities carried out by Roche Swiss were broad and the manufacturing activities were performed under Swiss Roche's instructions;
    - Roche Swiss had leased from Roche Spain a warehouse to store the products to be distributed;
    - The fact that Roche Spain could not conclude contracts in the name of Swiss Roche was not considered essential;

# Commissionnaire arrangements

## "International Case Law"

- **Spanish Supreme Court, 18 June 2014, ("Borax" case):**
  - **Confirmation of the substantial approach:**
    - No difference between the activities carried out by Borax Spain before and after the business restructuring;
    - Borax Spain held in Spain a "**complex business**" = (a **business cycle** was closed in Spain);
    - Borax Spain was deemed to be a Dependent Agent of Borax UK, due to the relevant contractual terms;

# Commissionnaire arrangements

## "BEPS Action 7"

- **BEPS Concerns:**

- Art. 5(5) relies on the **formal conclusion of contracts** in **the name of the foreign enterprise**;
- No PE in State of the *commissionnaire* by changing the terms of contracts without material changes in the functions performed in a State;

- **BEPS Solution:**

- **Changes** in the wording of **Art. 5(5)** of the OECD MC;
- Where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise should be considered to have a taxable presence in that country unless the intermediary is performing these activities in the course of an independent business

# OECD BEPS Action 7

## “Amendments to Art. 5(5) OECD MTC”

OLD	NEW
<i>[...] where a person — other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State <b>an authority to conclude contracts</b> [...]</i>	<i>[...] where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, <b>habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise</b></i>

# OECD BEPS Action 7

## “Amendments to Art. 5(5) OECD MTC”

OLD	NEW
<i>[...] in the name of the enterprise [...]</i>	<i>a) in the name of the enterprise, <b>OR</b> b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or c) for the provision of services by that enterprise [...]</i>

# Commissionnaire arrangements

## "BEPS Action 7"

- **Is there a PE in case of a Distributor (company)?**
- **The principal role leading to the conclusion of contracts:**
  - Where a person who **convinced the third party to enter into a contract with the enterprise** (i.e. price, contractual terms in general, etc..) even if (i) the contracts are standardized or (ii) the relevant prices are set by a computer tool;
  - **Remuneration** of the person interacting with the third parties based on its **turnover**;
  - Excluded in case of mere **promotional/marketing activities** relevant to the **product characteristics** (i.e. **pharmaceutical representative**).

# **Commissionnaire arrangements**

## **“BEPS Action 7”**

- **MLI - Countries that have opted for the amendment of the Treaties with regard to the Commissionnaire arrangements:** France, Netherlands, Norway, Russia, Spain
- Italy made a reservation on the new PE definitions in the MLI