

# **LIUC – Università Carlo Cattaneo**

International Tax Law

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*Agency Permanent Establishment and  
Digital Economy*

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**“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”;
- Irrelevance of the State of residence of the intermediary.

# Permanent establishment

## “Agency PE”

- It is a generally accepted principle that an enterprise should be treated as having a permanent establishment in a State if there is under certain conditions **a person acting for it**, even though the enterprise may not have a fixed place of business in that State within the meaning of Art. 5(1) and 5(2).
- Art. 5(5) stipulates the conditions under which an enterprise is deemed to have a permanent establishment in respect of any activity of a person acting for it.

# Permanent establishment

## “Agency PE”

- Agency PE has been introduced in order to provide to the Contracting States the right to tax a foreign enterprise which is significantly involved in the economic life of a State without the possession of a fixed place of business in that State.
- OECD MC Commentary on Art. 5(5): if it can be shown that the foreign enterprise has a Material PE, it is not necessary to show that the agent is a person who would fall under Art. 5(5).

# Permanent establishment

## “Agency PE”

- Persons whose activity may create a permanent establishment for the enterprise are persons, whether or not employees of the enterprise, who act on behalf of the enterprise and are not doing so in the course of carrying on a business as an independent agent.
- Such persons may be either individuals or companies.

# 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 situations where there is no “power of representation”.

# Permanent establishment

## “Agency PE”

- A person is acting in a Contracting State on behalf of an enterprise when that person involves the enterprise to a **particular extent** in business activities in the State concerned.
- E.g. agent acting for principal, partner acting for partnership, employee acting for employer.
- A person cannot be said to be acting on behalf of an enterprise if the enterprise is not directly or indirectly affected by the action performed by that person.



# Permanent establishment

## “Independent agent”

- A foreign enterprise is not deemed to have a PE in a Contracting State if the agent:
  - is independent
  - acts in the ordinary course of his/her business.
- This rule is an exemption to Art. 5(5).

# Permanent establishment

## “Independent agent”

- The independence of the agent has to be both juridical and economic:
  - **JURIDICAL**: it depends on the extent of the powers granted to the agent and on its degree of responsibility for his duties, e.g. if the foreign enterprise exercises a high control and if the agent acts on behalf of specific instructions provided by his/her principal.
  - **ECONOMICAL**: it depends on whether the entrepreneurial and economic risks have to be borne by the agent or by the foreign enterprise. If all the entrepreneurial risk is borne by the enterprise, it is highly unlikely that the agent is independent.

# 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

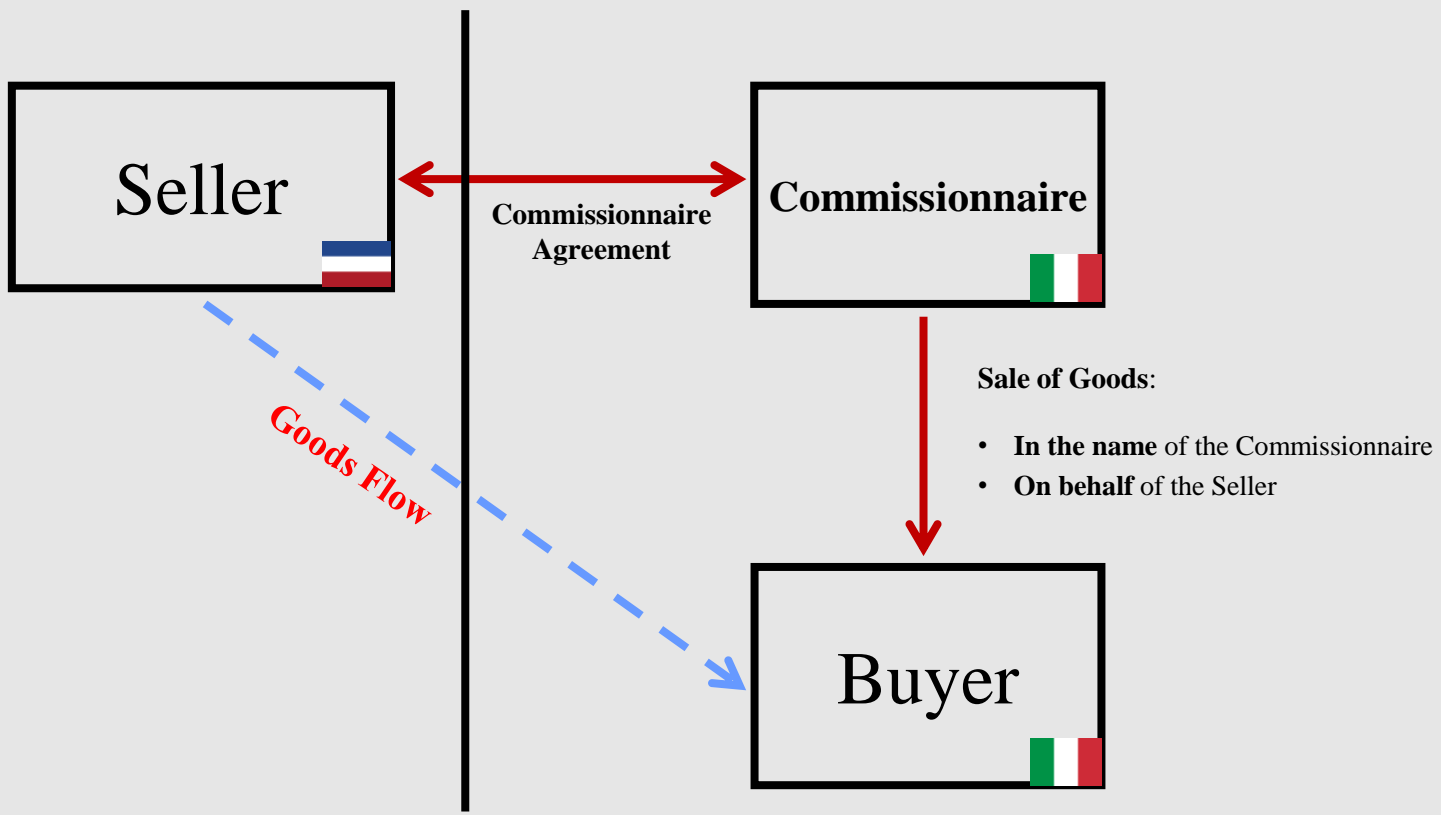
## “Key issues”

- 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

## “Example”

- 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 corporate 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<sub>19</sub> 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)** and **Art. 5(6)** 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
<p><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></p>	<p><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></p>

# OECD BEPS Action 7

## “Amendments to Art. 5(5) OECD MTC”

OLD	NEW
<p data-bbox="150 539 886 586"><i>[...] in the name of the enterprise</i></p> <p data-bbox="150 625 239 672"><i>[...]</i></p>	<p data-bbox="902 539 1609 586">a) <i>in the name of the enterprise, <b>OR</b></i></p> <p data-bbox="902 625 1798 925">b) <i>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</i></p> <p data-bbox="902 963 1798 1096">c) <i>for the provision of services by that enterprise [...]</i></p>

# OECD BEPS Action 7

## “Amendments to Art. 5(6) OECD MTC”

OLD	NEW
<p><i>[...] 6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. [...]</i></p>	<p><i>[...] 6. Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an enterprise of the other Contracting State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business.</i></p> <p><i><b>Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise</b></i></p> <p><i>[...]</i></p>



# 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**).
- Agents are not considered independent when they act **exclusively or almost exclusively on behalf of one or more enterprises** to which they are closely related

# Commissionnaire arrangements

## *“BEPS Action 7”*

- **OECD Model Convention (2017)**
- Transposal of new wording of Art. 5(5) and Art. 5(6) and consequent amendments to the Commentary
- New reference standard for future DTC

# Commissionnaire arrangements

## *“BEPS Action 7”*

- **MLI – Art. 12**
- Aimed at challenging the artificial avoidance of PE status through Commissionnaire arrangements and similar strategies (in line with the rationale of OECD changes to 2017 Model)
- **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

**TAX CHALLENGES  
POSED BY THE  
DIGITAL ECONOMY**

# Tax challenges posed by the digital economy

## “Introduction”

- One of the major technological innovations of the late twentieth century was the development and widespread use of the Internet.
- The term «**digital economy**» refers to the product of information and communication technologies featuring global connectivity on a 24/7 basis through a variety of devices.
- The digital economy has resulted in the development of several new models for doing business.

# Tax challenges posed by the digital economy

## “Issues”

- Digital economy is characterized by:
  - an unparalleled reliance on intangibles;
  - the massive use of data (notably personal data);
  - the widespread adoption of multi-sided business models;
  - the difficulty of determining the jurisdiction in which value creation occurs.

# Tax challenges posed by the digital economy

## “Impact on taxation”

- **Nexus:** identification of new territorial connection elements
- **Data:** use and relevance for the value creation market
- **Characterization:** new digital products payments

# Tax challenges posed by the digital economy

## “Impact on taxation”

- One of the first issues for States that wish to tax income from the digital economy is whether the nonresident enterprises deriving the income meet the minimum domestic threshold for source country taxation.
- Problems on the existence of a *virtual PE*.



# Tax challenges posed by the digital economy

## “BEPS – Action 1”

- Aimed at dealing with tax challenges posed by the digital economy.
- BEPS concerns on digital economy are based on the fast development of the digital economy, on the importance that Internet covers in global market and on the progressive dematerialization of digital structures.
- BEPS Action 1 emphasizes that the fast development of the global market has not been followed by a development of tax systems.

# Tax challenges posed by the digital economy

## “BEPS – Action 1”

### BEPS PROPOSALS:

- New Nexus in the form of a "**significant economic presence**"
- **Withholding tax** on certain types of digital transactions
- **Equalisation levy**

# Tax challenges posed by the digital economy

## “BEPS – Action 1”

- The proposals are not alternative as they may be implemented jointly
- The OECD has not recommended any of the proposals, leaving States with the decision of implement domestic measures for taxing digital businesses in order to gather information about their practical application to which rely on in the future discussions
- Examples of domestic measures:
  - India (2016): implementation of an **equalisation levy** *i.e.*, a 6% withholding is levied on payments to foreign companies for online advertising services
  - Israel (2016): where a foreign corporation’s core activity is conducted through the Internet and certain factors, indicating a **digital presence** in the Israeli market, are found to exist, that corporation’s activity should constitute an Israeli PE

# Tax challenges posed by the digital economy

## “Country practice - Italy”

- **Italy** – amendment to Art. 162(2) CITA regarding the PE «positive list»:

*“The term “permanent establishment” includes in particular:  
[...] f-bis) a significant and continuous economic presence  
in the Italian territory that has been arranged in such a way  
that does not give rise to a physical presence therein”.*

# **Tax challenges posed by the digital economy**

## **“Country practice - Italy”**

**Scope (Dossier of the Study Service of the Senate of the Republic, November 2017)**

- Amendment of the criteria based on which a permanent establishment is deemed to exist in order to overcome the current link between physical presence in a State and liability to tax
- Introduction of a specific provision addressing digital companies
- The references to the elements of stability, temporal occurrence and economic dimension of the main activity have the purpose of preventing manipulations which challenge the PE qualification

# Tax challenges posed by the digital economy

## “Country practice - Italy”

### Critical issues

- Definition of «*significant and continuous economic presence*»
- Coordination with double taxation treaties and MLI