SMU-CET Research paper:

Necessity of the Dependent Agent Permanent Establishment

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A. Executive Summary

This paper evaluates the necessity of the dependent agent permanent establishment (DAPE) in the context of sales commission agents acting on behalf of a related party principal.

When a foreign company wants to sells goods or services to local customers in a country, it can adopt a sales commission structure. Under this structure, the appointed sales commission agent acts on behalf of the foreign company in exchange for a sales commission. Very often, in the setting of a multinational group, the sales commission agent is a related party of the foreign company and its scope of activities conducted on behalf of the foreign company could vary, depending on the arrangement with the foreign company. In most cases, the sales commission agent does not have the authority to conclude sales contracts in the name of the foreign company.

The Base Erosion Profit Shifting (BEPS) project initiated by the OECD aimed to address BEPS opportunities exploited by multinationals. Specifically, the artificial avoidance of permanent establishment (PE) by multinationals was addressed in BEPS Action 7 which led to amendments to the DAPE provisions in the revised OECD Model Tax Convention (MTC) 2017. The revisions to the DAPE provisions involve the expansion of the scope of Article 5(5) in MTC where agents who habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the foreign principal amongst others, will be regarded as DAPEs. In addition, there is a tightening of the independent agent provision in Article 5(6) of MTC 2017 where an agent acting exclusively or almost exclusively on behalf of closely related enterprises, cannot be treated as an independent agent.

Pre BEPS, it was unlikely that a sales commission agent would be regarded as a DAPE of the foreign principal as the DAPE provision in MTC 2014 and earlier versions required the presence of the sales commission agent exercising the authority to conclude contracts in the name of the foreign principal for determining a DAPE. In addition, Article 5(6) of MTC 2014 and earlier versions allowed a related party sales commission agent to benefit from the independent agent exception as long as the legal and economic independence criteria was satisfied.

Post BEPS, a sales commission agent who did not exercise authority to conclude contracts in the name of its foreign principal but habitually plays a principal role leading to the conclusion of contracts that are routinely concluded without material modification by the foreign principal, will be regarded as a DAPE. Furthermore, a sales commission agent who acts on behalf of a related party principal, may not benefit from the independent agent exception under Article 5(6) of the MTC 2017 if it is found to be acting exclusively or almost exclusively for the related party principal. Taking into account the abovementioned revisions post BEPS, it is likely that there will be a surge in the number of DAPEs for related sales commission agents scenarios, leading to increased compliance costs for taxpayers and administration costs for tax authorities. The authors are of the view that there will be a likely increase in tax disputes arising from the different interpretations of various terms used in the revised DAPE provisions.

When a DAPE is established, the source jurisdiction has taxing rights on the local sales commission agent (also known as the dependent agent enterprise) and the DAPE of foreign principal. The Authorised OECD Approach (AoA) is the OECD's recommended approach for the purpose of attributing profits to the DAPE. The AoA does not endorse the single taxpayer approach which assumes no profits to be attributable to DAPE after deduction of an arm's length remuneration to the dependent agent enterprise. In the case of a sales commission agent acting on behalf of a related principal, it is also necessary to determine an arm's

length remuneration of the sales commission agent under Article 9 of the MTC. The MTC does not explicitly dictate the order of application of Article 7 and Article 9 of the MTC.

This paper uses two numerical examples to determine the amount of profits to be attributed to the DAPE in a situation where a sales commission agent acts on behalf of a related party principal post BEPS. The numerical examples are also used to assess whether the total profits to be taxed by the source jurisdiction (whether under the dependent agent enterprise or the DAPE) would be affected by the order of application of Article 7 and Article 9 of the MTC. The base example involved a sales commission agent negotiating the key elements of sales contract with customers only whilst the varied example included a wide array of additional functions performed by the sales commission agent on top of negotiating the key elements of sales contract with customers.

The analysis of the numerical examples revealed the following key findings:

- In the case where there are no significant people functions performed by the sales commission agent (base example), there will be no profits attributable to the DAPE regardless of the order of application of Article 7 and Article 9.

- In the case where there are significant people functions performed by the sales commission agent (varied example), there will be an amount of profits attributable to the DAPE if the application of Article 7 precedes Article 9. Conversely, should the Article 9 analysis precede the Article 7 analysis, given the same fact pattern, there will be no profits attributable to the DAPE. However, the total amount of the amount of profits attributable to the DAPE and the profits for the sales commission agent (when Article 7 is applied before Article 9) equates the amount of profits for the sales commission agent when Article 9 analysis precedes Article 7. It should be noted that there is no loss of tax revenue to the source jurisdiction resulting from the order of application of Article 7 and Article 9.

Based on the analysis, the authors put forth the following recommendations.

- Countries to adopt the preferred order of applying Article 9 followed by Article 7 in the situation where the sales commission agent is a related party and ends up deeming a DAPE for the foreign principal.

  If this recommendation is adopted, there will never be profits attributable to DAPE arising from a sales commission agent in a related party setting. In cases where the sales commission agent is a third party enterprise or a non-employee individual and a DAPE is deemed, it is also likely that there are no profits attributable to DAPE since the remuneration paid to these parties extinguishes the profits attributable to DAPE. In these mentioned situations, it would be unnecessary to establish the existence of a DAPE with zero profits (also known as zero-profits PE). However, the authors recognize that there could be profits attributable to a DAPE created via the activities of an employee on behalf of the foreign principal.

- Countries to recognize zero-profits PEs and grant an PE exemption in their domestic tax laws or to revise the DAPE provision in their existing treaties to exclude zero-profits DAPE. This recommendation will eliminate the need of tax filing for the zero-profits DAPE and also reduce tax disputes arising from differing interpretations of the terms used in the revised DAPE provisions.

The paper concludes with the authors' views that it would be unnecessary to find a DAPE and conduct a profit attribution exercise in scenarios where DAPES are deemed via the activities of a related party sales commission agent.

B. Paper

1. Introduction

Under the OECD Model Tax Convention (MTC) 2017, Article 5(5) deems a dependent agent PE (DAPE) of a foreign person in a jurisdiction. This happens when a person is found to have acted on behalf of another foreign person in its own jurisdiction for example, a sales agent which habitually enters into contracts in the name of its foreign principal in its jurisdiction. When a DAPE of a foreign person is found in a jurisdiction, this would mean that the jurisdiction would have the first right to tax the profits attributable to the PE. The jurisdiction of the foreign person would also be able to tax the profits attributable to the PE as part of the profits of the foreign person. However, the jurisdiction of the foreign person would also have to provide relief in respect of the tax levied by the other jurisdiction in order to avoid double taxation.

The OECD MTC 2017 advocates the use of the authorised OECD approach (AoA) to determine the amount of profits that should be attributed to the DAPE. For profit attribution to DAPE, the AoA states that it would be necessary to determine and deduct an arm's length reward to the DAPE for the services it provides to the non-resident enterprise (taking into account its assets and its risks if any. The AoA recognizes that there is a possibility of finding zero or negligible profits attributable to the DAPE. [1]

The DAPE provision in the OECD MTC 2017 was recently revised under BEPS Action 7. The scope of Article 5(5) has been expanded making it easier to find DAPEs under more circumstances. Arising from this, theoretically, the possibility of finding a DAPE but with zero or negligible profits attributable to it has also increased. If such were to be the case, we question the usefulness of the DAPE concept for the PE jurisdiction in some of these circumstances. To begin with, it would be unlikely that much tax revenue would be collected from the PE. Unnecessary compliance burden would be placed on the foreign person and the PE. Additional administrative burden would also be placed on the relevant tax administration.

This paper focuses only on the DAPE situation involving sales commission agents which are related parties. The paper is divided into three segments. The first segment looks at the origins of the DAPE provision and its subsequent changes. This includes those of BEPS Action 7 which resulted in the revised DAPE provision in Article 5(5) of the OECD MTC 2017. The paper then examines how the use of sales commission agents could constitute a DAPE under the revised Article 5(5).

The second segment focuses on the attribution of profits using AOA in the context of DAPE created due to a dependent agent enterprise (DAE) acting on behalf of a related party non-resident enterprise (NRE). The order of application of Article 7 and Article 9 of the OECD MTC would then be examined followed by a discussion of the single taxpayer approach.

The third and final segment attempts to answer the following research questions through the use of worked examples involving a sales commission agent, which is a related party, when it is deemed as a DAPE under Article 5(5) of the OECD MTC.

1) Whether the order of application of Article 7 and Article 9 affects the total profits taxed by the PE jurisdiction?

[1] Paragraph 234 of the AoA.

2) What is the extent of profits that can be attributed to the DAPE under different scenarios by varying the functional profile of the related party sales commission agent?

3) Is there a necessity for the DAPE where the sales commission agent is a related party?

The paper concludes with recommendations on possible ways to reduce compliance burden for enterprises and yet assure jurisdictions of their fair share of taxes.

2 The origins of DAPE provision

2.1 League of Nation 1929 report

The origins of the DAPE provision can be traced to the League of Nations 1929 report which defined the terms "Autonomous Agent and Permanent Establishment"[2].

In the report, "a permanent establishment may be presumed to exist:

> (1) When the agent carries out the whole or part of his activities in an office or other premises placed at his disposal by the enterprise;
>
> (2) When the office or premises where the agent carries out the whole or part of his activities are designated by outward signs as being an establishment of the enterprise itself;
>
> (3) When the agent is habitually in possession, for the purposes of sale, of a stock of goods belonging to the enterprise, exclusive of samples;
>
> (4) When the agent, having a business headquarters in the country, is a duly accredited agent who habitually enters into contracts on behalf of the enterprise for which he works;
>
> (5) When the agent is an employee who habitually transacts commercial business on behalf of the enterprise in return for remuneration."

Points (3) and (4) relate to a DAPE which is created when an agent does work for its principal or handles goods belonging to its principal. Point (5) relates to a DAPE created when an employee of the foreign enterprise acts on behalf of the foreign enterprise. It is interesting to note that a DAPE created through the actions of another enterprise or non-employee individual is distinguished from a DAPE created by the actions of an employee in the report. The authors would like to highlight that it was already envisaged back then in time that there could be different tax implications arising from a DAPE created through the actions of an enterprise's own employee versus a DAPE created by through the actions of another enterprise or non-employee individual. We will revisit this point in the later part of this paper.

In the League of Nations 1929 Report, the concept of an independent agent was already established and embedded in the exceptions to the DAPE. This include:

[2]League of Nations Fiscal Committee: Report to the Council on the Work of the First Session of the Committee; C516.M.175.1929.II. Accessed on 8 March 2019 http://setis.library.usyd.edu.au/oztexts/parsons.html

- A broker who places his services at the disposal of an enterprise in order to bring it into touch with customers when such enterprise does not do so on its own, even if his work for the enterprise is continuous or carried on at regular periods.
- A commission agent (commissionnaire) who acts in his own name for any number of undertakings and receives the normal rate of commission
- The case of commercial travellers not coming under any of the above-mentioned categories.

This was the precursor of the subsequent formulation in the OECD MTC where brokers, general commission agent or any other agent of an independent status was excluded from being deemed as DAPE.

2.2 League of Nations Mexico (1943), London (1946) Draft and Working Party 1 OEEC draft

The elements of contracting on behalf of principals, being in possession of a stock of goods (see points (3) and (4) in the preceding paragraph) and transacting on behalf of enterprise by an employee (see point (5) in the preceding paragraph) were found in the agency permanent establishment provisions in the League of Nations Mexico (1943) and London (1946) Draft[3] which included the following:

"When an enterprise of one of the contracting States regularly has business relations in the other State through an agent established there who is authorised to act on its behalf, it shall be deemed to have a permanent establishment in that State. A permanent establishment shall, for instance, be deemed to exist when the agent:

A. Is a duly accredited agent and habitually enters into contracts for the enterprise for which he works; or

B. Is bound by an employment contract and habitually transacts business on behalf of the enterprise in return for remuneration from the enterprise; or

C. Is habitually in possession, for the purpose of sale, of a depot or stock of goods belonging to the enterprise."

The two elements of contracting on behalf of principals and being in a possession of stock of goods are also contained in the first draft of DAPE provision by the Working Party 1 (WP1) of the OEEC[4] which reads as follows:-

"An agent acting in one of the territories on behalf of an enterprise of the other territory – other than an agent of an independent status to whom paragraph 5 applies – shall be deemed to be a permanent establishment in the first-mentioned territory if the agent:

(a) has and habitually exercises a general authority to negotiate and enter into contracts on behalf of the enterprise unless the agent's activities are limited to the purchase of goods or merchandise; or

(b) habitually maintains in the first-mentioned territory a stock of goods or merchandise belonging to the enterprises from which he regularly delivers goods or merchandise on its behalf.

[3]League of Nations Fiscal Committee London and Mexico Model Tax Conventions Commentary and Text. C.88.M.88.1946.II.A. Accessed on 8 March 2019 http://setis.library.usyd.edu.au/oztexts/parsons.html

[4] FC/WP1(56)1 Accessed on 8 Mar 2019 http://taxtreatieshistory.org/. This first working paper also sets out the first draft version of the DAPE provision in the OECD Model Tax Convention.

An employee of the enterprise shall be deemed to be a permanent establishment of the enterprise if he also satisfies the further conditions of (a) and (b)".

In this first draft of the OEEC, an employee would only create PE for its employer if the activities of the employee include both concluding contracts on behalf of the employer and the maintenance of stock of goods for delivery. This appeared to be of a narrower scope as compared to that under the League of Nations Mexico (1943) and London (1946) Draft which only required an employee to transact on behalf of the employer for the establishment of a PE. It was also observed by the authors that based on the wordings "unless the agent's activities are limited to the purchase of goods or merchandise" in part (a) of this first draft as mentioned above, a purchasing activity by an agent on behalf of the foreign enterprise would be viewed as preparatory and auxiliary and would not create a PE in the source jurisdiction.

2.3 Article 5(4) - the Final draft in the OEEC report[5]

Article 5(4) of the final draft of the DAPE provision in the OEEC report reads:

"A person acting in a Contracting State on behalf of an enterprise of the other Contracting State — other than an agent of an independent status to whom paragraph 5 applies — shall be deemed to be a permanent establishment in the first-mentioned State if he has, and habitually exercises in that State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise."

There are three noticeable changes from the initial draft of dependent agent permanent establishment by the WP1 of the OEEC. The changes are as follows:

- The removal of the maintenance of goods criterion for the existence of a dependent agent permanent establishment. In its commentary of the final draft of the OEEC report, the fiscal committee included the following explanation for the removal of the said criterion.

  "During the drafting of the Article, it was at one stage suggested that one of the tests that should be used to determine whether or not an agent to be regarded as a permanent establishment should be the availability in the country in which the agent operates, and at the disposal of the agent, of a stock of goods or merchandise belonging to the enterprise. This, is, of course, a criterion commonly employed in bilateral Conventions for the avoidance of double taxation. For a number of reasons, this suggestion was not pursued and in its present form paragraph 4 of the Article is founded on the view that the only real criterion is the nature of the authority entrusted to the agent; in brief, whether or not he has, and habitually exercises, an authority to conclude contracts in the name of the enterprise."

  The authors are of the view that the removal of the criterion relating to the maintenance of goods is technically sound. A local warehousing agent that only stores goods belonging to the foreign

[5] The Elimination of Double Taxation: 1st Report of the Fiscal Committee of the O.E.E.C. Accessed on 8 March 2019 http://setis.library.usyd.edu.au/oztexts/parsons.html

enterprise for purposes of delivery to the local customers should not be construed as a DAPE of the foreign company. This is particularly so when it did not participate in any sales related activity.

- The change in the wordings from contracting "on behalf of" to "in the name of" the enterprise. This change in the wordings, which was not explained, was significant. Agents who did not contract "in the name of" the enterprise (including commissionaire agents (see later section)), would not create a DAPE of the non-resident enterprise in the source country (Jones & Ludicke, October 2014). It is interesting to note that this change in wordings has also allowed non-resident enterprises to be indirectly represented in a country with the use of commissionaire structures without having a DAPE (Lang, Pistone, Schuch, Staringer, & Storck, 2014). The use of the commissionaire structures to avoid a PE, has frustrated many countries which failed to levy tax on foreign companies adopting such structures. This problem was also one of the key areas that was addressed in the redrafting of the DAPE provision under Action 7 of the Base Erosion and Profit Shifting (BEPS) project. We will cover this in a later section.

- The use of the term "person" in the final version to encompass enterprise, non-employee individual and employee individual to constitute a dependent agent if they habitually exercise the authority to conclude contracts in the name of the non-resident enterprise. The authors are of the view that this was likely a simplification of the drafting. The term "person" was generic and broad enough to cover all three groups mentioned. There was also no need for differentiation of an enterprise from an individual since the sole criterion to establish a DAPE was the authority to conclude contracts in the name of the foreign principal.

2.4 The DAPE provision in the 1963 OECD MTC and the 1977 OECD MTC

The final draft version of the DAPE provision in the OEEC report was adopted in the OECD 1963 draft convention (OECD, 1963).

Subsequently, some amendments in wordings were made in the DAPE provision in the OECD MTC 1977. The DAPE provision was renumbered to paragraph 5 of the Article 5 which reads:

"Notwithstanding the provisions of paragraphs 1 and 2, 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 an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph."

There are two key observations resulting from the amendment in the wordings. The first observation is that it was made clear that an agency PE can still exist when a fixed place of business PE does not arise due to the insertion of "Notwithstanding the provisions of paragraphs 1 and 2". The second observation is the narrowing of scope of the DAPE provision due to the exclusion of agents whose activities are limited to activities under paragraph 4 of the PE article (which include the purchasing of goods or merchandise) from DAPEs. This change of treatment for agents seeks to align to the treatment of not regarding a fixed

place of business as a permanent establishment where the activities carried out at the fixed place of business are those under paragraph 4 of the permanent establishment article.

The DAPE provision in Article 5(5) of the MTC 1977 remained unchanged in subsequent revised editions of MTC up to and including MTC 2014. In short, the DAPE provision in Article 5(5) lasted for 40 years till its revision in the OECD MTC 2017.

2.5 The Independent Agent provision

An agent of an independent status or an independent agent which is usually defined in the independent agent provision, will not create a PE for the foreign enterprise.

As mentioned in section 2.1, the independent agent provision was already found in the exceptions to DAPE in the League of Nations 1929 report. Paragraph 6 of the PE provision in the Mexico (1943) and London (1946) draft[6] includes two of the said exceptions to DAPE in the League of Nations 1929 report and it reads as follows:

"The fact that a broker places his services at the disposal of an enterprise in order to bring it into touch with customers does not in itself imply the existence of a permanent establishment for the enterprise, even if his work for the enterprise is, to a certain extent, continuous or is carried on at regular periods, and even if the goods sold have been temporarily placed in a warehouse. Similarly, the fact that a commission agent (commissionaire) acts in his own name for one or more enterprises and receives a normal rate of commission does not constitute a permanent establishment for any such enterprise, even if the goods sold have been temporarily placed in a warehouse."

In addition, paragraph 3 was also included in the PE provision of the Mexico (1943) and London (1946) draft as part of the independent agent provision which reads as follows:

"The fact that an enterprise established in one of the contracting States has business dealings in another contracting State through an agent of genuinely independent status (broker, commission agent, etc.) shall not be held to mean that the enterprise has a permanent establishment in the latter State"

The authors are of the view that the independent agent provision in the Mexico (1943) and London (1946) draft (taking into account both paragraphs 3 and 6) was likely cumbersome. Therefore an attempt to create a concise independent agent provision was made and can be found in the first draft of independent agent provision in Article 5(5) by the WP1 of the OEEC[7] which reads as follows:-

"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 where such persons are acting in the ordinary course of their business."

[6] League of Nations Fiscal Committee London and Mexico Model Tax Conventions Commentary and Text. C.88.M.88.1946.II.A. Accessed on 8 March 2019 http://setis.library.usyd.edu.au/oztexts/parsons.html
[7] FC/WP1(56)1 Accessed on 8 Mar 2019 http://taxtreatieshistory.org/.

This draft independent agent provision was later wholly adopted in the OECD 1963 draft convention (OECD, 1963). Some minor amendments in wordings were made to the independent agent provision in the OECD MTC 1977. The provision read as follows:

"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."

Similar to the DAPE provision, the abovementioned independent agent provision remained unchanged for the next 40 years until the revision in the OECD MTC 2017.

Paragraph 37 of Article 5 Commentary to MTC 2014 (OECD , 2014) provides the following guidance in determining an agent of an independent status:

An independent agent will not constitute a permanent establishment of the enterprise on whose behalf he acts only if:

a) he is independent of the enterprise both legally and economically, and

b) he acts in the ordinary course of his business when acting on behalf of the enterprise.

The criterion of legal and economic independence[8] in (a) evaluates the presence of comprehensive control over the agent's activities and his bearing of entrepreneurial risks respectively. An independent agent will not be subject to detailed instructions from the principal for its activities and bears entrepreneurial risks.

It should be noted that the exercise of control by a parent company over a subsidiary will not be relevant in evaluating whether there is legal independence[9]. The commentary did not lift the corporate veil and recognized the separate legal identity of the subsidiary. In other words, a subsidiary (including a wholly owned subsidiary) can be treated as an independent agent if it has legal and economic independence and acts in the ordinary course of business while acting on behalf of its parent company. This is despite the fact the said subsidiary is acting for only one principal, its parent company[10].

3. BEPS Action 7

The Base Erosion and Profit Shifting (BEPS) project was initiated by the OECD to tackle weaknesses in the international tax framework which created opportunities for BEPS and to ensure that profits are taxed where economic activities take place and value is created (OECD, 2015).

Specifically BEPS Action 7 addressed the artificial avoidance of DAPE status by multinationals which could be carried out in one of the following ways (OECD, 2015)

- Use of commissionaire arrangements. In simple terms, under a commissionaire arrangement, a local commissionaire sells products in the source country in its own name but on behalf of the non-resident enterprise. The non-resident enterprise is contractually bound to deliver the goods

[8] Para. 38 of MTC 2014 Commentary on Article 5
[9] Para. 38.1 of MTC 2014 Commentary on Article 5
[10] Para. 38.1 of MTC 2014 Commentary on Article 5 states that the number of principals the agent is acting for is a factor to consider the independence test but this factor is not determinative on its own.

to the customers and the title of the goods passes directly from the non-resident enterprise to the customers. Effectively, there is no contractual relationship created between customers and the principal. Customers' only right of recourse is against the commissionaire. The non-resident enterprise is not regarded to have a dependent agent permanent establishment in the source country as the local commissionaire did not conclude contracts "in the name of" the non-resident enterprise i.e. it is not caught under the DAPE provision in the OECD MTC 2014. Commissionaires can generally be found only in civil law jurisdictions but not common law jurisdictions.

- Use of local agents who substantially negotiated contracts but the contracts are formally concluded by the non-resident enterprise outside the source country.

- Avoiding dependent agent permanent establishment via the exception of Article 5(6) of the MTC[11]. As seen in the earlier section, a closely related agent e.g. a wholly owned subsidiary could be regarded as an independent agent under Article 5(6) of MTC[12] as long as it fulfills the legal and economic independence criteria and acts in its ordinary course of business.

The final report for BEPS Action 7 resulted in the subsequent amendments of the dependent agent provision and the independent agent provision in the MTC[13] to render the abovementioned arrangements ineffective.

3.1 Revised DAPE provision in Article 5(5) of MTC 2017

The revised DAPE provision in Article 5(5) of the revised MTC 2017 (OECD, 2017) reads:

"Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, 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, and these contracts are

a) in the name of the enterprise, or

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,

that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise ……"

Clearly, there is an expansion of scope of Article 5(5) resulting in more DAPEs namely from the following situations:

- Agents who habitually play the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the non-resident enterprise and the

[11] MTC 2014 and versions of MTC before 2014
[12] MTC 2014 and versions of MTC before 2014
[13] MTC 2017

contract is in the name of the non-resident enterprise. For example, a local company is engaged by a foreign principal to sell goods on its behalf. Under the arrangement, the local company solicits customers, negotiates all the terms and conditions of the sales contract based on guidelines provided by the foreign principal but does not have the authority to conclude the contract on behalf of the foreign principal. The foreign principal makes only little or no changes to the negotiated contract and signs the contract with the local customer. Pre BEPS, the activities of the local company cannot be treated as creating a DAPE of the foreign principal as it did not conclude contracts on behalf of the foreign principal. However, post BEPS, the activities of the local company will create a DAPE of the foreign principal in the source jurisdiction.

- Agents who habitually conclude contracts in their own name and the contracts are for the transfer of ownership of, for the granting of the right to use, property owned by non-resident principal or that the non-resident principal has the right to use. For example, a deemed PE of the non-resident enterprise is created when contracts are concluded by a commissionaire in its own name and these contracts create obligations of the non-resident enterprise to transfer ownership of goods because of the arrangement between the commissionaire and non-resident enterprise [14]. Pre BEPS, the activities of the commissionaire cannot be regarded to create a DAPE of the non-resident enterprise as the commissionaire did not conclude contracts in the name of the non-resident enterprise. However, post BEPS, the activities of the commissionaire will create a DAPE of the non-resident enterprise in the source jurisdiction.

- Agents who habitually conclude contracts in their own name and the contracts are for the provision of services by non-resident enterprise. For example, a deemed PE of the non-resident enterprise is created when contracts are concluded by a commissionaire in its own name and these contracts create obligations of the non-resident enterprise to provide services because of the arrangement between the commissionaire and non-resident enterprise. Pre BEPS, the commissionaire cannot be regarded as a DAPE as it did not conclude contracts in the name of the non-resident enterprise. However, post BEPS, the local commissionaire will be treated as a DAPE.

3.2 Revised independent agent provision in Article 5(6)

The revised independent agent provision in Article 5(6) in the revised MTC 2017 reads:

"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 firstmentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. 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."

Notably, explicit examples of agents of independent status such as "broker and commission agents" were deleted in the amended independent agent provision. There is no detailed explanation given for the deletion in the BEPS Action 7 report nor the relevant commentary in the OECD MTC 2017. The closest

[14] Para. 92 of the commentary to Article 5 of MTC 2017

explanation that can be found would be the one in paragraph 110 of the commentary to Article 5 paragraph 6 of the OECD MTC 2017.The commentary attempts to provide some explanation to help distinguish what would be considered to be activities carried on in the ordinary course of business by brokers and consequently can qualify under the independent agent provision, assuming the other conditions are fulfilled. The authors are of the view that the deletion of these examples is likely an attempt to tighten the independent agent exception through the removal of what may arguably be the prima facie exclusion of brokers and commission agents. Ultimately, broker and commission agents may not necessarily be of independent status. The revised Article 5(6) provision explicitly states that "a person acting exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related" cannot be regarded as an independent agent. The new Article 5(8)[15] of the MTC 2017 further explains the use of a 50% beneficial interest threshold in determining whether an agent is closely related to the non-resident principal. The commentary to MTC 2017[16] introduces a bright line test for the phrase "acting exclusively or almost exclusively" where the sales that an agent concludes for enterprises to which it is not closely related represent less than 10 per cent of all the sales that it concludes as an agent acting for other enterprises, that agent should be viewed as acting "exclusively or almost exclusively" on behalf of closely related enterprises. This bright line test is based on the premise that a person will not qualify as an independent agent if the person's activities on behalf of enterprises to which it is not closely related do not represent a significant part of the person's business. Taking into account the said revisions, for example, a commission agent which acts only for one related principal and does not act on behalf of any other parties, could not be treated as an agent of independent status.

The phrase "independent of the enterprise both legally and economically[17]" was removed in the revised commentary to MTC 2017 but the evaluation of comprehensive control over the agent's activities by the non-resident principal and the bearing of entrepreneurial risks by the agent are still contained in the said revised commentary[18].

Under paragraph 7 of Article 5 in the MTC 2017, it is generally accepted that the existence of a subsidiary company does not, of itself, constitute a permanent establishment of its parent company.[19] It is possible that a subsidiary will act on behalf of its parent company in such a way that the parent will be deemed to have a permanent establishment under paragraph 5. Given the relationship between the parent company and the subsidiary, it is quite common for a subsidiary to act exclusively or almost exclusively for its parent. In such a situation, it is unlikely that the subsidiary will be able to benefit from the "independent agent" exception of paragraph 6. However, this does not mean that a subsidiary will always constitute a permanent establishment of its parent company. The subsidiary still has to meet the requirements of Article 5(5) before it can be regarded as a dependent agent of the parent.[20].

[15] "A person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises."
[16] Para. 112 of the commentary to Article 5 of MTC 2017
[17] Para. 37 of the commentary to Article 5 of MTC 2014
[18] Para. 104 of the commentary to Article 5 of MTC 2017
[19] Paragraph 115 of the Commentary to Article 5 of MTC 2017.
[20] Para. 113 of the commentary to Article 5 of MTC 2017

The authors observed that there were a number of terms used in the revised Article 5(5) and Article 5(6) provisions which were not defined in the OECD MTC 2017 itself. For some of the terms, the explanation could be found in the accompanying commentary to the model. Theoretically, this would mean that reliance can be placed on the accompanying commentary to the model to define these terms. Where the OECD Member country or the country has provided its comments or observations to the model and its accompanying commentary, the interpretation adopted by the country would be made clearer. However, for countries which are not OECD Member countries and have not provided its comments or observations, there would be uncertainty in the interpretation of these terms if the countries do not rely on the commentary, leading to more potential disputes. The situation would be made worse in respect of terms used in the revised Articles where there is no guidance provided for either in the main Article itself or the accompanying commentary. This opens up the likelihood of even more disputes. The authors will touch on some of these areas in the later parts of this paper.

3.3 Increase in tax disputes arising from the amended DAPE provision in 2017 MTC

The amendments to the DAPE provision could exacerbate tax disputes between taxpayers and tax administrations and between tax administrations, arising from differing interpretations. This is the authors' assessment despite the low adoption rate[21] of the amended DAPE provision in 2017 MTC via the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI). The commentary provides limited guidance on the phrase "habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise". It merely explains that the principal role leading to the conclusion of contracts is typically associated with the actions of the person who convinced the third party to enter into a contract with the enterprise[22] and provides limited examples[23]. The commentary specifically highlighted that the said phrase would not be satisfied if an agent promotes and markets goods or services of an enterprise in a way that does not directly result in the conclusion of contracts; the question then arises on whether promotional and marketing activities carried out by an agent could directly result in conclusion of contracts and if so, what the scope of activities involves. There is no simple answer to this question. It is fact specific. The answer would differ depending on the type of goods or services on hand, the competitive situation of the market etc. For example, for goods that are common or commoditized, what is of importance would be the terms that could be offered for the sale of the goods, as opposed to the good itself or the promotional and marketing activities carried out. For goods or services that are unique and where the bargaining power is tilted towards the seller as opposed to the buyer, what could result in the conclusion of contracts would also unlikely not be relating to the efforts of the dependent agent.

What needs to be clarified is the criteria of "principal role test" and the meaning of "material modification" (PwC, 2015) taking into account the following considerations:

- In a situation where both the agent and the non-resident enterprise play a role in the conclusion of the contract, how do we ascertain whether the agent played the principal role e.g. convincing

[21] As of 9 April 2019, 48 out of 87 countries which have signed the MLI have indicated that they wish to adopt Article 12 – Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies.
[22] Para. 88 of the commentary to Article 5 of MTC 2017
[23] Para. 89 and 90 of the commentary to Article 5 of MTC 2017

the customer to buy or enter into the contract with the non-resident enterprise vis-a-vis a liaison and facilitative role? Further examples[24] could be introduced in the commentary to explain this.

- In a situation involving standardised contracts, would introducing a new business or customer to the non-resident enterprise by the agent tantamount to satisfying the principal role test?

- The term "material modification" could be interpreted as a modification of the material elements of the contract such as price, nature and quantity of goods and services[25]. Practical guidance needs to be provided on the circumstances under which the material modification threshold is not breached by the non-resident enterprise, leading to the establishment of a DAPE.

In the absence of the abovementioned clarifications, the rules for the DAPE standard remained unclear and could lead to disagreements between taxpayer and tax authorities and between tax authorities which represent a real barrier to cross border trade and investment.

As mentioned above, the authors would like to highlight that even if clarifications for DAPE rules were to be made clear in the commentary, the commentary is not legally binding on countries which adopt the revised DAPE provision in the 2017 MTC. This depends on the legal status of the commentary in the countries concerned. As such, disagreements between tax authorities could still arise due to one country adopting the interpretation of the DAPE provision based on the guidance in the commentary while the counterparty country does not apply the said guidance in the commentary. Similarly, tax disputes could also occur if one country adopts the bright line test in the commentary for the phrase "acting exclusively or almost exclusively" in Article 5(6) while the counterparty country does not adopt the same test.

4. Sales Commission Agent structure and how it could constitute a dependent agent

The sales commission agent structure is commonly used when a foreign company wants to sells goods or services to local customers in a country.

Broadly speaking, the foreign company (the principal), appoints the local sales commission agent (the agent) to introduce customers to the foreign company and/or to make direct sales. The agent could be an enterprise or an individual who may or may not be an employee of the principal. The agent promotes and markets the products to customers and sometimes be given authority to negotiate and enter into contracts on behalf of the principal, usually in return for a commission on the sales concluded through the agent's efforts (remuneration is paid in the case of an employee). Legal ownership of any products concerned does not pass to the sales commission agent, and legally, each customer's contract is with the principal, not the agent. Therefore, the principal assumes legal and commercial risk whereas an agent (normally) does not.

[24] EY has called for further examples to be included in the commentary in its comments on Revised Discussion Draft BEPS Action 7 Prevent the Artificial Avoidance of PE Status. (OECD, 2015).

[25] The revised discussion draft BEPS Action 7 Prevent the Artificial Avoidance of PE Status defines a dependent agent to include one who "negotiates the material elements of contracts" and in the paragraph 32 of the proposed changes to the commentary on Article 5, material elements of contracts will typically include the price, nature and quantity of goods or services to which the contract applies (OECD, 2015)

The sales commission agent structure is adopted by businesses for various reasons. For sales by a foreign principal into a country, it is important to maintain a local presence in the market so as to have a better understanding of the requirements of the market, achieve close proximity to local customers and commercial efficiency. For smaller businesses or in the initial phases of a business that is just starting up, these businesses may tend to rely on unrelated sales commission agent to break into a particular market. Typically, these would be the sales commission agent that works for many different principals. As the business expands and sales in a market grows, some businesses may then consider setting up a footprint in the local markets. Some may start small by appointing an exclusive unrelated sales commission agent. Some might supplement that with a representative office or even set up a branch office that acts on a sales commission agent basis. With further growth and expansion, businesses may then consider to set up a related party subsidiary to act either on a sales commission agent basis to facilitate sales in the market or as a distributor. This is dependent on a myriad of factors that includes commercial, legal, regulatory and tax considerations. Tax is usually unlikely to be the overriding factor.

In the event that the preferred choice of the business to sell into a foreign jurisdiction is through a local sales commission agent, the extent of activities carried out by the local sales commission agent could differ based on its arrangement with the foreign principal. At one end of the spectrum, the local sales commission agent merely identifies the customer and introduces the customer to the foreign principal without carrying out any other activities for the foreign principal. The other extreme could consist of the local sales commission agent carrying out a whole series of additional activities on behalf of the foreign principal on top of identifying and sourcing the local customer; these additional activities could include marketing of the goods to increase consumer awareness, warehousing of goods for delivery including making decisions on the rental of warehouse and inventory levels, negotiating the key elements of the contract perhaps even without detailed parameters from the principal, reviewing credit worthiness of customer and making sell decisions. All that is left for the principal is to put its name on the eventual contract with the customer.

From a tax perspective, one of the key issues is whether the sales commission agent will be regarded as a DAPE of the foreign principal (non-resident enterprise) which creates a taxable nexus in the source country. Post BEPS, a DAPE of the non-resident enterprise could be created if the activities of the sales commission agent conducted on behalf of the foreign principal satisfy one of the required conditions under the DAPE provision of Article 5(5) of the MTC 2017[26] as follows:

- The sales commission agent is given authority and habitually concludes contracts in the name of the non-resident enterprise. These contracts could be either for the sale of goods or the provision of services by the non-resident enterprise.

- In a scenario where contracts are concluded by the non-resident enterprise with the local customer, the sales commission agent habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the non-resident enterprise.

It should be noted even when one of the abovementioned conditions is met, a DAPE will not be found to exist[27] if the sales commission agent satisfies the independent agent exception of Article 5(6) of the MTC

[26] See earlier section on amended dependent agent provision in Article 5(5) of MTC 2017
[27] Para. 85 of the commentary to Article 5 of MTC 2017

2017. The said exception will be satisfied when the sales commission agent does not act exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, meets the independence criteria[28] and acts in the ordinary course of his business. If the local sales commission agent is not related to the non-resident enterprise, it could qualify as the Article 5(6) exception as long as the independence criteria is met and it is acting in the ordinary course of its business. In cases where the local sales commission agent is related to the non- resident enterprise(s), qualifying for Article 5(6) exception will depend on whether it acts exclusively or almost exclusively on behalf of its related enterprise(s). More often than not, the local sales commission agent does not act for any other agent other than the non-resident enterprise which is a closely related party (for example, the local sales commission agent is a subsidiary of the non-resident enterprise); the local sales commission agent is acting exclusively on behalf of closely related enterprise and would unlikely be treated as an independent agent exception. In such a scenario, the local sales commission agent would only create a DAPE for the non-resident enterprise if one of the abovementioned conditions under Article 5(5) is met.

One of the abovementioned conditions under DAPE provision of Article 5(5) of the MTC 2017 could also be satisfied by an individual who acts on behalf of the non-resident enterprise in the PE jurisdiction and creates a DAPE of the non-resident enterprise in the source jurisdiction. In cases where the individual is an employee of the non-resident enterprise, the exception under Article 5(6) of the MTC 2017 will not be applicable[29] as an employee can never qualify as an independent agent. The authors would like to point out that the case of an employee being treated as a DAPE is not new. This was already established in the League of Nations 1929 report as pointed out in Section 2.1. Non-employee individuals who act on behalf of the non-resident enterprise could potentially qualify as independent agent exception, subject to meeting the required conditions under Article 5(6) of the MTC 2017.

In summary, a foreign principal could have a sales commission agent structure. The sales commission agent could be a related party enterprise, an employee or an unrelated individual or enterprise. Under the new rules, assuming all these parties have the same functions, assets and risk profile, it is the authors' views that the related party enterprise and employee would always be caught under the revised Article 5(5). There would be no exception under Article 5(6) that these parties could rely on. Unrelated individuals/ enterprises have a chance of getting out of the deeming provision through the Article 5(6) exception.

With the expansion of Article 5(5) scope and tightening of Article 5(6) exception, it is likely that more DAPEs will be created in the source country arising from the activities of a sales commission agent carried on behalf of a non-resident enterprise. From a taxpayer perspective post BEPS, a review of existing sales commission agent structure is necessitated and such review is likely to reveal an increased level of tax risk in a source jurisdiction due to additional PEs being established with the change in DAPE rules. The establishment of additional PEs will involve the filing of income tax returns in the source jurisdiction coupled with potential profit attribution disputes with the local tax authority and may also trigger Value

[28] Para. 104 to 109 of MTC 2017 Commentary to Article 5 explains the independence criteria of an independent agent which is similar to legal and economic independence criteria under the MTC 2014 Commentary.
[29] Para. 103 of the commentary to Article 5 of MTC 2017

Added Tax (VAT) issues[30]. As such, some taxpayers have converted their existing sales commission agent structure to a low risk distributor[31] (LRD) model.

Under the LRD model, the local distributor buys from its related non-resident enterprise and sells to local customers in the local jurisdiction. It usually undertakes only operational sales and sometimes marketing activities whilst the non-resident enterprise conducts other more value adding activities such as research and development. The local distributor does not have any ownership of intangible. The local distributor under the said model usually assumes little risks because risks such as inventory risks, credit risks, currency risks are typically borne by the non-resident enterprise. For example, in many cases, the local distributor takes "flash title" to the goods immediately before sale to local customers thus minimizing its inventory risks. For tax purpose, the local distributor is not treated as a DAPE of the non-resident enterprise[32] and its profits to be taxed in the source country, will be determined based on the OECD Transfer Pricing Guidelines (TPG) (OECD, 2017), taking into account its functions performed, assets adopted and risks assumed. In general, most of the profits arising from the sale to local customers will be attributed to the non-resident enterprise since the local distributor performs little functions and assumes little risks. Conversely, only a small proportion of the profits arising from the sale to local customers will be subject to taxation in the source jurisdiction. This is an outcome that is not favoured by a number of jurisdictions since the adoption of the LRD model seem to achieve minimal taxation in the source jurisdiction. This concern is further exacerbated in the case of jurisdictions which has seen a conversion of full risk distributors to limited risk distributors i.e. a drop in the taxable profits for these jurisdictions.

The LRD model is currently facing further challenges in the international space. In the OECD Public Consultation Document on "Addressing the Tax Challenges of the Digitalisation of the Economy" that was released on 6 March 2019 (OECD, 2019), the OECD made an observation that the adoption of the LRD model was increasingly common for highly digitalized businesses. It took the view that this was a measure to mitigate the tax bill of companies operating in the digitalized economy in a large market jurisdiction.[33] The OECD goes on to explain that this was achieved as the current 2017 TPG did not recognize an intrinsic functional link[34] between marketing intangibles and the customer base in the market/source jurisdiction. From the OECD's perspective, this resulted in an under allocation of profits to the market jurisdiction. It took the view that some marketing intangibles could be seen as being created in the market jurisdiction[35] and the risks associated with these marketing intangibles should be allocated to the market/source jurisdiction and an appropriate amount of profits should also be allocated to the market/source jurisdiction. This is an area that is currently under hot debate as can be seen from the numerous inputs

[30] A DAPE may be treated as a fixed establishment for VAT purposes and if so, the foreign non-resident enterprise may need to register for VAT in the source jurisdiction.

[31] It is observed by EY that some of the taxpayers are converting their sales and distribution activities from a sales agency model to a buy/sell distributor (EY, 2017)

[32] This is despite the fact that the local distributor may be a subsidiary of the non-resident enterprise. Article 5(7) of the 2017 MTC provides that the control of a parent company over a subsidiary does not constitute the subsidiary a PE of the parent company.

[33] Para. 13 of "Public Consultation Document - Addressing the Tax Challenges of the Digitalisation of the Economy 13 February – 6 March 2019"

[34] Para 30 of "Public Consultation Document - Addressing the Tax Challenges of the Digitalisation of the Economy 13 February – 6 March 2019"

[35] Para 31 of "Public Consultation Document - Addressing the Tax Challenges of the Digitalisation of the Economy 13 February – 6 March 2019" suggested two ways of manifestation of the intrinsic functional link.

and feedback that has been provided by businesses, tax practitioners and academics in the public consultation exercise. Views on these assertions relating to the LRD model are varied. As this is not the focus of the current paper, the authors would reserve our comments relating to this development.

In a similar vein, the topic of DAPEs will be incomplete without some mention of the tax issues relating to the digitalization of the economy. The digitalization of the economy allows a non-resident enterprise to sell goods or services remotely to customers in another country without creating a physical presence therein (remote sales model). As a result, a taxable presence is not created in the market jurisdiction under existing rules. For example, the non-resident enterprise may utilise a website to sell its goods directly to customers in another country. The server on which the website is maintained, is located in the country of residence of the non-resident enterprise; the goods are delivered directly by the non-resident enterprise cross-border to the customers in the other country. Under the revised rules in Article 5 post BEPS Action 7, there continues to be no PE established in the market jurisdiction. Consequently, the market jurisdiction would not have taxing rights on profits arising from the sales of goods and services to customers in its jurisdictions despite some perceived participation by the customers in its domestic economy. On this point, the authors would like to share the view that this perspective would need to be balanced against the age old divide between the fundamental concept of "trading in" and "trading with" that can be found in tax law. An enterprise is subject to tax in a jurisdiction only if it was found to be "trading in" that jurisdiction. If the enterprise was found to be "trading with" the jurisdiction, there should be no tax consequences. It remains an open point as to whether remote sales would come under the bucket of "trading in" or "trading with".

The ability of highly digitalized businesses to adopt a remote sales model or LRD model in a source jurisdiction and the perceived ability to reduce its taxes therein, has sparked off the debate as to whether the current revised rules[36] based on the BEPS project were sufficient to address BEPS with regards to cross-border transactions in the digital age. The Task force on the Digital Economy (TFDE) has been tasked to monitor the developments in digitalization (OECD, 2019) together with its corresponding tax implications and evaluate if there is a need to revise profit allocation and nexus rules[37] and how it should be carried out. On-going work is carried out by the TFDE and a final report was expected to be delivered in 2020.

5. Authorised OECD Approach (AoA)

The international tax principles for attributing profits to a PE are provided in Article 7 of the OECD Model Tax Convention on Income and on Capital. Article 7 has undergone a number of changes since its introduction into the model. As a result, there are many different versions of Article 7 that are in use today. This resulted in considerable variation in the interpretation of Article 7 and the principles that are used to attribute profits to PEs across different jurisdictions. The OECD came up with the AOA in 2008 in an attempt to standardize the approach of jurisdictions in attributing profits to a PE. This report was not constrained by either original intent or by historical practice and interpretation of Article 7. The focus was on formulating the most preferred approach to attributing profits to a PE under Article 7 given modern-

[36] Including TPG

[37] There are two key proposals being considered namely the "user participation" proposal and the "marketing intangibles" proposal.

day multinational operations and trade. This report was subsequently modified in 2010, taking into account the revised text of Article 7 in the 2010 update to the Model Tax Convention and published simultaneously (2010 report).[38]

Briefly, the two key steps in the AOA based on the 2010 Report (OECD, 2010) are as follows:

- The first step involves a functional and factual analysis and to hypothesize the PE as a separate and independent enterprise. Economically significant activities and responsibilities undertaken by the PE through the performance of significant people functions must be identified so as to attribute economic ownership of assets and assumption of risks to the PE. Internal dealings between the hypothesized PE and the rest of the enterprise of which it is a part of as well as external dealings between the hypothesized PE and external parties must also be recognised.

- In the second step, the remuneration of the dealings identified in Step one, is determined by applying the transfer pricing guidelines with reference to Article 9 of the MTC, taking into account the functions performed, assets used and risks assumed by the hypothesized PE.

Despite the best efforts of the OECD, the AoA was not widely adopted. Relatively few treaties include the 2010 version of Article 7 in their treaties. A number of OECD and non-OECD countries have expressly stated their intention not to include the 2010 version of Article 7 in their treaties.[39] To-date, only a handful of countries such as Denmark, Germany, Japan and the Netherlands have adopted the AOA either in their domestic tax laws, practice/tax rulings and/or tax circulars[40]. The UN Committee of Experts on International Cooperation in Tax Matters has rejected the inclusion of the 2010 version of Article 7 and consequently rejected the implementation of the full AoA.

Given the changes to the definition of PEs under BEPS Action 7 (see earlier section), the Action 7 Report carried out some preliminary work on the issue of attribution of profit. It concluded that the PE threshold changes do not require substantive modifications to the existing rules and guidance concerning the attribution of profits to PE under Article 7. However, there was a need for additional guidance on how the rules of Article 7 would apply to PEs resulting from changes in that report. There was also a need to factor in the results of the work on other parts of the BEPS Action Plan dealing with transfer pricing, in particular, those relating to intangibles, risk and capital under the 2015 BEPS Report on Actions 8-10 "Aligning Transfer Pricing Outcomes with Value Creation".[41] Hence, the OECD worked on providing additional guidance under the AoA in respect of these instances.

The OECD issued two discussion drafts on the topic and invited comments from the public. The first discussion draft was published on 4 July 2016 for the consultation period of 4 July to 5 September 2016 (Discussion draft 1). The discussion draft presents two fact-patterns that the OECD felt would benefit from additional guidance on attribution of profits to PEs i.e. a) dependent agent PEs, including those created through commissionaire and similar arrangements; and b) warehouses as fixed place of business PEs. For

[38] Preface to 2010 Report on the Attribution of profits to PEs 22 July 2010, OECD.
[39] See the reservations of Chile, Greece, Mexico, New Zealand, Portugal and Turkey in paragraphs 95,96 and 97 of the Commentary on Article 7 as well as the positions of Argentina, Brazil, China, India, Indonesia, Latvia, Malaysia, Romania, Serbia, South Africa, Thailand and Hong Kong in paragraph 1, 1.1 and 1.2 of the positions on Article 7
[40] Based on a survey conducted by a member firm of Nexia International (Ebner Stolz, 2016)
[41] Para 3 to Public Discussion Draft BEPS Action 7 Additional Guidance on the Attribution of Profits to Permanent Establishments 4 July to 5 September 2016.

each fact-pattern, and through the use of examples, a number of questions were identified on which comments were sought from commentators. [42] This discussion draft drew a lot of varied comments (Comments to Discussion draft 1)[43] from commentators and countries. The Committee on Fiscal Affairs recommended pursuing this work under a different approach adopted under Discussion Draft 1. The OECD (Working Party 6) then came up with a second discussion draft on 22 June 2017 for the consultation period of 22 June to 15 September 2017[44] (Discussion draft 2). Similarly, this discussion draft continued to draw comments (Comments to Discussion draft 2) [45] from commentators and countries. Eventually, this culminated in the publication of an Additional Guidance on the Attribution of Profits to PEs BEPS Action 7 on March 2018 (March 2018 Guidance)[46].

For practical reasons of standardization, the authors have attempted to apply the AoA in the scenarios analysed for the research questions. In the course of the research for this paper, the authors have gone through most of the comments provided by commentators relevant to the topic on hand for both Discussion drafts 1 and 2 and relied on some of these observations to come up with our conclusions.

5.1 Interaction and application of Article 7 and Article 9 of the MTC

As explained in the earlier paragraphs, Paragraphs 5 and 6 of Article 5 of the OECD MTC sets out the circumstances in which an enterprise is treated as having a PE in respect of activities undertaken for that enterprise i.e. dependent agent PE (DAPE). This test is applicable when it is found that the enterprise does not have a fixed place PE arising from the activities undertaken. When a DAPE arises from the activities of a dependent agent, the host country has taxing rights over two different legal entities, the dependent agent enterprise (DAE) if it is a resident of the PE jurisdiction; and the DAPE, which is a PE of the non-resident enterprise.[47] For the purposes of attributing profits to the DAPE under Article 7 of the OECD MTC, this paper applies the AoA.

There are instances where the dependent agent that performs the activities that gave rise to a DAPE, is also an associated enterprise of the non-resident enterprise acting as a principal and is a resident in the PE jurisdiction. In addition to the attribution of profits to the DAPE, it will also be necessary to determine the arm's length remuneration of the DAE under Article 9 of the OECD MTC. The arm's length remuneration of the DAE would be deductible to come up with the attribution of profits to the DAPE.[48] Diagram 1 attempts to provide an illustration of the interaction and application of Articles 7 and 9.

[42] Public Discussion Draft – BEPS Action 7, Additional Guidance on the Attribution of Profits to Permanent Establishments, 4 July – 5 September 2016. (OECD, 2016)
[43] All comments received on PROPOSED ADDITIONAL GUIDANCE ON THE ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS 8 September 2016. (OECD, 2016)
[44] Public Discussion Draft – BEPS Action 7, Additional Guidance on the Attribution of Profits to Permanent Establishments, 22 June – 15 September 2017. (OECD, 2017)
[45] All Comments received on PROPOSED ADDITIONAL GUIDANCE ON THE ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS 4 October 2017. OECD. (OECD, 2017)
[46] OECD. (2018). Additional Guidance on the Attribution of Profits to Permanent Establishments, BEPS Action 7. Retrieved from www.oecd.org/tax/beps/additional-guidance-attribution-of-profits-to-a-permanent-establishment-under-beps-action7.htm.
[47] 2010 report, Part 1 para 230.
[48] 2010 report, Part 1 para 234.

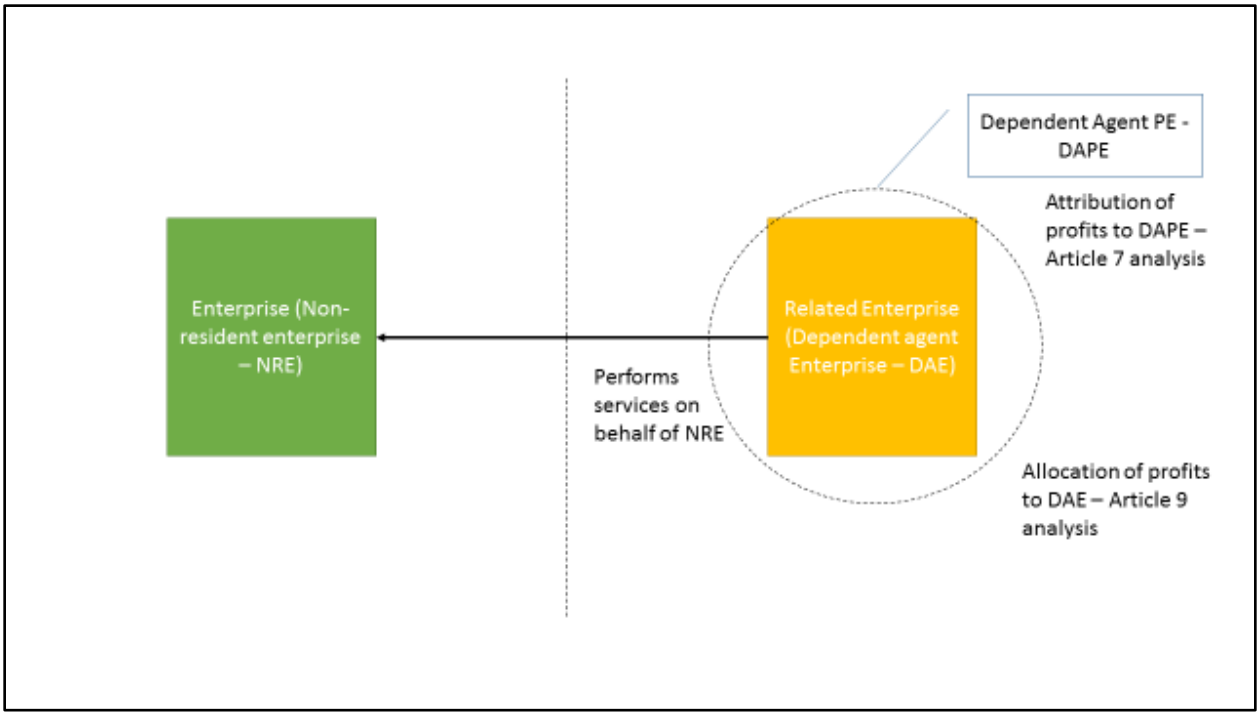

Diagram 1 – Interaction and application of Article 7 and 9

5.2 Order of application of Article 7 and Article 9

The MTC and its accompanying commentary does not explicitly prescribe the order of application of Article 7 and 9 for the scenario on hand. Discussion draft 1 suggests that it would be logical and efficient first to accurately delineate the actual transaction between the NRE and the DAE and to determine the resulting arm's length profits. This would provide the arm's length fee deductible in the DAPE.[49] Interestingly, this suggested approach does not seem to be acceptable to all jurisdictions. By the time of the March 2018 guidance, it was stated that different jurisdictions have different preferences. Some jurisdiction may prefer to undertake an Article 7 analysis first followed by Article 9. While other jurisdictions may prefer otherwise. The March 2018 Guidance concludes that the order of application should not impact the amount of profits over which the source jurisdiction has taxing rights over. What is important is that the approach adopted is consistent and made transparent to all.[50]

From the authors' perspective, conducting an Article 9 analysis first followed by an Article 7 analysis seemed to be inherent in paragraph 234[51] of Part 1 of the 2010 report which requires the ascertainment

[49] Para. 19 of Discussion Draft 1.

[50] Para. 34 of March 2018 Guidance states that "the order in which Article 7 and Article 9 are applied should not impact the amount of profits over which the source country has taxing rights as a result of the activities of the intermediary on behalf of its associated non-resident enterprise in the source country"..

[51] Paragraph 234 of Part 1 of the 2010 Report on the Attribution of Profits to Permanent Establishments (OECD, 2010) highlighted the need to determine and deduct an arm's length reward to the dependent agent enterprise in calculating the profits attributable to the DAPE.

and deduction of an arm's length reward to the DAE for the services rendered in order to calculate the profits attributable to the DAPE. Furthermore, the example[52] provided in paragraph 112 of Part 3 of the 2010 report appeared to endorse this preferred order. This also come across as a more pragmatic approach to the authors. Arising from this, the authors are of the view that while the amount of profits to be taxed on the DAE and DAPE respectively can be different[53] dependent on the order in which Article 7 and Article 9 is applied, the level of total profits in the source country should remain the same[54]. In the subsequent sections of this paper, the authors will attempt to substantiate this.

The authors are not alone in our views expressed above. Some commentators to Discussion Draft 1 share the same view. PwC expressed the view that the order of application would have an impact on the amount of profits attributed to the DAPE. PwC then went on to state that an important start point for profit attribution is the correct amount of profits after taking into account the contributions from related party entities i.e. Article 9 should be applied first, followed by Article 7. [55] Generally, most commentators are of the view that it is also more practical to do an Article 9 analysis followed by an Article7 analysis[56]. BIAC's comments particularly resonated with the authors. It expressed the view that most MNEs that will be impacted have not had the volume of experience in applying profit attribution in practice. Likewise, most tax administrations as well. The Article 9 analysis is the more well used and should be the first analysis to be applied. [57]

5.3 Significant people functions v Control risk functions

For attributing profits to PEs, the 2010 report adopts the concept of significant people functions for the purpose of attributing risks and economic ownership of assets to PEs. Specifically, for the attribution of risks, the significant people functions should involve the active decision making with regard to the acceptance and/or management of risks[58].

The TPG, on the other hand, uses the notion of "control over risk functions" for the allocation of risks to an entity. In paragraph 1.65 of the TPG, the "control risk functions" include (i) the capability to make decisions to take on, lay off, or decline a risk-bearing opportunity, together with the actual performance of that decision-making function and (ii) the capability to make decisions on whether and how to respond to the risks associated with the opportunity, together with the actual performance of that decision-making function.

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[52] "If one enterprise is acting as agent for a second enterprise and the activities of the first enterprise create a dependent agent PE as defined in Article 5(5), it will first be necessary to apply the guidance in Section C under Article 9 to establish the arm's length price of the transactions between the first enterprise and the agent enterprise (where the agent is an associated enterprise), and then to apply the guidance in Section D"
on Article 7 to attribute an arm's length amount of profits to the dependent agent PE"

[53] In page 208 of the comments to discussion draft 2, PwC is of the view that the attributed profits for DAPE might be impacted by the order of applying Articles 7 and 9.

[54] Paragraph 34 of the March 2018 Guidance.

[55] Pg 307 of comments to discussion draft 1

[56] In page 99 of the comments to discussion draft 2, EY reasoned that it is more logical for Article 9 analysis to precede the analysis under Article 7.

[57] Pg 47 of comments to discussion draft 2

[58] Paragraph 22 of Part 1 of the 2010 Report

At first glance, there is a considerable overlap[59] between the two concepts of "Significant people functions" and "Control over risk functions" as both of them involve decision making pertaining to risks. However the March 2018 Guidance clarified that these two concepts are not the same and therefore could not be used interchangeably for the purposes of Article 7 and Article 9[60]. It acknowledged that while the functions performed by the DAE could constitute both significant people functions and control over risk functions, the risk(s) in connection with these said functions should not be simultaneously allocated to both the DAE and the DAPE to avoid "double counting of profits" which will result in double taxation in the source country.

A subtle observation from the use of these two concepts is the increased emphasis of human capital resources in determining the location of value creation where corresponding profits should be taxed. In particular, it is now widely recognised that a value is created as a result of a thoughtful decision made by empowered employees (Ciresa, 2018)

Practically, using these two concepts remain a challenge. The 2010 report mandates the attribution of risks and economic ownership of assets to the DAPE when the DAE undertakes significant people functions in connection with the risks/economic ownership of assets on behalf of the non-resident[61], but does not provide any guidance on how to assess whether the performance of significant people functions by the DAE is on behalf of the non-resident or on DAE's own account.

Although the TPG prescribed a systematic approach in allocating risks to the specific entity for a transaction, it did not provide any clear examples involving the type and hierarchical level[62] of decision making in connection with the allocation of control over risks to a specific entity within a multinational group. As such, the following difficulties could arise in the allocation of control over risks.

- It is sometimes hard to distinguish control over risks functions from mere oversight functions and actual local decision making from merely ticking the box where robust and rigid risk policies are already put in place;
- Control over risks functions could be scattered amongst different layers of decision makers (Verlinden, Ledure, & Dessy, March/April 2016) who could be located in different entities within the multinational group. In such a situation, based on paragraph 1.98 of TPG and with the assumption that the different entities have the financial capacity to assume the risks, the said risks should be allocated to the associated enterprise which exercise the most control. It should also be noted that the ascertainment of the associated enterprise which exercise the most control is highly subjective.

[59] Other authors including Piotr Drobnik (Drobnik, May/June 2018, p. 206) are of the view that the concept of risk control functions and the concept of decision making with regard to the acceptance and/or management of risk that underpins the notion of significant people functions are in substance the same.
[60] Paragraph 39 of the March 2018 Additional Guidance
[61] Paragraph 232 of Part 1 of the 2010 Report.
[62] Paragraph 1.66 only provides an example where the mere formalizing of a decision making does not suffice as having control over risk.

In view of the above and the context where risk management functions[63] are performed by the DAE on behalf of the NRE, there is a lack of clarity as to whether the control over risks should be allocated solely to the NRE[64] or the DAE; in other more complex cases, it is questionable whether control over risks should be shared between the NRE and the DAE and if so, how.

It is interesting to note that under the application of Article 9 in the context of a dependent agent enterprise ("DAE") performing certain risk control functions, the TPG did not require an evaluation of whether these risk control functions are performed on the DAE's own account or on behalf of the non-resident enterprise ("NRE"). In other words, when the risk control functions are performed by the DAE on behalf of the NRE and Article 9 is applied before Article 7, the risks control functions with the corresponding risks are allocated to DAE[65] assuming that DAE has the financial capacity to bear the risks. In the subsequent analysis under Article 7, the risk control functions with the associated risks should not be allocated to the DAPE as doing so will result in the profits associated with the said risks being taxed on the DAE and the DAPE in the source country, giving rise to the double counting of profits. Conversely, given the same circumstances, if Article 7 is applied before Article 9, the risk control functions with the corresponding risks will be allocated to the DAPE first under the Article 7 analysis but the said functions with the corresponding risks will not be allocated at the same time to the DAE to avoid the double counting of profits in the source country.

5.4 Single taxpayer approach position

The single taxpayer approach assumes that there will be no profits attributable to a DAPE after deducting an arm's length remuneration to the DAE. In other words, risks and the associated profits would never be attributed to a DAPE under the said approach. The basis for this approach is explained in paragraph 235 of the 2010 report that "the compensation to the DAE, if arm's length under Article 9, is considered to adequately reward the DAE for its functions performed, assets used and risks assumed, and since there

[63] Risk management functions includes both control over risks functions and risk mitigation functions. Risk mitigation functions is defined in paragraph 1.61 of TPG as having the capability to take measures that affect risk outcomes, together with the actual performance of such risk mitigation.

[64] Paragraph 1.65 of the TPG states that it is not necessary for a party to perform the day to-day mitigation in order to have control of the risks and such day to day mitigation could be outsourced with the party having the capability to determine the objectives of the outsourced activities, to evaluate whether the objectives are being met and to hire and fire the service provider. In paragraph 1.70 of the TPG, the example of a fund manager being hired by an investor to invest funds on its behalf showed that the investor who gives to another person the authority to perform risk mitigation activities such as those performed by the fund manager does not necessarily transfer control of the investment risk to the person making these day-to-day decisions. In the context of a DAPE, it is possible that risk mitigation activities are merely outsourced to the DAE with the non-resident enterprise still retaining control over the relevant risks.

[65] In page 262 of comments to the discussion draft 1, KPMG has asked for a reconciliation of the conclusion that a DAE is determined to perform people functions on its own behalf under the Article 9 analysis, with the conclusion that the DAE is performing the control functions on behalf of NRE with the application of AOA. The authors are of the opinion that in the absence of such reconciliation by OECD, it is technically possible for the two said conclusions to co-exist as the TPG did not mandate the differentiation of performing people functions on behalf of DAE's own account from the performance of people functions on behalf of the NRE when performing Article 9 analysis.

are no other functions performed, assets used and risks assumed in the host country there can be no further profits to attribute".

The OECD does not endorse the single taxpayer approach for the following reasons[66]:

- The approach ignores one of the important aspects of the PE concept which is to accord taxing rights on profits in a source country under certain circumstances even when assets and risks legally belong to the non-resident enterprise;
- The acceptance of the single taxpayer approach will result in the AOA being applied differently for dependent agent PEs vis-à-vis fixed place of business PEs;
- The single taxpayer approach could give rise to the same profit attribution results for dependent agent PEs situations which are vastly different.
- The single taxpayer approach will lead to the redundancy of Article 5(5) of the model tax convention since profits are never attributed to a dependent agent PE under the said approach.

As mentioned above, few countries have adopted the AoA. Among the countries that has adopted the AoA, it is interesting to note that Germany has adopted the single taxpayer approach with regard to DAPE found in Germany. Germany adopts the zero-sum theory and generally assume the allocation of a "zero-result" to a DAPE in the case of legal entities that act as permanent representatives[67,68]. However, where the DAPE results from an enterprise's own employee acting in the other country, there will be profit or loss attributed to the representative PE.[69] Similarly, the single taxpayer approach is also adopted in the Austria-Germany Income and Capital Tax treaty. [70]

The Netherlands has also adopted a similar approach for DAPEs as Germany although the need to abandon the single taxpayer approach is described in the Decree[71] that outlined the Dutch position with respect to the attribution of profits to PEs in the Netherlands. The Dutch Secretary of Finance is of the view that it is not necessary to attribute profits to a DAPE when the DAE is remunerated at arm's length for its services performed on behalf of the NRE; there would still be a need to attribute profits to a DAPE created through the employees of the NRE (Sahin & Le Blanc, 2011).

While India has not adopted the AOA, in the Morgan Stanley & Co. Inc case[72], the Indian Supreme Court took the view that where the transactions between the DAE and the DAPE are held to be at arm's length, taking into account all the risk-taking functions of the DAE, nothing further would be left to attribute to the DAPE. There have been many discussions as to whether the India Supreme Court supports the dual taxpayer approach or the single taxpayer approach. Some authors have concluded that a close reading of

[66] Paragraphs 236 to 239 in Part 1 of the 2010 report
[67] EY Global Tax Alert (EY, 2017)
[68] Section 2.39.2 of the unofficial translation of the Administrative Principles Administrative Principles on the Profit Attribution to Permanent Establishments (Administrative Principles) (Federal Ministry of Finance, 2016)
[69] Section 2.39.1 of the Administrative Principles
[70] Paragraph 2 of Protocol to the Convention between the Republic of Austria and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital and to Trade Tax and Land Tax concluded on 24 August 2000 (unofficial translation prepared by IBFD) (accessed 26 Apr 2019)
[71] Decree of the Dutch State Secretary of Finance of 15 January 2011, No. IFZ2010/00457M as published in the Staatscourant on 27 January 2011, No.1375.
[72] DIT International Taxation, Mumbai vs Morgan Stanley & Co. INC (2007) 292 ITR 416

the decision indicates support for the OECD dual taxpayer approach as the Supreme Court judgement on the allocation of profits is in line with that i.e. to the extent the DAPE assessment properly took into account the risks of the enterprise DAE, there was no reason to require the enterprise to report another PE profit.[73] On the other hand, some commentators took the view that the Morgan Stanley & Co. Inc case was an endorsement of the single taxpayer approach.

From the authors' perspective, we agree with the OECD that the dual taxpayer approach is more sound from a conceptual and policy perspective. This approach would ensure consistency in treatment among the different types of PEs. In the case of DAPEs, as there is a definite need to deduct the arm's length reward that is paid to the DAE for the services rendered, the likelihood of encountering situations where there are no further profits to be attributable to the DAPE would increase. This leads to the same outcome arising from the use of the single taxpayer approach. Where there are no further profits to be attributed to the DAPE, we would advocate the use of the single taxpayer approach in such circumstances as it would be a lot more pragmatic and administratively efficient and has already been adopted in some countries such as India, the Netherlands and Germany. The authors' views are also supported by some of the commentators to discussion draft 2 such as the University of Vienna[74], Universite of Lausanne[75] and Tax Executives Institute[76]. While the OECD does not recognize the single taxpayer approach, Paragraph 246 of the 2010 Report acknowledges that countries may use administratively convenient ways of recognizing the existence of a DAPE and to collect the appropriate amount of tax resulting from the activity of the DAPE. In practice, some countries actually collect the tax only from the DAE even though the amount of tax is calculated by reference to the activities of both DAE and DAPE.

6. Attribution of profits to related party sales commission agent

This section of the paper looks at the scenario where a related party acts as the sales commission agent for an enterprise, thus deeming a DAPE for the enterprise. This results in a need to determine the profits that would be attributed to the DAPE. The fact pattern of the scenario would be varied, the resulting implications would be discussed and analysed.

6.1 Base example

Facts

Company A, a company resident in Country X, manufactures consumer goods in Country X for sale. Company B, a wholly owned subsidiary of Company A and resident in Country Y, acts as a commission agent for Company A. Company B negotiates the key elements of the contracts with local buyers in

[73] (Pijl, 2008)

[74] In page 323 of the compilation of comments to Discussion Draft 2, University of Vienna called for the dual taxpayer approach to be abandoned or considered as an alternative option.

[75] In page 269 of the compilation of comments to Discussion Draft 2, Universite of Lausanne explained that in situations where the intermediary falls under the scope of Art. 9, the single taxpayer approach should prevail, especially in light of the new (strengthened) chapter I of the OECD TP guidelines.

[76] In page 278 of the comments to discussion draft 2, Tax Executive Institute highlighted the need for the OECD to reconsider the single taxpayer approach as it creates certainty, adds administrative simplicity and reduces the possibility of disputes.

Country Y and subsequently, the contracts are concluded by Company A with the local buyers without material changes to the terms of the contracts. The consumer goods are sold to the local buyers by Company A. Company B does not take title of ownership of consumer goods at any point in time. Company B does not act as a commission agent for any other companies. Company B is the exclusive selling agent for Company A in Country Y.

The consumer goods sold to local buyers in Country Y, are stored at a warehouse[77] in Country Y. The warehouse is owned by an unrelated party. Company A paid rental to the warehouse owner. Personnel of Company A makes decisions relating to the rental of the warehouse. This includes the choice of warehouse and the terms and conditions of the rental arrangement. Personnel of Company A in Country X are responsible for determining and monitoring the inventory levels of the consumer goods stored in the said warehouse. Personnel of Company A in Country X are also responsible for reviewing the credit worthiness of the local buyers in Country Y and determining the credit terms to be extended.

In this scenario, Company A paid Company B a commission based on a percentage (5% in this case) of sales to local buyers in Country Y.

There is a tax treaty between Country X and Country Y. The terms of the treaty are similar to those found in the OECD MTC 2017, in particular Articles 5, 7 and 9. An illustration of the example can be found in Diagram 2 below.

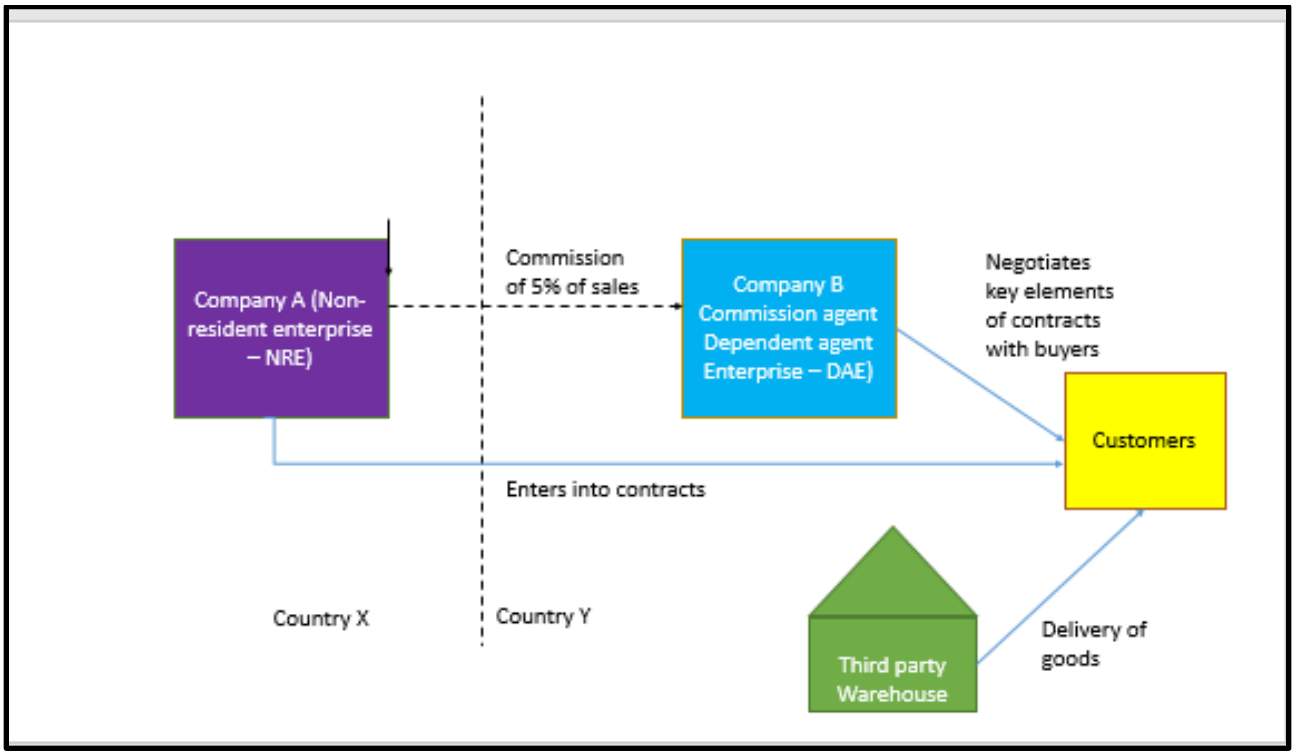

Diagram 2: Illustration of base example

[77] It is assumed that the warehouse does not constitute a fixed place of business permanent establishment of Company A in Country Y.

Analysis

As mentioned in an earlier section, the term "principal role leading to the conclusion of contracts" is not explicitly defined in the OECD commentary. In the commentary, it explained that this was aimed at situations where the conclusion of contracts directly resulted from the actions of the person performed in the Contracting State on behalf of the enterprise.[78] This was typically associated with the actions of the person who convinced the third party to enter into a contract with the enterprise.[79] On the assumption that the consumer goods are homogeneous i.e. the goods cannot be further customized for each and every customer; the contract terms are fairly standard i.e. prices are fixed and bulk discounts and negotiation parameters have been predetermined by Company A and credit terms are also determined by Company A, we conclude that Company B habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by Company A. These contracts are in the name of Company A and for the transfer of the ownership of goods owned by Company A. The principal role in this example relates to the sourcing of customers. Under Article 5(5), Company A has a PE in Country Y. In addition, Company B cannot be regarded as an independent agent under Article 5(6) in this case as it acts exclusively on behalf of Company A, a closely related party[80]. This is because Company B does not act as a commission agent for any other company except Company A, the parent company that owns all the shareholdings in Company B.

An analysis under Article 9 is carried out first before the analysis under Article 7.

Analysis under Article 9

Under Article 9, the functional and factual analysis of the related party transaction between Company A and Company B revealed that Company B is providing a service to Company A by identifying buyers in Country Y and assisting in the negotiation of the contract. Company B is remunerated at arm's length for the said provision of service as per what an independent commission agent, performing similar functions and assuming similar risks and adopting similar assets, will be remunerated. However, risks control functions (Deciding on choice of warehouse and terms and conditions of warehousing arrangement, determining and monitoring inventory levels, reviewing credit worthiness of buyers and determining credit terms) are allocated to Company A as these functions are performed by personnel of Company A[81] in Country X. It is also noted that the said control over risks is exercised by Company A which contractually assumed the risks and has the financial capacity to assume such risks[82]. Accordingly, risks arising from the warehousing arrangement, inventory risks and credit risks are allocated to Company A; any

[78] Para 88 OECD Commentary to Article 5 of OECD MTC 2017.
[79] Para 88 OECD Commentary to Article 5 of OECD MTC 2017.
[80] Two companies are closely related parties if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises (paragraph 120 of the 2017 MTC commentary).
[81] "Control" is defined as the capacity to make decisions to take on risks and decisions on whether and how to manage risk, internally or an external provider and this requires the company to have people – employees or directors- who have the authority to, and effectively do, perform these control functions (paragraph 1.65 of TPG).
[82] Paragraph 1.87 of TPG

profits/remuneration together with downside consequences in connection with the assumption of these risks should be attributed to Company A.

Analysis under Article 7

Applying the March 2018 guidance, under Article 7 and applying the step one of the AOA, the functional and factual analysis showed that Company B's personnel are in substance, concluding the sales with buyers in Country Y on behalf of Company A. As such, the hypothesized PE is treated to assume Company A's rights and obligations arising from the sale transactions with external buyers[83]'[84], the transaction between Company A and Company B. However, the rights and obligations arising from the transaction between Company A and the external warehouse owner are treated as assumed by the head office since the significant people functions relating to the warehousing of goods i.e. decision on the choice of warehouse and terms and conditions of warehousing agreement, are performed by the head office. The internal dealing between the DAPE and head office is characterized as a sale of goods from head office to PE.

No significant people functions relevant to the assumption of inventory risks (and economic ownership of the inventory[85]) as well as credit risks (and economic ownership of trade receivables), are performed by the personnel of Company B on behalf of Company A. As such, these said risks and corresponding economic ownership of assets should not be attributed to the PE.

Applying step two of the AOA, the OECD TPG will be used to determine the arm's length price of the internal dealing between PE and the head office. In this case, this price would be the price charged by Company A if Company A sells the consumer goods to unrelated party under similar circumstances (with no attribution of similar functions and assumption of similar risks related to such functions to the unrelated buyer). This arm's length price will be reflected as the cost of goods sold in the PE's profit and loss statement together with the deductible expense of the amount paid to Company B. The warehousing expenses, bad debt losses and inventory losses are reflected as expenses in head office's profit and loss statement. It should be noted that the operating profit is nil for the DAPE in this example.

The authors are of the view that the proposed profit and loss statement will be identical[86] in this example if Article 7 (attribution of profits to PE) were to be applied first, followed by Article 9. Given that there are

[83] In pg 130 of the comments to discussion draft 1, EY opined that it may not be reasonable to attribute third party sales to the DAPE if the DAPE "walks, talks and acts as a sales agent". However, paragraph 30 of the March 2018 Guidance seemed to attribute third party sales to the DAPE once a PE is found to exist under Article 5(5).

[84] In pg 259 of the comments to discussion draft 1, KPMG is of the view that sales to third parties should not be attributed to a DAPE if no legal, contractual or economic ownership can be allocated to the DAPE. However, the authors concur with the different view of Piotr Drobnik (Drobnik, May/June 2018) that the party (head office or DAPE) to which third sales are allocated, is irrelevant for profit attribution purposes under Article 7 and thus the allocation of third party sales to DAPE in this example is in order.

[85] Para. 75 of Part 1 of the 2010 Report states that the place of use is the basis for attributing economic ownership for tangible assets unless circumstances in the case warrant a different view. However, para. 243 of the same report suggests that in the case of DAPEs, the performance of significant people functions should be adopted as the criterion for attributing economic ownership of inventory.

[86] The proposed profit and loss statement for the relevant parties will not be identical if significant people functions were to be performed by the dependent agent enterprise on behalf of the foreign enterprise in the host

no significant people functions performed by the Company B on behalf of the Company A, performing the Article 7 analysis would produce the same outcome for the Head office and the NRE. The Article 9 analysis would also remain unchanged. This would lead to the same outcome of nil operating profit to be attributable to the DAPE.

Proposed profit and loss statement in the base example[87]

	Company B (DAE)	Company A (NRE)	Head office	DAPE
Sales/sales commission	10[88]	200	190	200
Cost of sales		-40	-40	-190[89]
Gross profit		160	150	10
Operating expenses				
Sales commission		-10	0	-10
Warehousing		-6	-6	-0
Bad debt exp		-4	-4	0
Inventory loss		-3	-3	0
Others	-8	-7	-7	0
Operating profit	2	130	130	0

Key:

- Article 9 analysis
- Article 7 analysis

Some commentators, such as the German Federal Chamber of Tax Advisers,[90] have expressed the view that Company B does not make the decision to sell the goods on behalf of Company A i.e. the DAPE cannot be said to assume the rights and obligations arising from the sale transactions with the external buyers. As such, the sales to customers in Country Y should not be attributed to DAPE. The authors are of the view that this reasoning is also in line with the AoA principles in the 2010 report. However, this is different from the current view[91] adopted by the OECD in the March 2018 guidance that once a DAPE is established under Article 5(5), the rights and obligations resulting from contracts to which Article 5(5) refers to i.e. the sales contracts, will be allocated to DAPE. Despite the difference, the authors are of the view that this does not change the outcome of the Article 9 and 7 analysis, regardless of order adopted, in this fact pattern as shown in the profit and loss statement below.

country. However the total profits in the host country should be same regardless of the priority of application for Articles 7 and 9 as purported in paragraph 34 of the March 2018 guidance (OECD, 2018).

[87] For simplicity, the authors have relied on the figures used by the OECD in discussion draft 1.

[88] This is worked out based on 5% commission of the total sales of 200 to third parties.

[89] This is worked out to provide the DAPE with a gross profit of 10.

[90] Pg 81 of comments to discussion draft 1

[91] Para. 30 of the March 2018 guidance

Proposed profit and loss statement under the other school of thought (where DAPE gets attributed with nil sales)

	Company B (DAE)	Company A (NRE)	Head office	DAPE
Sales/sales commission	10	200	200	10
Cost of sales		-40	-40	0
Gross profit		160	160	10
Operating expenses				
Sales commission		-10	-10	10
Warehousing		-6	-6	0
Bad debt exp		-4	-4	0
Inventory loss		-3	-3	0
Others	-8	-7	-7	0
Operating profit	2	130	130	0

Conclusions that can be drawn from this example

In general, where the DAE does not perform any significant people function, the above examples have shown that that there are clearly no further profits to be attributed to the DAPE. This is regardless of the order of application of Articles 7 and 9. This observation is also aligned with the OECD's view expressed in the March 2018 guidance that the order of application need not matter. Differences in views in terms of whether rights and obligations resulting from sales contracts should be attributed to the DAPE as a start point for the application of Article 7, also do not change the outcome of nil profits attribution to the DAPE. As such, the authors are of the view it is sound to conclude that where the DAE does not perform any significant people function, there would be no further profits to be attributed to the DAPE.

The authors agree with Baker & Mckenzie's views that were brought up in their comments to discussion draft 1.[92] They highlighted that Company B was a DAPE only due to the lowered PE threshold brought about by the 2017 changes to Article 5(5) i.e. the lowering of PE threshold. If we look deep into the facts, Company B only performed the sales activity. It did not perform any functions involved in agreeing to a sale contract which led to the bearing of risk. As mentioned above, the authors assumed that a DAPE was constituted by taking a literal interpretation of the phrase "principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise". If one breaks down the different steps leading to the conclusion of the contracts, given that Company B only performed the functions of sourcing for customers and negotiating with the customers based on pre-determined parameters worked out by Company A, it is debatable as to whether these two functions can be said to be "principal roles". Interpreting the terms in accordance with the light and object of the said paragraph, one can always argue that it is the type of goods and the quality of the goods (up to the stage when it is in the physical possession of the customer) that are important in leading to the conclusion of a sale contract. The terms that can be offered to a customer is also another important factor leading to the

[92] Pg 350 of comments to discussion draft 1

conclusion of a sale contract. Without these other vital aspects, the mere sourcing of customers cannot be said to be a principal role leading to the conclusion of the sale contract. Under this view, perhaps there is no DAPE to begin with. This will lead us to the outcome shown under the alternative shown above i.e. the outcome is unchanged.

Given the above, the authors also share the concerns that have been brought up by the German Federal Chamber of Tax Advisers.[93] Despite no change in the final profit attribution outcome, more DAPEs would be established under the revised DAPE provision in the MTC (see earlier section). This will lead to a significant increase of compliance and associated costs. Coupled with different interpretation among tax authorities on the application of Articles 7 and 9, this will result in an increased risk of tax disputes for taxpayers and increased dispute resolution costs for both taxpayers and tax authorities alike.

6.2 Varied example 1

Facts

The facts are similar to those in the base example except for the following:

Personnel of Company B makes decisions on the choice of warehouse and the terms and conditions of the warehousing arrangement. Personnel of Company B in Country X are responsible for determining and monitoring the inventory levels of the consumer goods stored in the said warehouse. Personnel of Company B in Country X are also responsible for reviewing the credit worthiness of the local buyers in Country Y and determining the credit terms to be extended.

Analysis

The authors would adopt the same approach as used in the earlier analysis under paragraph 6.1 for the base example. Applying a literal interpretation of Article 5(5), we would again conclude that Company A would have a PE in Country Y. This is on the basis that Company B habitually plays the principal role leading to the conclusion of contract that are routinely concluded without material modification by Company A in Country Y and these contracts are in the name of Company A and for the transfer of the ownership of goods owned by Company A. For this example, the principal role has been very much expanded to include sourcing of customers, credit assessment of customers, inventory and warehousing of goods to ensure that sales contracts are fulfilled. Once again, Company B cannot be regarded as an independent agent under Article 5(6) in this case as it acts exclusively on behalf of Company A, a closely related party.

Applying Article 9 followed by Article 7

Under Article 9, the functional analysis of the related party transaction between Company A and Company B revealed that Company B is providing a service to Company A by identifying buyers in Country Y and assisting in the negotiation of the contract. In this case, risks control functions (determining and monitoring inventory levels, reviewing credit worthiness of buyers and determining credit terms, deciding

[93] Pg 81 of comments to discussion draft 1

on choice of warehouse and terms and conditions in warehouse agreement) are allocated to Company B as these functions are performed by personnel of Company B in Country X. Assuming that Company B has the financial capacity to bear inventory risks, credit risks and any risks/obligations arising from the warehousing arrangement, these risks/obligations are allocated to Company B [94] . Any profits/remuneration together with downside consequences in connection with the assumption of these risks or obligations should be attributed to Company B.

Company B is remunerated at arm's length (in this case $30) for the said provision of service as per what an independent commission agent, performing similar functions and assuming similar risks and adopting similar assets, will be remunerated.

Under Article 7 and step one of the AOA, the hypothesized PE is treated to assume Company A's rights and obligations arising from the sale transactions with external buyers, the transaction between Company A and Company B as well as the transaction between Company A and the external warehouse (significant people functions relating to the warehousing of goods i.e. decision on the choice of warehouse owner, are performed by Company B on behalf of the PE). The internal dealing between the DAPE and head office is still characterized as a sale of goods from head office to PE.

The factual analysis under step one of the AOA also revealed that the significant people functions relevant to the assumption of inventory risks (and economic ownership of the inventory), credit risks (and economic ownership of trade receivables) and any risks/obligations arising from the warehousing arrangement, are performed by the personnel of Company B on behalf of Company A. However, since the said risks have already been allocated to Company B under Article 9, these said risks and corresponding economic ownership of assets should not be attributed to the PE to prevent double counting of profits (see earlier section on order of application of Article 9 and 7) in Country X. Accordingly, the downside implications of assuming these risks/obligations i.e. bad debt losses, inventory losses, warehousing expenses should not be reflected in the PE's profit and loss statement.

Applying step two of the AOA, the OECD TPG will be used to determine the arm's length price of the internal dealing between PE and the head office. This arm's length price should be similar to the cost of goods sold of $190 in the PE's profit and loss statement in the base example together with the other deductible expenses such as the amount paid to Company B ($30 in this case).

Also, the warehousing expenses ($6), bad debt losses ($4) and inventory losses ($3) are reflected as expenses in Company B's profit and loss statement.

[94] Paragraph 1.98 of TPG states that if an associated enterprise assuming the risk does not exercise control over the risk or has the financial capacity to assume the risk, the risk should be allocated to the enterprise exercising control and having the financial capacity to assume the risk.

Proposed profit and loss statement in the varied example (significant people functions performed by DAE on behalf of DAPE)

Applying Article 9 followed by Article 7

	Company B (DAE)	Company A (NRE)	Head office	DAPE
Sales/sales commission	30	200	190	200
Cost of sales		-40	-40	-190
Gross profit		160	150	10
Operating expenses				
Sales commission		-30		-30
Warehousing	-6			-0
Bad debt exp	-4			0
Inventory loss	-3			0
Others	-8	-7	-7	0
Operating profit	9	123	143	-20

The DAPE has a loss of $20 while the head office has a profit of $143. In total, profits of $9 will be taxed in Country Y. It is not clear if the DAPE loss of $20 can be used to deduct against future profits of the DAPE (if there ever will be) in Country Y. From the authors' perspective, the DAPE loss of $20 would be akin to the outcome where there are no further profits to be attributable to the DAPE.

Applying Article 7 followed by Article 9

Under Article 7 and step one of the AOA, the hypothesized PE is treated to assume Company A's rights and obligations arising from the sale transactions with external buyers, the transaction between Company A and Company B as well as the transaction between Company A and the external warehouse (significant people functions relating to the warehousing of goods i.e. decision on the choice of warehouse, are performed by Company B on behalf of the PE). The internal dealing between the DAPE and head office is still characterized as a sale of goods from head office to PE.

The factual analysis under step one of the AOA also revealed that the significant people functions relevant to the assumption of inventory risks (and economic ownership of the inventory), credit risks (and economic ownership of trade receivables) and any risks/obligations arising from the warehousing arrangement, are performed by the personnel of Company B on behalf of Company A. As such, these said risks and corresponding economic ownership of assets should be attributed to the DAPE. Notably, since Article 7 is first applied before Article 9, the said attribution to the PE is carried out. As such, the downside implications of assuming these risks or obligations i.e. bad debt losses, inventory losses, warehousing expenses should be reflected in the DAPE's profit and loss statement.

Applying step two of the AOA, the OECD TPG will be used to determine the arm's length price of the internal dealing between PE and the head office. This arm's length price is reflected in the cost of goods sold of $170[95] in the PE's profit and loss statement together with the other deductible expenses such as the amount paid to Company B, bad debt losses, inventory losses, warehousing expenses.

Under Article 9, the functional analysis of the related party transaction between Company A and Company B revealed that Company B is providing a service to Company A by identifying buyers in Country Y and assisting in the negotiation of the contract. Since the inventory risks (and economic ownership of the inventory), credit risks (and economic ownership of trade receivables) and any risks arising from the warehousing arrangement have already been allocated to PE under Article 7, these said risks and corresponding economic ownership of assets should not be attributed to the Company B to prevent double counting of profits (see earlier section on order of application of Article 9 and 7) in Country X.

Company B is remunerated at arm's length for the said provision of service as per what an independent commission agent, performing similar functions with no attribution of the mentioned risks and assets in the immediate preceding paragraph, will be remunerated. The amount of arm's length remuneration for Company B should be identical to that in the base example i.e. $10.

Proposed profit and loss statement in the varied example (significant people functions performed by DAE on behalf of DAPE)

Applying Article 7 followed by Article 9

	Company B (DAE)	Company A (NRE)	Head office	DAPE
Sales/sales commission	10	200	170	200
Cost of sales		-40	-40	-170
Gross profit		160	150	30
Operating expenses				
Sales commission		-10	0	-10
Warehousing		-6	0	-6
Bad debt exp		-4	0	-4
Inventory loss		-3	0	-3
Others	-8	-7	-7	0
Operating profit	2	130	123	7

[95] Assume that the resale price margin method for transfer pricing is used and that an independent reseller with similar functions performed and assets and risks assumed, has a resale price margin of 15% of sales. Hence the DAPE resale margin is $30 (15% x external sales of $200) and the cost of goods sold is $170, being the difference between the external sales of $200 and resale margin of $30.

The DAPE has an operating profit of $7 while the head office has a profit of $123. The DAPE has an operating profit of $2. In total, Country Y is able to tax a total of profits amounting to $9. From country Y perspective, the outcome is similar regardless of the order of application of Articles 7 and 9. The only difference is in terms of the entity in which the profits are taxed. Depending on the actual tax rates applicable to the DAE and the DAPE and their tax circumstances (e.g. carry forward losses etc), the actual tax implication would differ.

Conclusions that can be drawn from this example

In the event where the DAE performs some significant people functions, the order of application of Articles 7 and 9 does causes some differences to the profits that are attributable to the DAE and the DAPE. Where the Article 9 analysis precedes the Article 7 analysis, there will generally be no further profits attributed to the DAPE as the risks would have already been allocated to the DAE. Where the Article 7 analysis precedes the Article 9 analysis, there will be some profits attributed to the DAPE as the risks would then be attributed to the DAPE first and the DAE would not be taxed on the same profits attributed to the DAPE. From a host country perspective, there two outcomes may not be significantly different since the total profits arising from the economic activities carried out in the country that can be taxed in the same country remains unchanged. The only difference lies in the entity/PE in which the profits are taxed. From the perspective of a multinational group where the DAE and DAPE are all members of the same group, this may also not be a significant difference.

We would like to follow through our earlier analysis on the spectrum of activities that a sales agent might perform and the deeming of the DAPE due to the change in the scope of Article 5(5). Under this example, Company B performs a lot more functions that is necessary in the chain of activities leading up to the conclusion of a sale contract. Where the Article 9 analysis is performed first, the relevant risks associated with the functions undertaken by Company B would have been allocated to Company B (DAE). Company B would be rewarded under the Article 9 analysis. Accordingly, by the time we get to the Article 7 analysis, there would be no risks left to be allocated to the DAPE i.e. we will end up with the outcome of no further profits to be attributable to the DAPE. Once again, this is a sound outcome from the authors' perspective. All functions performed by Company B have been remunerated, in the capacity of Company B as the DAE. When the Article 7 analysis is performed before the Article 9 analysis, there will be some profits left to be attributed to DAPE created by Company B. The authors would opine that this is a logical outcome. The risks that are allocated to the DAPE under the Article 7 analysis would not be allocated under the Article 9 analysis. The appropriate reward for undertaking such risks is taken care of in the capacity of the DAPE under the Article 7 analysis. Correspondingly, there would be a smaller remuneration allocated to the DAE under the Article 9 analysis. On a net basis, as shown above, the total profit attributable to Country Y does not differ.

7. Analysis

In this section of the paper, the authors would do a brief summary of the conclusions above and put forth some recommendations.

7.1 Combined conclusions that can be drawn from the two examples

Based on the above analysis, in the situation of the sales commission agent deeming a DAPE for an NRE, it can be seen that as long as Article 9 is applied before Article 7, there will never be a situation where further profits will be attributed to the DAPE if the DAE is paid an arm's length fee for the services rendered in view of the functions performed, risks assumed and the assets used.

The same conclusion was similarly drawn by some of the commentators to Discussion Draft 2. Andrew Hickman in his comments to Discussion Draft 2[96] explained that if significant risks are assumed by the DAE and the price paid to the DAE is at arm's length, there will never be any profits attributable to the PE. This is due to the rule of no double counting of risks. Deloitte has also expressed the view that if there is no risk controlling function in the PE country, the return for risk taking will be borne by the head office and not the PE. If the risk is controlled by people in the DAE, the DAE will be attributed with return for taking risk under the Article 9 analysis. There will be no further return to be attributed to the DAPE which is created due to the lowered PE threshold.[97] Similarly, Joe Andrus and Richard Collier have also expressed similar views and highlighted the importance of emphasizing the point that the DAPE should not receive a function-based reward for functions performed by the DAE since the DAE should be rewarded for its functions under transfer pricing rule. There should not be a separate functional reward to the DAPE.[98] The commentators go further to suggest that greater source country taxation can result only from the assertion that a PE exists if either the DAE/DAPE is attributed functions, risks or assets that would not have been taxable in the country had there been no PE.[99]

7.2 Risk allocation under Article 9 versus risk attribution under Article 7

In the above analysis, the authors have not done an in-depth analysis in terms of the different ways in which risks are allocated to the DAE under Article 9 and attributed to the DAPE under Article 7. Apart from the differences highlighted in paragraph 5.3 above, the authors have not ventured further into this area. The authors are of the view that this is beyond the scope of this paper. Nonetheless, it is worthwhile to note the comments from the Silicon Valley Tax Director Group this would be one of the possible reasons as to why certain analysis differs in outcome. If risk attribution under the AoA is revised to take into account the changes in Chapter 1.D of the TPG with regards to risk allocation, the differences would go away.[100]

[96] Pg 13 of comments to discussion draft 2.
[97] Pg 95 of comments to discussion draft 2.
[98] Pg 157 of comments to discussion draft 2.
[99] Pg 158 of comments to discussion draft 2.
[100] Pg 336 of comments to discussion draft 1

8. Recommendation and conclusion

In view of the above analysis, the authors strongly recommend that countries adopt the preferred order of applying Article 9 followed by Article 7 in the situation where the DAE is a related party and ends up deeming a DAPE for the NRE. As shown above, this will always lead to the outcome of no further profit attribution to the DAPE if the Article 9 analysis is carried out properly. The country where the DAE/DAPE is operating in is not short changed in terms of tax revenue as the functions performed, assets used and risks assumed in the country would already be allocated to the DAE under the Article 9 analysis and adequately remunerated.

The analysis above stands true regardless of the changes to Article 5(5) and 5(6) i.e. there is no cliff effect. This also begs the question on the value of the DAPE in a related party setting. Where the Article 9 analysis is correctly done and is the first step to be done, there is effectively no need to find a DAPE.

Where the DAE is a third party is acting on behalf of the NRE, the application of Article 9 is not relevant but the same outcome of no further profit attribution to DAPE would still apply. The remuneration paid to the third party would definitely be at arm's length and would equate the outcome that would have been determined under the Article 9 analysis had the DAE been a related party, all things being equal. The profits attributed to the DAPE under the Article 7 analysis would similarly be extinguished by the remuneration paid to the DAE leading to the outcome where there are no further profits attributable to the DAPE.

In the other situation where a non-employee individual is acting on behalf of the NRE, the remuneration paid to the non-employee individual would also be at arm's length and the profits attributed to the DAPE under the Article 7 analysis would similarly be extinguished by the remuneration paid to the non-employee individual leading to the outcome where there are no further profits attributable to the DAPE.

From a compliance perspective, given that there are no further profits to be attributed to the DAPE in the above situations, there would be no need for the DAPE to file a separate return. Only the DAE or the non-employee individual would need to file its/his return, which is what it/he would have to do under normal circumstances.

From a tax administration perspective, one of the following recommendations could be implemented to reduce the administration costs of tax administrations for the above situations involving no further profits to be attributed to the DAPE (zero-profits PEs):

- Under the domestic tax laws of the PE country, a PE exemption[101] can be granted for zero-profits PE created as a result of activities by a DAE or a non-employee individual on behalf of NRE. This is akin to adopting the single taxpayer approach for these situations and the arm's length remuneration paid to the DAE or non-employee individual is taxed.

[101] In pg 102 of comments to discussion draft 2, EY recommended the exemption of recognition of PE where it is clear there are no profits attributable to the PE.

- The DAPE provision under tax treaties[102,103] could be revised to exclude DAPE created as a result of activities by a DAE or an non-employee individual provided that an arm's length remuneration is paid to the DAE or the non-employee individual.

if one of the above recommendations is adopted, the NRE/DAPE is not required to file a tax return in the PE country and disputes arising from the interpretation and application of Article 5(5) by tax administrations and taxpayers would also be reduced.

The only situation where there is a possibility that the DAPE could be attributed with further profits is the situation where the DAPE is deemed through the activities of the NRE's employees in the PE country. In such a situation, the NRE employees would usually be remunerated presumably based on their employment terms and conditions. Given the language used in the 2010 report where there should be a deduction given for the arm's length reward to the DAE for the services provided, it is debatable if the remuneration that is paid to the NRE employees can be considered as such and be deducted from the profits attributed to the DAPE. Firstly, the NRE employees, strictly speaking, are not enterprises in their own right. Secondly, it is not clear how functions, assets and risks can be attributed to these employees. Thirdly, these employees, may not always be subject to tax in the PE country for the services that they have rendered. This would be fact specific and dependent on whether the taxing rights over their employment income would be allocated to the PE country under Article 15[104] and how much of their employment income would eventually be taxed. Given the various debatable points, attribution of profits to such a DAPE would be uncertain although minimally, in keeping up with the logic of allowing the PE deductions for expenses incurred, the authors are of the view that the remuneration that is paid to these employees for their activities in the PE country ought to be deducted against the PE profits. That being said, under most circumstances, the authors are of the view that it would be rather unlikely that the remuneration paid to these employees would fully extinguish the profits attributable to the PE. As such, the authors would conclude that there would generally be further profits attributed to the DAPE that was deemed through the activities of the employees of the NRE. This conclusion is similar to the current viewpoint of the German tax administration and the Dutch tax administration that there will still be remaining profits attributable to the DAPE created as a result of the activities of employees of NRE.

Looking back at the evolution of the wording of Article 5(5) where the deeming of DAPEs was distinguished between agents which are enterprises or non-employee individuals and employees of the NRE in the first instance, the authors wonder if there was already an understanding in terms of the difference in outcome for profit attribution to the DAPE in such scenarios back then. These were the days that preceded even the arm's length principle and way preceded AoA. Based on some preliminary research done, the authors have the impression that agents started off primarily as employees acting on behalf of an enterprise. The situation where enterprises or non-employee individuals act as agents for the NRE was a later

[102] In pg 230 of comments to discussion draft 2, the Silicon Tax Valley Directors Group recommends the inclusion of a new paragraph under Article 5 of the MTC which provides for allowing an NRE and a closely related person in a source country to make a binding election, and maintain their intercompany arrangements, so as to ensure the host country collects the same tax it would if the closely related person gave rise to a PE, yet resulting in no PE being deemed to exist.

[103] Based on EY's recommendation in pg 138 of comments to discussion draft 1.

[104] Under Article 15 of the OECD MTC 2017, sole taxing rights of employment income are granted to the country of residence of the employee if the period threshold of 183 days is not exceeded in the source country and other conditions are met.

phenomenon. Given the developments in commercial arrangements such as outsourcing, and the different developmental tracks that PE crystallization rules and PE profit attribution rules took, there is a possibility that one set of rules was developed without the other in mind. This has thus led to the outcome that there was unlikely to be further profits attribution to DAPEs which were crystallized by DAEs which were related enterprise, thus rendering the finding of DAPEs in this situation fairly unnecessary. Nonetheless, this remains a speculation on the part of the authors. Further in-depth research would be needed but that would be a topic for another paper.

In conclusion, the authors remain convinced of our views that it would be unnecessary to find a DAPE and to do a profit attribution exercise where the DAE is a related party enterprise, a third party enterprise or where a non-employee individual is acting on behalf of the NRE. This conclusion remains unchanged even with the lowering of the PE thresholds for Articles 5 and 6. Finding a DAPE and doing a profit attribution exercise is only necessary where the DAPE is deemed through the actions of employees of the NRE.

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