

## Contacts

National tax policy leader  
**Albert Baker**  
416-643-8753

National leader -  
International Tax  
**Etienne Bruson**  
604-640-3175

Canadian Desk leader  
Hong Kong  
**Chris Roberge**  
852-285 25627

Atlantic  
**Brian Brophy**  
709-758-5234

Quebec  
**François Champoux**  
514-393-5019

Ontario  
**Mark Noonan**  
613-751-6688

**Tony Maddalena**  
905-315-5734

Toronto  
**Tony Ancimer**  
416-601-5945

**Sandra Slaats**  
416-643-8227

Alberta and Prairies  
**Andrew McBride**  
403-503-1497

**Charles Evans**  
780-421-3884

British Columbia  
**Brad Gordica**  
604-640-3344

## Related links

[International Tax services](#)  
[Deloitte Tax services](#)

## International tax alert

### BEPS update - PE status, treaty abuse

December 11, 2014

On October 31, 2014, continuing its work on the base erosion and profit shifting (BEPS) project, the OECD released a discussion draft on Action 7 in relation to preventing the artificial avoidance of permanent establishment (PE) status. As part of this work, the OECD is considering modernizing the PE threshold to address digital cross-border business, in line with the work on BEPS Action 1.

On November 21, 2014, the OECD released a follow-up discussion draft on Action 6 in relation to preventing treaty abuse. This follow-up discussion draft invites comments on a number of areas which were not addressed or fully addressed in the September release.

Public comments are invited on both releases.

### Action 7 - proposals re Article 5 of the OECD model treaty

**Artificial avoidance of PE status through *commissionnaire* arrangements and similar strategies:** The OECD proposes changes to the current rules on dependent and independent agents. Activities performed by an intermediary in a sales country that are intended to result in the regular conclusion of contracts by a foreign entity will in future create an agency PE (taxable presence) of the foreign entity. The exception for independent agents remains, but the discussion draft proposes tightening the rule to make it clear this will not apply to an agent acting only for a group of companies.

The discussion draft puts forward four alternative (but similar) proposals to amend the agency PE provisions (Article 5(5) of the model treaty). The alternatives are:

1. Add a reference to contracts for the provision of property or services by the foreign entity where the intermediary “engages with specific persons in a way that results in the conclusions of contracts”;
2. Add a reference to contracts for the provision of property or services by the foreign entity where the intermediary “concludes contracts, or negotiates the material elements of contracts”;
3. Focus on contracts which, by virtue of the legal relationship between the agent and the foreign enterprise “are on the account and risk of the enterprise” where the intermediary “engages with specific persons in a way that results in the conclusion of contracts”;
4. Focus on contracts which, by virtue of the legal relationship between the agent and the foreign enterprise, “are on the account and risk of the enterprise” where the intermediary “concludes contracts, or negotiates the material elements of contracts”.

In addition, the OECD proposes to strengthen the requirements (in Article 5(6) of the model treaty) for an agent to be considered “independent” such that it does not create a PE of a foreign entity. The exemption would only apply where the agent is acting on behalf of “various persons” and specifically clarifies that acting “exclusively or almost exclusively on behalf of one enterprise or associated enterprises” will not be sufficient to be considered an independent agent.

**Artificial avoidance of PE status through the specific activity exemptions:** The OECD proposes changes to the list of exceptions for specific activities (such as the maintenance of stocks of goods for storage, display, delivery or processing and purchasing) under which a fixed place of business is treated as not creating a PE (Article 5(4) of the model treaty). This proposal modernizes the exemptions for activities such as warehousing that would have been considered preparatory or auxiliary when the model treaty provisions were originally negotiated. Modern ways of doing business - and in particular internet sales - have made warehousing in the form of sophisticated logistics centres a key part of the value chains of many businesses; the current exemption is perceived by many governments as being too wide. The discussion draft considers possible alternative proposals:

1. A catch-all requirement that for the exemption to apply each specific activity (or the combination of activities) must be of a “preparatory or auxiliary character”;
2. If proposal 1 is not adopted, remove “delivery” from the specific activity exemptions;
3. If proposal 1 is not adopted, remove “purchasing goods or merchandising” from the specific activity exemptions;
4. As an alternative to proposal 3 if proposal 1 is not adopted, remove “purchasing goods or merchandising” and “collecting information” from the specific activity exemptions.

In addition, the OECD is concerned with situations where activities are “fragmented” between related parties in order to meet the requirements for activities to be preparatory or auxiliary. Two alternative proposals are proposed:

1. The specific activity exemptions would not apply where “the same enterprise or an associated enterprise” carries on activities, one of the enterprises has a PE (under the provisions of the rest of Article 5) and the business activities constitute “complementary functions that are part of a cohesive business operation”;
2. The specific activity exemptions would not apply as with proposal 1, and also where the “overall activity resulting from the combination of the activities... is not of a preparatory or auxiliary character” where the activities constitute “complementary functions that are part of a cohesive business operation”. Under this option, there is no need for one or other enterprise to have a PE under the rest of the provisions of Article 5.

**Splitting up of construction contracts:** The OECD is considering proposals to deal with the splitting up of contracts between related parties, which may affect the application of the 12-month time period for creating PEs for building sites, construction or installation projects (Article 5(3) of the model treaty) (and also non-OECD model services PE articles for countries that have adopted them). The proposals put forward are:

1. For the purposes of determining the 12-month period, activities carried on by associated enterprises will be added to the period of time of an enterprise’s activities on site;

2. As an alternative, the principal purposes test proposed in relation to preventing treaty abuse under Action 6 of the BEPS Action Plan could be used to address splitting up of contracts. An example would be added to the Commentary on Article 5 of the model treaty to illustrate this.

**Insurance:** The discussion draft addresses a concern that has been raised that insurance companies may do large-scale business in a country without having a PE. The OECD is considering two alternative approaches:

1. A specific PE threshold, similar to that found in the UN model treaty, for an insurance company, “if it collects premiums in the territory ... or insures risks situated therein”. (Reinsurance is excluded from this proposal.)
2. No specific treaty provision for insurance companies, and any issues would be dealt with through the proposed changes to PEs in respect of sales in the options noted above under “Artificial avoidance of PE status through the specific activity exemptions”, which would apply equally to insurance as to other industries.

The discussion draft seeks input on these alternative approaches and also asks for input on whether reinsurance raises specific concerns related to the avoidance of PE status.

### Action 7 and transfer pricing

The need to coordinate the work on thresholds for PEs with the BEPS work on transfer pricing (particularly on interest deductions and other financial payments, intangibles and risks and capital) is recognized. The discussion draft comments that the preliminary work by the OECD to date has not identified changes that would be required in relation to the attribution of profits to a PE (although some additions and/or clarifications would be useful). The OECD acknowledges, however, that work on other areas, in particular risks and capital, might involve a reconsideration of some aspects of the existing rules.

### Timetable for Action 7

Comments are invited by January 9, 2015, and in particular the OECD is interested in examples of unintended effects. A public consultation meeting will be held at the OECD in Paris on January 21, 2015. The meeting will be broadcast over the internet.

Given that changes to the definition of taxable presence will require amendments to double tax treaties, it may take some time for the final rules to take effect globally. Changes could be made through a multilateral convention, but we should also expect countries to use bilateral protocols to implement quicker change.

### Action 6 - follow-up work on LOB rule to prevent treaty abuse

Comments are invited on the following in respect of the limitation on benefits (LOB) rule:

- **Widely held CIVs:** Whether the recommendations of the 2010 OECD Report, “The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles” are adequate or whether improvements could be made.
- **Non-widely held CIVs:** This could include, for example, sovereign wealth, alternative and private equity funds. These funds may not qualify as residents and, even if they do, may fail to meet the current draft of the LOB rule.

- **Pensions:** The residence of pension funds, the exemption of income where both states generally exempt from tax the investment income of domestic pensions, the 50% ownership test and the definition of pension funds.
- **Competent authority discretionary relief:** The factors that competent authorities should take into account when determining whether relief should be available.
- **Derivative benefit provisions/equivalent beneficiaries:** Possible ways in which a derivative benefits test could be included to allow intermediate companies used for valid commercial reasons to access treaty benefits. This is tied in with other BEPS Actions.
- **Timing issues:** In particular, how to treat a company which becomes or ceases to be publicly-listed during a taxable period.
- **Small countries with non-substantial stock exchanges:** Modifying the publicly-listed provision to reflect the fact that listings may not be sought in smaller local markets, while ensuring that an entity has sufficient nexus to warrant the application of the treaty.
- **Interpretation of the active business provision:** Head office operations, and the combination of different activities (for example, manufacturing and investment) carried on in the same country should be considered.

### Action 6 - follow-up work on the PPT to prevent treaty abuse

The discussion draft identifies possible issues with the principal purposes test (PPT):

- **Establishing an administrative process to ensure that the PPT is only applied after senior approval:** There is a recognition that general anti-abuse rules found in domestic law may be subject to approval by a committee of senior officials. The commentary on the PPT could include the suggestion that countries consider establishing a similar process for applying the PPT.
- **Arbitration:** The majority of countries support the application of the PPT being a matter that is suitable for arbitration.

Comments are invited on:

- **Extending the list of examples** in the PPT commentary;
- **Alignment with LOB commentary**, in particular, in respect of the competent authority discretionary LOB rule which also considers purpose;
- **Availability of discretionary relief:** As currently drafted, if the PPT applies, the relevant income would be taxable under domestic law without any treaty benefits. In some cases, however, it may be appropriate to provide some form of treaty relief. The example given is a transaction which transforms dividends into a capital gain on shares. Tax authorities may consider it appropriate to apply the relief provided under the dividends article;
- **The alternative “conduit-PPT rule”:** This alternative to the PPT may be used by states to address treaty-shopping conduit strategies that would not be caught by the LOB rule. The commentary could include possible examples, which could be taken from the exchange of notes between the United Kingdom and United States in respect of the conduit arrangement rules in the 2001 treaty.

## Other issues to be addressed as part of the follow-up work on Action 6

- **New treaty tie-breaker rule:** The possible encouragement of competent authorities to address as quickly as possible requests that will be made under the new rule.
- **Triangulation/permanent establishment in third state:** Comments are invited on whether the rule should be extended to situations beyond where the profits of the permanent establishment are exempt, and whether the exemptions from the rule are broad enough.

## Timetable for Action 6

Comments should be sent to the OECD by January 9, 2015 and there is a public consultation meeting on January 22, 2015.

## Treaty abuse developments in Canada

Closer to home, at the end of August the Department of Finance announced that draft legislation regarding Canada 's domestic "anti-treaty shopping" proposal would not be advanced at that time pending further work in the area by the OECD. (This was addressed in our **September 22, 2014 International Tax Alert**.) While some may have hoped that this pause would be a permanent pause, based on comments from Department of Finance officials at the Canadian Tax Foundation Annual Conference (held November 30 to December 2, 2014 in Vancouver), work in this area is proceeding – however, the ultimate form of the proposal and the timing of its release remain to be seen.

*Albert Baker, Toronto*

---

[Home](#) | [Legal](#) | [Privacy](#)

2 Queen Street East, Suite 1200  
Toronto, ON M5C 3G7 Canada

© Deloitte LLP and affiliated entities.

This publication is produced by Deloitte LLP as an information service to clients and friends of the firm, and is not intended to substitute for competent professional advice. No action should be initiated without consulting your professional advisors. Your use of this document is at your own risk.

Deloitte, one of Canada's leading professional services firms, provides audit, tax, consulting, and financial advisory services. Deloitte LLP, an Ontario limited liability partnership, is the Canadian member firm of Deloitte Touche Tohmatsu Limited.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see [www.deloitte.com/about](http://www.deloitte.com/about) for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

[www.deloitte.ca](http://www.deloitte.ca)

If you do not wish to receive future marketing emails from Deloitte, forward this email to [unsubscribe@deloitte.ca](mailto:unsubscribe@deloitte.ca).

Please add "@deloitte.ca" to your safe senders list to ensure delivery to your inbox and to view images.