Deloitte.

BEPS Action 7: Preventing the artificial avoidance of Permanent Establishment (“PE”) status

Background

- Action 7 of BEPS focuses on updating the definition of PE in Article 5 of the OECD model tax treaty. The main objective is to prevent the artificial avoidance of PEs where there is significant activity in a country.
- On 15 May 2015 the OECD released a revised Discussion Draft on Action 7. This selects and refines proposals put forward in an earlier draft (issued on 31 October 2014).
- The proposed changes in the latest Discussion Draft are wide-reaching and, if adopted, will significantly increase the occasions on which a PE will be created.
- There are a number of areas of uncertainty and potentially additional compliance costs for businesses.
- Whilst many countries want change in this area there is no consensus on the latest proposals. For example, the US Treasury has suggested that it is uncomfortable with the uncertainty created and may enter a reservation if this Discussion Draft is the final form.

Proposed changes to the model tax treaty

- The definition of Agency PE is widened to include situations where the intermediary negotiates the material elements of contracts which are then concluded by a foreign entity, unless the intermediary is an independent agent.
- The definition of independent agent will not be available to agents acting mainly or only for one group of companies.
- The specific activity exemptions are restricted to activities that are preparatory or auxiliary to the business as a whole.
- The specific activity exemptions are not available where activities that constitute a fixed place of business in a country are artificially ‘fragmented’ between group companies to meet the exemptions for activities that are auxiliary or preparatory.
- The OECD will provide further guidance and examples on the application of the principles for attributing profits to PEs by the end of 2016.
- Changes to bilateral double tax treaties to reflect the new conditions will be included as part of the multilateral instrument with earliest effect from 2017.

Next steps and action

- Businesses should start considering the potential impact of the proposals on their business models now.
- Changes to businesses’ supply chain structures may be required.
- The following actions are, therefore, recommended:
  - **Identify** whether activities of local operations are likely to create PEs under the proposals of the latest Discussion Draft.
  - **Assess the impact** of any potential new PEs on the business structures, including additional compliance costs and potential double taxation situations.
  - **Evaluate** appropriate strategies to reduce uncertainty.
  - **Implement** selected strategies bearing in mind some areas may become clearer in September when the final report is published.

How Deloitte can help

- **PE reviews:** A review of current operational structures (including activities of internationally mobile employees) focused upon identifying potential risk areas and providing guidance on strategies to help reduce uncertainty as to how the activity will be treated under the new model treaty.
- **Alignment of business models to recommendations from Action 7:** Evaluation of, and assistance with, the implementation of business models that align with PE requirements.
- **PE tool:** New modules to the employee mobility analytics tool that help identify potential PEs based on employee travel records, highlight areas of risk and, in some instances, quantify potential exposure.

Designed and produced by The Creative Studio at Deloitte, London. 46104A