



To: Marlies de Ruiters, Head, Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA  
Date: 17 December 2014  
Re: **Comments to the OECD's discussion draft on Action 7 of the BEPS Action Plan of 31 October 2014**

Dear Marlies,

Here are my comments to the above draft.

It is true that taxpayers avoid PE's for tax reasons, but some of these reasons are good. E.g.

1. Avoiding PE's avoids the double tax that arises when income and cost allocations do not match.  
E.g. XCo in StateR has a PE in StateS. StateS taxes XCo's PE income, but disagrees with certain costs allocated to it. If StateR argues that those costs belong to StateS, XCo pays double tax.
2. Avoiding PE's avoids the double tax arising from a lack of cross border consolidation.  
E.g. States A, B and R all levy 25% income tax. ACo is resident in State R and has PE's in States A and B. ACo makes profit of 100 in State A and losses of 90 in State B. ACo pays 25 tax in State A, has a worldwide EBT of  $(100-90)=10$  and an effective tax rate of  $(\frac{100 \times 25\%}{10})=25\%$ . If ACo avoided PE's, its effective tax rate would be  $(\frac{(100-90) \times 25\%}{10})=25\%$ .
3. Avoiding PE's reduces the overall administrative burden:
  - one set of accounts instead of many;
  - one tax return instead of many;
  - no TP documentation;
  - no AOA complexities\*;
  - one audit instead of many; and
  - one tax dispute instead of many.

\* The AOA is complex: free capital is a vague concept with too many ways to calculate it; it is rejected by the UN/2/3 of the world's countries, thus requiring different systems for different countries; and the asset allocation to the place of use leads to complications: e.g. for pipelines or drilling rigs on one year assignments.

It is understandable that governments, as a matter of policy, want to see more tax in the source state and no double non-tax. However, to be credible, they have to be seen caring just as much about double tax and reducing administrative burdens. It would therefore be great if the deliverable on this action also:

- a. Strongly recommends (again) that governments include article 7'3 and 25'5 in their tax treaties.
- b. Links this action to the adoption of an arbitration clause in the multilateral instrument of action 15. Such a clause should be robust so taxpayer access cannot be frustrated through formalistic arguments.
- c. Minimises the compliance burden created by more PE's through strongly recommending the use of bilateral safe harbours as discussed in the revision of the TPG, Chapter IV, Section E on safe harbours of 16 May 2013.
- d. Links this action to the incorporation of these safe harbours into the multilateral instrument of action 15 with default percentages which governments could opt out from on a bilateral basis.
- e. Addresses the complexity of the AOA and income and cost mismatching. Many new PE's will still perform low risk routine functions in centralised business models in order to minimise the double tax mentioned under point 2 here above. The AOA gives little practical guidance on distinguishing between low risk distributor PE's and fully fledged reseller PE's and was not written for the new 5'5 and 5'6.

More source taxation should not have to be synonymous with more uncertainty caused by severe complexity.

# Johann H. Müller

International tax professional

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Further:

- i. Please define “exclusively” and “almost exclusively” in the new article 5, paragraph 6.  
E.g. is “exclusively” 10% of the turnover generated by being an agent for third parties?  
If countries fear that a clear definition leads to taxpayers targeting it, one should remember that taxpayers have a right to certainty; this should not be compromised by using vagueness as an anti-BEPS tool. It is illogical to argue that a margin is only acceptable when it is hit or exceeded by accident and not by design.
- ii. The 4 alternatives to article 5, paragraph 5, seem to imply that if an enterprise acts on behalf of related EnterpriseA, but for the account of related EnterpriseB, then neither EnterpriseA nor EnterpriseB will have a PE, in spite of the new article 5, paragraph 6. Is this intentional?

Thank you for taking the time to read this. I am registering to attend the public consultation of 21 January 2015. Should you wish me to elaborate on any of my points at that meeting, I would be happy to do so.

Yours sincerely,

*Johann H. Müller*