Executive summary

On 11 and 12 October 2016, the Organisation for Economic Co-operation and Development (OECD) held a public consultation with respect to the discussion drafts on Additional Guidance on Profit Attribution to Permanent Establishments (the PE Discussion Draft) and on Revised Guidance on Profit Splits (the PSM Discussion Draft) that were released earlier this year. The consultation was an opportunity for stakeholders to engage directly with the OECD Secretariat and the country delegates who are responsible for the OECD’s transfer pricing work. The OECD Working Party will discuss the comments and next steps at its next meeting in November 2016.

Detailed discussion

On 5 October 2015, the OECD released final reports on all 15 focus areas in its Action Plan on Base Erosion and Profit Shifting (BEPS). Among the final reports were the final report on Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status (the Action 7 Report) and the final report on Actions 8-10: Aligning Transfer Pricing Outcomes with Value Creation (the Actions 8-10 Report). Following these reports, the OECD on 4 July 2016 issued the PE and the PSM Discussion Drafts. The PE Discussion Draft included two fact patterns that were considered to particularly benefit from additional

OECD holds public consultation on attribution of profits to PEs and profit splits
guidance concerning the attributions of profits to PEs. These facts patterns were: (a) dependent agent PEs, including those created through commissionaire and similar arrangements; and (b) warehouses as fixed place of business PEs. The PSM Discussion Draft contained proposed revisions to the guidance on the application of the transactional profit split method, together with a number of questions. Both discussion drafts included an invitation to interested parties to send their comments. In total, the OECD received over 860 pages of comments on the two discussion drafts.

The public consultation on 11 and 12 October 2016 was a dialogue among stakeholders, country tax officials, and the OECD Secretariat on key issues and concerns addressed in those comments. The consultation was hosted by OECD Working Party No. 6, which is responsible for the OECD’s work on transfer pricing matters. The first day of the public consultations covered the additional guidance on profit attribution to PEs; the second day covered the proposed revisions to the guidance on application of profit splits.

Additional Permanent Establishment Guidance

The consultation on the Additional Permanent Establishment Guidance began with opening remarks from Hans van Egdom, the Co-Chair of Working Party No. 6. He mentioned the key issues to be discussed: (i) the order of application of Article 7 and Article 9 of the OECD Model Tax Convention; (ii) the difference in allocation of risks under Article 7 and under Article 9; (iii) the difference between the notion of significant people function under Article 7 and control over risk under Article 9; (iv) the impact of the 2015 guidance on the transactional profit split method in the context of global value chains. In particular, it considered the approaches to splitting profits through transactional profit splits of actual profits and transactional profit splits of anticipated profits. It also proposed further draft guidance on the appropriate application of transactional profit split methods.

In their opening statements to the day, the Business International Advisory Committee (BIAC), representing international business, focused on the question of when a profit split should be applied. BIAC stressed the primacy of the most appropriate method (the principle that any transfer pricing method should be assessed against alternative...
transfer pricing methods taking into account the facts of the situation and the availability of data in order to choose the most appropriate method) and the need to protect the arm’s length principle. They argued that the profit split method should not be used as a default option, suggesting that in some situations, a profit split would be too complicated. They called for more detail and a wider range of examples in the guidance to ensure that the profit split method would be applied consistently. They also wanted to see more guidance on valuation and the application of profit splits to ongoing transactions.

By comparison, the BEPS monitoring group, as a representative of civil society, called for the systemization of the profit split method. They believe that sooner or later some form of a unitary taxation model will need to be applied to multinationals. They believe the profit split method should not be used as a “fall back” suggesting that in many cases there is significant value contributed by members of an integrated multinational group. This “synergy profit” is, in their view, the root of the problems with taxing multinationals. Their concerns are that if the profit split method continues to be used on an ad hoc basis, this will only add to these difficulties.

The discussions during the second day looked at:

- Profit splits of anticipated profits and actual profits and whether they involved different situations that need to be addressed separately in the guidance.
- What factors relating to the activities of the parties, the transaction in scope and the market are relevant in considering when a transactional profit split of anticipated or actual profits is likely to be the most appropriate method.
- What are “unique and valuable contributions” for the purposes of determining whether a transactional profit split method is the most appropriate method.
- What is the relevance of sequential/parallel integration to determining whether a profit split of actual or anticipated profits is the most appropriate method.
- What is the relevance of sharing of risks to transactional profit splits of actual profits and how to define “sharing of risks” in this context.
- The relevance of a value chain analysis to when and how to apply a transactional profit split method.

The Chair concluded – based on the input of international business – that more clarification in the guidance is needed, in particular on the interaction with chapter I of the OECD Transfer Pricing Guidelines, which has been amended as a result of BEPS Actions 8-10. Furthermore, he noted that the BEPS monitoring group, as a representative of civil society, has fundamental issues with the current and proposed guidance, on the framework of respecting separate legal entities and the application of the arm’s length principle. They favor that some form of a unitary taxation model will need to be applied to multinationals.

Next steps

The OECD Working Party will discuss the comments at its next meeting in November. For now it is unclear whether new discussion drafts will be released.

Implications

The changes in the threshold for PEs included in the October 2015 BEPS deliverables, in combination with the proposed changes on attribution of profits to PEs, and the proposed changes on profit splits may have significant impact on global businesses. Global businesses should evaluate the implications of the proposed additional guidance and also monitor the follow up work by the OECD.

Endnotes


3. EY issued multiple alerts on the various topics covered in the Action 8-10 report. See EY Global Tax Alert, [OECD releases final transfer pricing guidance on risk and recognition under Actions 8-10](http://www.oecd.org/tax/transfer-pricing/BEPS-discussion-draft-on-the-revised-guidance-on-profit-splits.pdf), dated 13 October 2015, on the topics that are most relevant for the business consultation.
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