Mexico City, January 9, 2015

Via e-mail

taxtreaties@oecd.org

Marlies de Ruiter
Head of Tax Treaties, Transfer Pricing
and Financial Transactions Division OECD/CTPA

Dear Ms. De Ruiter,

On behalf of IFA Grupo Mexicano, A.C. (Mexican Branch of the International Fiscal Association) kindly find below the comments to the Public Discussion Draft on Action 7 of the BEPS Action Plan –"*Prevent the Artificial Avoidance of the PE Status*" (the "Draft").

A. Artificial avoidance of PE status through *commissionaire* arrangements and similar strategies.

A.1. Paragraph 5.

Current status	Alternative proposals
5. 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	5. Notwithstanding the provisions of paragraphs 1 and 2 **but subject to the provisions of paragraph 6**, where a person is acting on behalf of an enterprise
and has, and habitually exercises, in a Contracting State an authority to conclude contracts	**and in doing so, habitually engages with specific persons in a way that results in the conclusion of contracts [Alternatives A & C]**

	and in doing so, habitually concludes contracts or negotiates the material elements of contracts **[Alternatives B & D]**
in the name of the enterprise,	**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,** **[Alternatives A & B]**
	which, by virtue of the legal relationship between that person and the enterprise, are on the account and risk of the enterprise, **[Alternatives C & D]**
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.	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.

A.1.1. Alternatives A & C vis-à-vis Alternatives B & D.

Alternatives A & C of the Draft are very broad and could catch situations escaping the rationale of triggering a permanent establishment ("PE") on the country of source. The foregoing because the scope of the intermediary's interactions to be deemed as directly resulting in the conclusion of contracts is undefined and, in fact, it would be impossible to define such a scope given the undetermined number of facts and circumstances that would need to be foreseen in such definition. The result of this would be to generate more confusion and gray areas on the analysis of PE exposure. Therefore, Alternatives B & D are preferable over Alternatives A & C.

A.1.2. Alternatives A & B vis-à-vis Alternatives C & D.

The current wording of Article 5(5) foresee that the conclusion of contracts must be done in the name of the enterprise.

Paragraph 32.1 of the Commentaries to Article 5(5) of the Model Tax Convention provides that "(…) the phrase 'authority to conclude contracts in the name of the enterprise' does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; **the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise** (…)".

Such paragraph of the Commentaries was added at the request of common law countries where agreements signed by the agent in its own name actually bind the enterprise directly. In civil law countries, agreements signed by the agent in its own name do not bind the enterprise directly, but it is the agent who is bound directly while the enterprise is bound with the agent. However, the Commentaries have generated confusion on courts decisions at civil law countries because some

have interpreted them in a more functional way[1] while others have interpreted them in a more juridical way[2].

Alternatives A & B and Alternatives C & D of the Draft both seek to eliminate the difficulties described above arising from the phrase "contracts in the name of" from two different approaches. Alternatives A & B address the issue by focusing on what is the object of the contract entered into by the agent (i.e., property or services to be provided by the enterprise), regardless of whether such contract was entered in the name of the enterprise or in its own name. Alternatives C & D address the issue by focusing on whether the contract entered into by the agent is on the account and risk of the enterprise, regardless of whether such contract was entered in the name of the enterprise or in its own name.

In our opinion, to avoid any confusions, the phrase **"a) in the name of the enterprise"** should be deleted from Alternatives A & B so that it effectively focuses only on what is the object of the contract entered into by the agent. Therefore, Alternatives A & B should read as follows:

~~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,

We consider more appropriate to deal with the issue through Alternatives A & B (adjusted as proposed above) because Alternatives C & D could pose an additional difficulty on the interpretation of the phrase **"on the account and risk"**. In addition, Alternatives C & D require to demonstrate the existence of a legal relationship between the agent and the enterprise while Alternatives A & B focus only on the object of the contract.

[1] A commissionaire acting in its own name could trigger a PE at source because, although the enterprise is not bound directly through the agreement signed by the commissionaire, it is bound indirectly through the agreement entered into between the enterprise and the commissionaire.
[2] A commissionaire acting in its own name cannot trigger a PE because the enterprise is never bound directly through the agreement signed by the commissionaire.

A.1.3. Conclusion.

In our opinion, the most appropriate wording of Article 5(5) to deal with the commissionaire issue would be as follows:

> 5. Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting on behalf of an enterprise and in doing so, habitually concludes contracts or negotiates the material elements of contracts
>
> a) 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
> b) 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, 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.

A.2. Paragraph 6.

Current status	**Alternative proposal**
6. 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.	6. 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 first-mentioned State as an independent agent acting on behalf of various persons 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 enterprise or associated enterprises, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to these enterprises.

A.2.1. First sentence of alternative proposal.

The phrase **"independent agent acting on behalf of <u>various</u> persons"** could lead to confusion and inappropriate assessment on the existence of a PE. Indeed, according to the proposed wording of Article 5(6), and in particular according to such phrase, paragraph 5 would continue to apply for purposes of assessing the existence of a PE if an independent agent acts on behalf of only one independent person, but it would not apply if the independent agent acts on behalf of various independent persons (i.e., two or more).

In this regard, we are of the opinion that such phrase should be deleted from the proposed wording. The foregoing because paragraph 5 should still be deemed not to apply regardless of whether the independent agent acts on behalf of only one independent person. In other words, whether the independent agent acts on behalf of only one independent person should not be by itself determinative on the analysis because otherwise cases where independent agents legitimately act on behalf of only one independent person (i.e., where the independent agent has only one client) would trigger PE exposure for such independent person.

Our proposed wording would be as follows:

6. 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 first-mentioned State as an independent agent ~~acting~~

~~on behalf of various persons~~ and acts for the enterprise in the ordinary course of that business.

A.2.2. Second sentence of alternative proposal.

Being consistent with the adjustments proposed to the first sentence, the second sentence should be adjusted to make clear that paragraph 5 will continue to apply where the agent acts on behalf of one or more associated enterprises, as follows:

6. (…) Where, however, a person acts exclusively or almost exclusively on behalf of one **or more** ~~enterprise or~~ associated enterprises, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to these enterprises.

A.2.3. Conclusion.

In our opinion, the most appropriate wording of Article 5(6) to deal with the commissionaire issue would be as follows:

6. 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 first-mentioned 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 associated enterprises, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to these enterprises.

B. Artificial avoidance of PE status through the specific activity exemptions.

B.1. Specific activity exemptions.

The Focus Group suggests amending Article 5(4) regarding the activities exemption by restricting its scope through the qualification of all such activities being of a preparatory or an auxiliary nature as per Alternative E of the Draft.

We are of the opinion that Alternative E of the Draft should be adopted as it is consistent with the original intent of the Model Convention in that all exempted activities have the common feature of being of an auxiliary or preparatory nature (Vid. Paragraph 21 of the Commentaries to Article 5(4) of the Model Tax Convention).

Moreover, besides adopting Alternative E, we also suggest further clarification within such alternative in the sense that information collection by a newspaper bureau qualifies as having a preparatory and/or auxiliary nature.

If Alternative E is not adopted, the Focus Group suggests taking measures suggested on Alternative F together with Alternatives G or H.

Alternative F should be avoided in any case because removing reference to "delivery" in subparagraphs a) and b) of paragraph 4 of Article 5 may give rise to unintended scenarios of a PE. For example, enterprises engaged in a building site, construction or installation project, will typically make deliveries in connection with such activities and whilst such deliveries could be viewed as having a preparatory or auxiliary nature, they would trigger a PE if Alternative F were adopted.

In Alternative G, the exception for "purchasing goods or merchandise" is deleted from subparagraph d) of paragraph 4 of Article 5 thereby leaving the exception pertaining to "collecting information". In Alternative H, the full exception included on subparagraph d) (i.e., "purchasing goods or merchandise" and "collecting information") is deleted.

We are of the opinion that, assuming Alternative E is not adopted, Alternative G, rather than Alternative H, should be adopted. The foregoing because removing the exception for "purchasing goods and merchandise" would be in

accordance with the arm's length principle, while leaving the exception for "collecting information" is appropriate given that the latter's scope is already limited pursuant to the Commentaries of the Model Tax Convention (Vid. Paragraph 22 of the Commentaries to Article 5(4) of the Model Tax Convention). In this regard, we also dissent with the Commentaries of the Model Tax Convention that collecting information is an extension of "mere purchasing" (collecting information could well be an independent activity) and additional commentaries are needed as well for clarification purposes.

B.2. Fragmentation of activities.

According to the Draft, to prevent the artificial avoidance of PE status there are certain concerns about the application of Article 5(4), where preparatory or auxiliary activities are fragmented between related or associated parties. In this regard, two alternatives of a rule (Alternatives I and J) are proposed to address this issue.

In our opinion, Alternative J better addresses BEPS concerns, as it does not necessarily require triggering of a PE by one of the associated enterprises for the rule to apply, which is a *sine qua non* requisite pursuant to Alternative I.

Indeed, from the wording of Alternative I the fixed place or places of the enterprise or the associated enterprise shall be considered a PE (on an individual basis), in order to consider that the overall activities carried out by the two enterprises at the same place or other place, qualify as a PE under the provisions of article 5. However, it may be the case that the fixed place or places mentioned above may not qualify as a PE on an individual basis and hence, the business activities carried out by the two enterprises would not be considered as a PE even though they constitute complementary functions that are part of a cohesive business operation. Therefore, as previously mentioned, in our opinion Alternative J shall be considered rather than Alternative I.

Also, in our opinion, Subparagraph 4.1.a) should be deleted and reference to the "two enterprises" should be amended to include "two or more enterprises".

Moreover, clarification is needed as to who would trigger the PE. Although we read it as all involved enterprises would severally trigger a PE, this issue needs to be clarified to avoid unwanted misinterpretations of the wording.

Based on the foregoing, in our opinion, the most appropriate wording for an additional paragraph 4.1 dealing with the fragmentation of activities issue would be as follows:

> 4.1. Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise carries on or any associated enterprises ~~carries~~ carry on business activities at the same place or at ~~another~~ different places in the same Contracting State and the overall activity resulting from the combination of the activities carried on by ~~the~~ such enterprise or ~~two~~ associated enterprises ~~at the same place, or by the same enterprise or associated enterprises at the two places,~~ is not of a preparatory or auxiliary character, provided that the business activities carried on by ~~the~~ such ~~two enterprises at the same place, or by the same~~ enterprise or associated enterprises ~~at the two places,~~ constitute complementary functions that are part of a cohesive business operation.

By adopting the suggested language for Paragraph 4.1. (i.e., eliminating Subparagraph 4.1.a)), an enterprise having a PE in a Contracting State, and/or its related enterprises, may still carry out activities of a preparatory or auxiliary nature without automatically triggering a PE, provided said activities do not constitute complementary functions that are part of a cohesive business operation, which is still consistent with BEPS.

Further Commentaries clarifying what constitutes a “cohesive business operation” should be included.

C. Splitting-up of contracts.

The Draft proposes two alternative solutions (Alternatives K and L) to deal with the issue related to splitting-up of contracts and the circumvention of the restrictions imposed by Article 5(3). Alternative K comprises dealing with this issue through an "automatic" rule that takes into account any activities performed by associated enterprises without consideration of the nature of these activities, or the circumstances and/or conditions that led to splitting-up them. Alternative L comprises dealing with this issue by merely relying on the general anti-abuse rule (Principal Purpose Test) proposed as part of the work on Action 6.

Alternative K may give rise to situations in which a PE is deemed to exist in undesired circumstances. Such is the case, as mentioned in the Draft, where a foreign resident is sent for a minimal number of days to perform some work at a building, or installation site, where the bulk of the work is provided by a local contractor. Another example is whether for legitimate business, or contractual reasons, a MNE group performs building or installation contract through various subsidiaries in a particular country, being one of them specialized in the analysis of the project, another one in a portion of its execution, a third one in a different part of its execution and so on; none of them lasting more than 12 months in its performance of work.

Although the language being proposed ("*For the sole purpose of determining…*") would partially address these circumstances, we consider that it is not comprehensive and there may be situations in which the provision is not applied strictly to the situations intended to be covered.

Bear in mind that some building or installation contracts could be very complex in nature, requiring several dependent, or independent contractors to participate; thus, the "automatic" addition of time may result in undesired circumstances creating a PE to a foreign resident, where the 12 month period is for legitimate business reasons not exceeded.

Bear also in mind that the current rule requires the 12 month period in the performance of a building, or installation contract to be exceeded; thus, an anti-

abuse provision that determines the existence of a PE even though such time threshold has not been met should be an exception where the provision is being abused, and not the general rule.

For all what expressed above, we consider that the "automatic" approach for time addition should be avoided and instead, an anti-abuse rule proposed as part of Action 6 should be relied on.

D. Insurance.

Considering insurance companies could conduct large-scale business in another country without being taxed on the relevant profits, the Focus Group proposes as Alternative M to include a paragraph dealing with this issue that would deem a PE to exist for the insurance company where insurance premiums are collected or where risks are insured through a dependent agent. Another possible approach would be Alternative N which involves merely relying on the changes to Article 5(5) and 5(6) per Alternatives A to D described above.

Although it does make sense from a BEPS perspective to include such specific provision, bear in mind that there could be local law restrictions on the particular countries involved that would restrict foreign insurance companies to collect premiums and insure risks anyway, meaning that the PE concern would not exist in any case. This is why paragraph 39 of the Commentaries to Article 5(6) recognize the following:

> "(…) The decision as to whether or not a provision along these lines should be included in a convention will depend on the factual and legal situation prevailing in the Contracting States concerned. Frequently, therefore, such a provision will not be contemplated. In view of this fact, it did not seem advisable to insert a provision along these lines in the Model Convention."

In Mexico, for example, a provision like the one proposed on Alternative M would make sense considering the current legal situation. Indeed, today foreign

insurance companies are allowed to insure risks located in the country provided that the agreement is executed abroad, and, as of April 2015, the same rule will continue to apply in the same way when the insurance is hired by an individual. However, it could be the case that local law restrictions of other jurisdictions forbid foreign insurance companies from insuring risks occurring within such jurisdictions in which case there would not be a possible PE scenario arising from a collection of insurance premiums in said jurisdictions' territories or from insuring risks occurring within said territories.

In our opinion, it would make more sense to include the proposed wording of Alternative M within paragraph 39 of the Commentaries to Article 5(6) as an example for countries wanting to adopt an approach as the one described on Alternative M rather than including the wording directly on the Model Tax Convention. Moreover, even if such wording was not included either on the text of the Model Tax Convention (per proposed on Alternative M) or on the Commentaries (per our proposal), we are of the opinion that said paragraph 39 already deals with this issue fairly enough and, in any case, it will depend on the countries negotiating a Tax Convention whether they include or not a particular provision pertaining to insurance companies.

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The participation of IFA Grupo Mexicano, A.C. is made on its own behalf exclusively as an IFA Branch, and in no case in name or on behalf of Central IFA or IFA as a whole.

We hope you find these comments interesting and useful. We remain yours for any questions or comments you may have.

Sincerely,

IFA Grupo Mexicano A.C.