

Mexico City, September 5, 2016

Via e-mail

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**Tax Treaties, Transfer Pricing
and Financial Transactions Division OECD/CTPA**

Dear all,

On behalf of IFA Grupo Mexicano, A.C. (Mexican Branch of the International Fiscal Association), kindly find below the comments on the Public Discussion Draft –“*BEPS ACTION 7 – Additional Guidance on the Attribution of Profits to Permanent Establishments*” (the “Draft”).

**I. GUIDANCE ON PARTICULAR FACT PATTERNS RELATED TO
DEPENDENT AGENT PERMANENT ESTABLISHMENTS (“DAPE”)**

- 1. *Commentators are invited to express their views on whether the order in which the analyses are applied under Article 9 of the MTC and Article 7 of the MTC can affect the outcome, and what guidance should be provided on the order of application.***

Conceptually speaking and assuming that the factual and functional analysis of the Dependent Agent Enterprise (“DAE”) (per Article 9 of the MTC) and of the DAPE (per Article 7 of the MTC) were aligned, the outcome would be the same; in this case, guidance could be provided in the sense that Step 2 of the Authorized OECD Approach (“AOA”) is unnecessary if such alignment is revealed in Step 1. If there is no alignment between the factual and functional analysis of the DAE and of the DAPE, then the outcome would be affected. In the latter case, the analysis of Article 9 should be applied first in order to determine the arm’s length profit of the DAE which in turn is the fee deductible in the DAPE, and guidance should be provided in that sense.

a. EXAMPLE 1

- 2. *Do you agree with the functional and factual analysis performed in Example 1 under the AOA?***

Yes. We agree with the functional and factual analysis under the AOA, since DAE does not undertake significant people functions (“SPF”) relevant to the assumption and/or management of risk on behalf of DAPE, nor it determines an economic ownership of assets by DAPE (See *Paragraph 232 of the 2010 Attribution of Profits Report*).

3. Do you agree with the construction of the profits or losses of the DAPE in Example 1 under the AOA?

Yes, because as mentioned in our answer to question 2 there are no SPF involved in this example and therefore no risks and/or assets should be attributed to DAPE. Under this scenario, it is correct to assess a Cost of Goods Sold (“COGS”) in an amount sufficient not to attribute any profits to the DAPE after an arm’s length reward is paid to the DAE.

4. What would be the conclusion if, because of the wording of Article 7 in the applicable tax treaty, an approach other than the AOA applied? If the conclusion is different, what would be the differences?

Under an approach other than the AOA (namely the single taxpayer approach), there would be no difference in the conclusion since DAPE is not being attributed any assets or risks under the AOA in this example.

5. In the types of cases illustrated by Example 1, is it appropriate to conclude that, where under the functional and factual analysis under Article 7, the dependent agent enterprise does not perform significant people functions on behalf of the non-resident enterprise, there will be no profits attributable to the DAPE after the payment of an appropriate fee to the DAE under Article 9?

Yes, it is appropriate provided that DAPE is not attributed with the economic ownership of assets which would result in a profit under the AOA (see *Paragraph 235 of the 2010 Attribution of Profits Report*).

b. EXAMPLE 2

6. Do commentators agree with the construction of the profits or losses of the DAPE in Example 2 under the AOA?

Generally we do agree with the construction of profits or losses; however, we consider that additional guidelines should be provided in order to avoid a

double counting of deductible items or costs upon applying the analysis of the fee payable to Sellco under Article 9 of the MTC.

7. What would be the conclusion if, because of the wording of Article 7 in the applicable tax treaty, an approach other than the AOA applied? If the conclusion is different, what would be the differences?

Under an approach other than the AOA (namely the single taxpayer approach), there would not be any attribution of assets or risks to DAPE, since those would correspond to Prima. Therefore, DAPE would not be attributed with the \$2 funding return from Sellco since no economic ownership of assets is recognized.

8. In your opinion, what would be the consequences if, in the example, Sellco does not have the financial capacity to assume the inventory and credit risks? In that case, to which party would you allocate those risks? How would it affect the fee payable to Sellco and the profits to be attributed to the DAPE?

Per Article 9 of the MTC, risk will be assumed by Prima and therefore fees payable to DAE are reduced in proportion to the assumption of risks. The fee payable to Sellco would be reduced in order to reflect the new operating margin considering the new allocation of risks; on the other hand, the profits to be attributed to DAPE would increase in proportion to the risks assumed. Nevertheless the source state will still tax the \$9 of total profit but allocated in different proportions between DAPE and Sellco. The following chart reflects the reasoning that supports our conclusion:

	Sellco	Sellco Adjustment	DAPE Adjustment
Sales income	\$30.00	\$20.00	\$200.00
COGS	\$0.00	\$0.00	\$170.00
Gross P&L	\$30.00	\$20.00	\$30.00
Opex	\$8.00	\$8.00	\$0.00
Sales commission	\$0.00	\$0.00	\$20.00
Bad debts	\$4.00	\$0.00	\$4.00
Inventory loss	\$3.00	\$0.00	\$3.00

Warehouse cost	\$6.00	\$6.00	\$0.00
Operating Profit	\$9.00	\$6.00	\$3.00

9. ***(1) What are your views on the fact that in Example 2 the same functions that are considered under the Article 9 analysis to allocate risks to Sellco, are also taken into account, under Article 7, as the SPF that result in the attribution of economic ownership of assets to the DAPE? What is your opinion about the fact that, in this example, the inventory and credit risks are allocated to Sellco under Article 9 and the economic ownership of inventory and receivables are attributed to the DAPE? (2) Does your reading of the current guidance of the 2010 Attribution of Profits Report, and in particular with paragraphs 230 to 245, support the conclusions of the Example?***

(1) We agree on the fact that the same functions are taken into account for purposes of Articles 9 and 7 of the MTC since the analysis in the example properly analyzes “the actual conduct of the parties” (Article 9) and the SPF involved (Article 7).

In our opinion because there is an overlap of risk attribution to Sellco under Article 9 and thereafter to DAPE under Article 7, clear guidelines should be provided to prevent double counting of resulting costs and write offs in both the P&L of DAPE and in the fee payable to DAE.

(2) Yes. Paragraph 244 of the 2010 Attribution of Profits Report establishes that no presumption of assets and risks should be attributed to the DAPE merely by the fact that the same assets and risks were assumed by the DAE on the analysis of Article 9 of the MTC. In the case at hand, the SPF were properly attributed to the DAPE under the AOA functional and factual analysis.

c. EXAMPLE 3

10. ***Do commentators agree with the construction of the profits or losses of the DAPE in Example 3 under the AOA?***

Yes, provided that DAPE acts as a distributor and that, considering the fact pattern of the global group operation, the applied transfer methodology is appropriate (see *Paragraph 185 of the 2010 Attribution of Profits Report*) to calculate the DAPE’s profitability in an arm’s length basis in accordance with the

OECD's Transfer Pricing Guidelines ("Guidelines") and considering DAPE as a separate and independent enterprise.

- 11. *What would be the conclusion if, because of the wording of Article 7 in the applicable tax treaty, an approach other than the AOA applied? If the conclusion is different, what would be the differences?***

The conclusion would be the same because, in this specific Example, there are no internal dealings between DAPE and Prima that could affect the allocation of profits in DAPE. Additionally, the profitability of DAPE, even with the different wording of Article 7, should be calculated in an arm's length basis as if DAPE were a separate and independent enterprise.

d. EXAMPLE 4

- 12. *Do commentators agree with the construction of the profits or losses of the DAPE in Example 4 under the AOA?***

We agree with the construction of the P&L determined under the AOA; however, issues arise as to whether the collection of customer receivables by DAE translates into SPF of relevance for the DAPE (see *Paragraph 1.105 of the Guidelines*).

- 13. *Do commentators agree that the profits or losses in the DAPE over and above the fee payable to Sellco arise because the contractual allocation of risk to Prima is respected under Article 9, and is not shared with Sellco, whereas under Article 7 the risk is partly attributed to Prima's Head Office and partly to the DAPE of Prima? In other words, the difference arises from differences between allocation of risk between two separate enterprises and attribution of risk within the same enterprise?***

The differences arise since the analysis under Article 9 leads to risk being assumed entirely by Prima regardless that DAE is also exercising control over the risk, situation that does not occur under the AOA analysis because SPF in relation to the risk are appropriately shared between Prima and DAPE by the respective contributions to the total credit management cost.

We suggest that clear guidance is offered in terms of sharing SPF mirroring the guidance provided under Paragraph 1.94 of the Guidelines.

II. GUIDANCE ON THE ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS ARISING FROM ACTIVITIES NOT COVERED BY SPECIFIC EXCEPTIONS IN ARTICLE 5(4)

a. EXAMPLE 5

14. *Do commentators agree with the construction of the profits or losses of the PE in Scenario A of Example 5 under the AOA?*

We agree with the conclusion of Scenario A of Example 5 under the AOA, considering that the nature of the internal dealings between the PE in Country W and WRU Head Office in Country A have been clearly identified.

As to the specific construction of profits or losses of the PE in Scenario A, since the functional and factual analysis of the assets, risks and functions have been appropriately attributed between the PE and the Head Office, there is a need to determine how much of WRU's free capital is needed to cover the assets and functions attributed to the PE in Country W (*see Part I, Paragraph 107 of the 2010 Attribution of Profits Report*). In this respect, considering that Scenario A lays the hypothesis that under Step 1 of the AOA the PE should be remunerated for operating the warehouse and that it has the economic ownership of such warehouse, we agree with the construction of profits.

15. *Do commentators agree with the conclusion reached in Scenarios B and C of Example 5 under the AOA?*

We agree with the conclusion reached in Scenarios B and C under the AOA since the profits are being attributed first, by identifying the assets economically owned by the PE in Country W, as well as considering the risks and functions performed therein. Then, as it occurred under Scenario A, the dealings between the PE and the Head Office should be recognized in determining the attributable income and losses of the PE, regardless of the absence of third-party income.

With respect to the conclusion reached in Paragraph 102 in Scenario C of Example 5, we agree that additional functions and assumptions of risks to Wareco would only affect the profits of WRU's Head Office and not those of the PE, since under the AOA's first step the attribution of profits depends on the distribution of functions and risks and none are being assigned to the PE under this last hypothesis. However, if additional SPF were to be carried out by WRU in Country W the PE would be involved in that distribution of risks and therefore its profits

would be affected (see *Part I, Paragraph 26 of the 2010 Attribution of Profits Report*).

16. *In particular, do you agree that there can be an investment return on the asset or assets creating or being part of the PE when there are no personnel of the non-resident enterprise operating the PE?*

Yes, we agree that there can be an investment return on the assets attributed to the PE regardless of whether there is personnel or not of the non-resident enterprise operating the PE. This is because the economic ownership of tangible assets is based on their place of use (see *Paragraph 75 of the 2010 Attribution of Profits Report*).

17. *Do you agree with the streamlined approach proposed in this example for cases where there are no functions performed in the PE apart from the economic ownership of the asset, i.e. attribute profits to the PE commensurate with investment in that asset (taking into account appropriate funding costs and the compensation payable for investment advice)? How would you identify the investment return?*

We agree that the streamlined approach could be a valid alternative for determining profits of the PE in absence of SPF in the latter. However, the streamlined approach is not recognized in the 2010 Attribution of Profits Report, and no additional guidance for its application is provided in this draft. Therefore, precise guidelines on the methodology applicable to the streamlined approach in cases such as Scenario B and C should be provided.

18. *Do you agree that if the non-resident enterprise has no personnel operating at the fixed place of business PE, then significant people functions performed by other parties on their own account in the jurisdiction of the PE do not lead to the attribution of risks or assets to the PE, and no profits would be attributable to the PE? If not, please explain the reasons for taking a different view.*

We agree. Parties performing SPF in the jurisdiction of the PE do not lead to the attribution of risks or assets to the PE, provided that such SPF are performed on their own account. The foregoing since the key element for determining if SPF are relevant to the attribution of profits of a PE is whether the relevant parties are performing said functions on behalf of the non-resident enterprise (see *Paragraph 47 of the 2010 Attribution of Profits Report*).

19. Under Scenario C, if Wareco were a related enterprise, and if it is assumed that the arm's length fee is 110% of its costs, would there be any difference to the outcome of the attribution of profits to the PE of WRU?

No. There would be no difference to the outcome of the attribution of profits to the PE of WRU since the functional and factual analysis of the PE would not be affected in any way, as it would otherwise be the case if dealing with a DAPE triggered out of the activities performed by Wareco if the latter was a DAE of WRU. The only change in the outcome of the operation would pertain to the compensation between WRU and Wareco, since it would need to be adjusted if such compensation is determined under the analysis of Article 9.

20. What would be the conclusion if, because of the wording of Article 7 in the applicable tax treaty, an approach other than the AOA applied? If the conclusion is different, what would be the differences?

In this particular case, there should be no difference in the conclusion since the PE is not being attributed with any risks arising from the performance of SPF, and the latter is only attributed profits considering an investment return which is recognized under the single taxpayers approach.

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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 the 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.